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PREPARING FOR TURNOVER – WHAT A DEVELOPER SHOULD BE MINDFUL OF

February 16, 2016

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With all of the new construction of condominiums and single family homes, developers should be mindful that the end of the project cycle and turnover of the homeowners or condominium association is just as important as the beginning of the cycle and can have a meaningful impact on the developer's bottom line. As such, developers should plan ahead and be mindful of the turnover process. There is cottage industry in Florida of attorneys who counsel their association clients that it is common place for the association to sue the developer once the developer of a residential community turns over control of the board of directors to the owners. By properly planning and actively participating in the turnover process, developers can minimize this risk of litigation and ideally obtain a release from the association.

Turnover of residential associations is controlled by two different statutes, either Florida Statutes Section 718.301 for condominiums (the "Condo Turnover Statute"), or Florida Statutes Section 720.307 for homeowners associations ("HOA Turnover Statute"). Both the Condo Turnover Statute and the HOA Turnover Statute require the developer to turn over control of the board of directors when a certain threshold of units within a condominium or non-condominium project have been conveyed by the developer to third party purchasers (e.g., within three months after 90% of the units have been conveyed) and require the developer to turn over or provide the association with specific documents and reports.

The two most important documents required by the Condo Turnover Statute are the engineering report and audit of the association's financial records. The engineering report reflects the current state of the building such as the roof, elevators, fire safety system and electrical system. From the planning stage of the project, developers need to be mindful of the engineering report and its potential impact on the turnover process. With plenty of time before the turnover deadline, developers should obtain an engineering report to understand if there are issues that should be addressed before the issuance of the final report. Of course, a report may show deficiencies that are not construction defects but are caused by normal wear and tear and a developer may want to use these line items as leverage to secure a final release.

A financial audit is also required upon turnover of a condominium association. An audit sets forth the association's financial condition and confirms whether the developer properly funded its obligations. . [Decisions made by the developer impact the audit and how the condominium is governed. These decisions include whether the developer wants to pay assessments like all other unit owners or, alternatively, guarantee a certain level of assessments in lieu of paying assessments on units owned by the developer. Another decision that impacts the audit is whether reserves are collected from unit owners or the developer elects to waive reserves as permitted by Florida's Condominium Act. As a result, developers need to be mindful of these varied decisions well before the recording of the declaration because many of these decisions take place prior to the recording of the condominium's declaration and effect how much a developer needs to fund into assessments and reserves.

Like the Condo Turnover Statute, the HOA Turnover Statute requires an audit of the association's financial records and the same general issues discussed above apply. Unlike the Condo Turnover Statute, however, the HOA Turnover Statute does not require the developer to obtain an engineering report. Regardless, developers may consider obtaining an engineering report to record the state of the common areas at turnover in an effort to prevent unfounded claims by an association. Additionally, if there are deficiencies (and the developer intends to address them), developers can use an engineering report as a show of good faith to the owner controlled association. Such a strategy may assist a developer in keeping the lines of communication open with the association to ensure a smooth transition.

A strategy employed by successful developers is creating an ad hoc committee of owners prior to turnover to start educating the owners about turnover. Open communication, good working relationships and clearly established expectations help ensure a smooth transition. While developers cannot prevent owner controlled associations from filing suits, developers can take affirmative steps to minimize the risk and perhaps to obtain the ultimate prize, a negotiated general release without the cost of litigation.

For more information on this topic, please contact Barry Lapides on the firm's Business, Finance and Tax Team.

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