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OUTLINE OF LEGAL REQUIREMENTS FOR COMMON INTEREST ASSOCIATION TRANSITIONS

I. INTRODUCTION

When a condominium or other common interest community is created, the declarant is ordinarily the owner of all of the new units and, as such, controls the community association. By the time the declarant transfers all of the units and departs, the unit owners should have all of the votes in the association and the power to elect its officers and directors. The unit owner-controlled association should also have possession of all of the books, records, and property of the association to enable it to function on behalf of the unit owners.

The Connecticut Common Interest Ownership Act ("CIOA") contains procedures for this transition process. In addition to the statutory requirements for transition, there are a number of practical concerns that the declarant and the association should address as part of the transition process. When both the statutory and the practical requirements are attended to, the transition can be an orderly procedure which benefits all parties and minimizes the chance of disputes or litigation.

II. WHEN DOES TRANSITION TAKE PLACE?

CIOA provides that at the creation of the association, the declarant has the power to appoint all of the members of the board of directors. Through this power, the declarant is able to control the election of the association's officers and the operation of the association.

As soon as one-third of the units have been sold to unit owners other than the declarant, the unit owners are entitled to elect not less than one-third of the members of the board. (CIOA Section 47-245(e)). At this time, the declarant still controls the association by virtue of its control of a majority of the directors. However, for the first time, the unit owners are entitled to participate at the board level in the discussions concerning the operation of the association. This gives them an opportunity to become involved with association activities. It also allows the declarant, if it has not done so already, to begin

to familiarize the unit owners with the operation of the association so that once the transition takes place, the unit owners already know how the association works, and the practical concerns which the community must face.

CIOA requires that all unit owners be entitled to elect all of the board of directors once 60% of all of the units that may be created in the common interest community have been sold (Section 47-245(d)). It is possible that all of the units will not be sold by the declarant for a considerable period of time. In an economic downturn, the declarant may be unable to sell the units it has built and may choose to rent them to tenants. It is also possible for the declarant to reserve the development right to create more units in the future, but not to create them for a number of years. In each of these situations, the declarant may stop selling units before the 60% level is reached and for that situation to continue for some time.

The policy of CIOA is that control of the association should be turned over to the unit owners within a reasonable time after the declarant stops building and selling units, even if it has the right to build or sell more units in the future. For this reason, Section 47-245(d) of the Act also requires that the unit owners elect a majority of the board "two years after all declarants have ceased to offer units for sale in the ordinary course of business" or "two years after any right to add new units was last exercised."

Under Section 47-245(d), upon the termination of the period of declarant control, the declarant has only the same rights to vote the votes of the units it owns that each other unit owner has as to his or her unit or units.

III. STATUTORY REQUIREMENTS

Section 47-245(h) of CIOA sets out the items that must be turned over by the declarant to the unit owner controlled association within thirty days after unit owners other than the declarant elect a majority of the members of the executive board. Also, Section 47-245(h) requires that "all property of the unit owners and of the association held by or controlled by the declarant" be turned over, including but not limited to the items specifically listed in the statute. These items are as follows:

A. Documents

1. The original or a certified copy of the recorded declaration together with all amendment recorded to date.
2. Full-size copies of the surveys and plans filed with the declaration and all amendments to date.

3. The association's certificate of incorporation if the association is incorporated.
4. The bylaws with all amendments to date.
5. Minute books and other books and records of the association. These should include:
 - a. Copies of annual state franchise tax filings.
 - b. Copies of tax returns and elections to be taxed as a homeowner's association.
 - c. Copies of corporate filings including biennial reports, changes of officers and directors, and changes of registered agent. (These items are frequently neglected and may result in the association's corporate existence being terminated for failure to file reports or in legal papers being served on an individual who is no longer connected with the association. If these items are not completely up-to-date, or if they are not furnished as part of the transition, the association should update all of the filings. A new filing must be made to reflect the new unit owner officers and directors.)
 - d. Minutes of all meetings of the executive board and of the unit owners from the time the Association was first created.
 - e. Proof of notice of all association and unit owners' meetings.
6. Any rules and regulations of the association.
 - a. Any rules, policies or procedures, of general application, should be abstracted from the minutes into a resolution book, distributed to all unit owners and furnished to purchasers with resale certificates.
 - b. Many associations develop unwritten rules and policies which, if not properly adopted, may be successfully, and embarrassingly, challenged by unit owners later on. If the association has any such unwritten policies or rules, and wishes to continue following them, these should be formally adopted by the board after appropriate notice and comment.

B. An Audited Accounting for Association Funds and Financial Statements from the Date the Association Received Funds and Ending on the Date the Period of Declarant Control Ends.

This section recognizes that a declarant may record a declaration and create an association, but not start collecting common charges or otherwise begin association operations until some time after the declaration has been recorded.

This section also deals with the question of whether the audit must be certified, or indeed can be certified, by requiring that the financial statements be audited by an independent certified public accountant and be accompanied by the accountant's letter expressing either:

1. The opinion that the financial statements present fairly the financial position of the association in conformity with generally accepted accounting principles; or
2. A disclaimer of the accountant's ability to attest to the fairness of the presentation of the financial information in conformity with generally accepted accounting principles and the reasons therefor.

If the declarant has done a bad job of bookkeeping, the records may not be sufficient for the accountant ever to certify the accounting. If the accountant cannot certify the accounting, he or she is required to state the reasons why it cannot be certified. These reasons will serve as a guide to the unit owner controlled association in determining whether the declarant has any further liability to the unit owners. While failure to keep financial records sufficient to permit a certified audit is a breach fiduciary duty in itself, it may be that while the records are skimpy, all the money has in fact been properly applied.

Subsection 47-245(h)(2) also provides that the expenses of the audit shall not be paid for or charged to the association. Under prior law, many declarants characterized the cost of the audit as a common expense.

The declarations of some condominiums will contain a provision requiring that the annual financial statements of the association be audited if the common interest community contains fifty or more units. See, for example, Section 18.7 of the model declaration contained in the Connecticut Common Interest Ownership Manual which is inserted to comply with Section 402.01 of the FNMA Servicers Lending Guide.

It should also be noted that Subsection 47-245(I) requires the declarant to furnish unaudited financial statements to the unit owners every six months during the period of declarant control.

- C. Association Funds or Control Thereof. Existing bank accounts can be continued, but the board should adopt new banking resolutions designating new signatories and terminating the old ones.
- D. All of the declarant's tangible personal property that has been represented by the declarant to be the property of the association, or, unless the declarant has disclosed in the public offering statement that all such personal property used in the common interest community will remain the declarant's property, all of the declarant's tangible personal property that is necessary for and has been used exclusively in the operation and enjoyment of the common elements, and inventories of these properties. This provision requires the declarant to transfer items that were implicitly as well as explicitly represented as association's property. It also recognizes that declarant's right to disclaim such implications.
- E. A copy of any plans and specifications used in the construction of the improvements in the common interest community which were completed within two years before the declaration was recorded. These plans and specifications can be of great use to the association and its new manager in operating the condominium and in planning for future repairs and maintenance. If at all possible, the association should arrange for a knowledgeable board member or the manager to meet with the declarant and the general contractor to review the materials and their files to obtain originals or copies of anything that might be of use.
- F. All insurance policies then in force, in which the unit owners, the association, or its directors and officer are named as insured persons.
 - 1. All insurance policies should be reviewed carefully to be sure that they provide at least the coverage required by the documents and any other coverage the association may wish to have.
 - 2. If the declarant was managing the association at no charge, it may not have been carrying the fidelity bond required by Public Act 90-306. Even if the bond is in place, the covered individuals will have to be changed.
 - 3. Copies of applications for all insurance policies.
 - 4. Copies of all materials relating to open insurance claims.
 - 5. Copies of all materials relating to insurance claims it made within the last

seven years.

- G. Copies of any certificates of occupancy that may have been issued with respect to any improvements comprising the common interest community.
- H. Any other permits issued by governmental bodies applicable to the common interest community and which are currently in force or which were issued within one year prior to the date on which unit owners other than the declarant took control of the association.
- I. Written warranties of the contractor, subcontractors, suppliers and manufacturers that are still effective.
- J. A roster of unit owners and mortgagees and their addresses and telephone numbers, if known, as shown on the declarant's records. The Association should also furnish the following:
 - 1. The name and address of each current unit owner together with any notices sent by the unit owner setting out names and addresses or changes in names and addresses.
 - 2. A copy of the Resale Certificate and Certificates of Unpaid Common Charges issued at the time the unit owner acquired the unit.
 - 3. A ledger of payments and charges for the unit from the time the unit owner acquired the unit to the present. (This is frequently kept in a central computer system. If the Association changes computer systems or manager, it should obtain a hard copy of all ledgers for all units at the time of the changeover.)
 - 4. Copies of all late payment notices or dunning letters sent to the unit owner.
 - 5. Copies of all violation notices and notices of fines sent to the unit owner.
 - 6. Copies of all correspondence, telephone messages and other materials received from or about the unit owner or sent to the unit owner.
- K. Employment contracts in which the association is a contracting party.
- L. Any service contract in which the association is a contracting party or in which the association or the unit owners have any obligation to pay a fee to the persons performing the services.

- M. Resignations of officers and directors of the declarant association, appointments of officers and directors of the new unit owners association, and appointment of a new statutory agent for service. Even if the declarant does not furnish these resignations, the election of their replacements operates to remove them from office.

IV. TERMINATION OF CONTRACTS WITH THE DECLARANT

It is common practice for declarant controlled associations to enter into management and other contracts with the declarant or an affiliate of the declarant. There is nothing necessarily improper about this practice. In the early stages of many common interest communities it is easier, and less expensive, for the declarant to serve as the manager of the association than to hire an outside manager. After the first few units have been sold, while the declarant is still building other units, the declarant may be best able to provide repair, maintenance and landscaping services to the association at the lowest cost.

Some declarants have, however, attempted to enter into long-term management and maintenance contracts at excessive fees in order to make a further profit from the development of a common interest community.

Whether these contracts were entered into for the practical benefit of the association or the financial benefit of the declarant, the unit owners, when they take control of the association, should be entitled to have it managed and serviced by contractors of their own choosing. For this reason, CIOA contains provisions allowing the association to terminate these contracts after the unit owners take control.

Section 47-247 of CIOA allows the association, after transition, to terminate without a penalty, certain contracts made by the association while it was controlled by the declarant. These contracts include:

- A. Any management contract, employment contract or lease of recreation or parking areas for facilities;
- B. Any other contract or lease between the association and the declarant or an affiliate of the declarant; or
- C. Any contract or lease that is not bona fide or was unconscionable or commercially unreasonable to the unit owners at the time entered into under the circumstances then prevailing.

It should be noted that under CIOA, a meeting of the unit owners is not required to terminate such contracts. The Act only says that the association may terminate them, and, unless the bylaws of the association provide otherwise, the executive board has the power, under Section 47-245(a) to act on behalf of the association.

CIOA recognizes that there are certain agreements which are so crucial to the existence of the common interest community that they cannot be terminated even if they were made improperly by the association at the time it was under declarant control. Section 47-247(b) of CIOA exempts ground leases in leasehold common interest communities and proprietary leases in cooperatives.

V. THE PRACTICAL REQUIREMENTS

Both the declarant and the unit owners benefit from a well planned and orderly transition. From the unit owners' point of view, the benefits include:

- A. The unit owners, or at least their elected representatives, understand the workings of the association and the buildings and equipment of the common interest community. They are prepared to take control with a minimum of surprises and will make as few mistakes as possible.
- B. The unit owners will have all of the records, information, and equipment necessary to operate the common interest community.
- C. If there are any disputes with the declarant, they can be handled as expeditiously as possible by a transition committee and not interfere with the other responsibilities of the executive board and the association.

From the declarant's point of view, the advantages include:

- A. A reduction in the number of disputes or potential disputes with the association.
- B. A separation of disputes involving individual unit owners from those involving the unit owners as a group.
- C. An association that is neither surprised nor hostile because of the realities of operating a common interest community.
- D. A designated transition committee with which to work out any disputes between the declarant and the association.

- E. Frequently, the respect and goodwill of the unit purchasers who will perceive the declarant as having done its job well and who will provide a source of purchasers or referrals of purchasers for future projects.

Both sides will benefit from a reduction in the number of unnecessary disputes between the declarant and the association and, in the process, will save both money and effort.

Some of the basic elements of an orderly transition include the following:

- A. Pre-transition Training

Even before the unit owners elect their first director, the declarant should begin a process of educating the unit owners and identifying potential leaders among the unit owners. If the declarant has hired an independent management company, the management company can be responsible for much of the pre-transition activities.

The unit owner education process can be conducted formally or informally, depending on the size of the community, and the preferences of the declarant. All unit owners should be made familiar with the organization of the community and the association and the operation of the physical plant. Since most unit purchasers have never lived in a common interest community before, they are not usually familiar with how such a community works. The unit owner education program begins with the public offering statement and other marketing materials prepared by the declarant and includes the sales presentation made by the declarant's sales representatives.

From time to time, as units are sold, the declarant can hold orientation meetings with unit owners to explain the workings of the association and to answer questions. In a larger project, the declarant may prepare periodic newsletters which can include information on the operation of the association and the community. The annual budget notices required by Section 47-245(I) of CIOA, and the comments that accompany them, can also be used for unit owner education.

Some declarants have found it useful to establish "shadow committees" of unit owners to work with the declarant and its representatives even before the unit owners are entitled to elect members of the executive board. These shadow committees may deal with many of the items which will be the responsibility of the association and its executive board after transition, such as budgets and finance, rules and rules enforcement, maintenance, social activities and new member orientation. These committees give the unit owners an opportunity to become familiar with the association and help to identify potential leaders.

- B. Transition Committees

Both the declarant and the unit owners benefit from having specific committees designated to deal with transition issues. In a smaller association, the transition committee may consist of the unit owner members of the executive board. In a larger community, it may consist in part of board members and in part of other unit owners appointed by the board. Subject to the direction and approval of the board, the unit owner transition committee can negotiate with a consistent and continuing voice on behalf of the unit owners.

The declarant too should designate a small transition group to prepare the items required for the turnover and to work with the unit owner transition committee on outstanding issues. For a smaller declarant, the transition committee may be the individual declarant, his or her bookkeeper and construction manager. For a larger declarant, a small group of specific individuals should be designated.

C. Resolution of Open Items

Although the transition does not terminate the declarant's liability for the operation of the association during the period of declarant control or for the construction and completion of the buildings in the common interest community, it provides a useful opportunity for the parties to review everything that has happened to date and to resolve any items that remain open.

On taking control of the association, the unit owners, represented by their transition committee, should conduct a thorough review of the declarant's activities. With the assistance of a lawyer and an accountant, they should review all of the books and records of the association to make sure they have been properly kept and to determine whether any changes should be made. If this review discloses any deficiencies on the part of the declarant, the association should present its claim to the declarant and attempt to negotiate the resolution of these claims

The association should also conduct a thorough inspection of the physical plant, usually with the assistance of a consulting architect or engineer, to determine whether the declarant has met all of its obligations under the statutory warranties and under the documents. The association should also review any construction still underway to see that it too complies. If this review discloses any deficiencies or "punch list" items, and it usually does, these should be discussed with the declarant and, if possible, the parties should agree as to what the declarant will do to remedy the deficiencies and when the work will be done.

In conducting a review of the physical plant, it should be remembered that the association's control and responsibilities cover the common elements as opposed to the units. Issues concerning the proper completion of the units are matters between the declarant and the individual purchasers. Nevertheless, particularly where common problems occur regarding a number of units, the association and its transition committee are the most useful vehicles for resolving these items. However, the association should not attempt to negotiate concerning the units without first holding a unit owners' meeting to discuss how this is to be handled.

VI. CONCLUSION

The condominiums that establish themselves as the best places to live in, and the best places in which to buy, will be those that are the best run. The first step in creating a well-run condominium is a thorough and effective transition in which the unit owners receive all of the information and training they need in order to operate the condominium. Even if the declarant neglects its obligations in the transition process, the unit owners, with organization, effort and good professional advice, can get the condominium off to a strong and effective start.