

# Developer Transition

## Too Much of a Good Thing . . . Can be Bad

By Charles Chester, Esquire, Shelah Lynn, Attorney at Law, and Lucia Anna (Pia) Trigiani, Attorney at Law, CCAL

Let's face it, without developers, where would community associations be? Developers are the creators. Developers are the fathers, the mothers, the parents who breathe life into community associations. Like a parent cares for a child, developers must care for their communities, particularly in the early stages of development. Developers have the responsibility in the early stages of development to conduct the business of the community association.

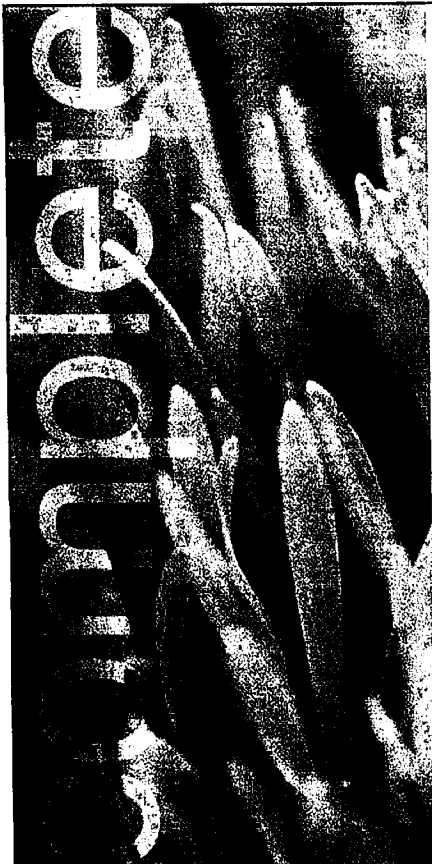
Like a parent teaches a child to survive on his own, developers must teach the members of a community association how to administer the operations of the community. The developer holds the hand of the homeowners in a newly minted community in the beginning until the community members are ready to take it over and conduct business on their own. That is what transition from developer control of the association is all about. Or perhaps a better way to say it, that is what good transition is all about.

Do developers do the transitions well? That depends. Some do and some do not. Some hold on too long; some let go too early. Developers are visionaries. They are the dreamers who can look at a piece of dirt and see homes, recreational facilities, open space. Developers take a

concept on paper and put it into the ground, building homes and hopefully neighborhoods in which we all find a sense of community. Some developers are not about the details of running a community. Others are good at it and do not know when to let go.

As a result, the law has stepped in some instances to help the developer and the community association through transition – to establish boundaries or requirements that are designed to treat transition as a process, rather than a single event. The law may not address all of those issues. And, where the law does not address all of the matters that must be considered in transition, the governing documents may fill the void. Thus, as we often are told, the governing documents of the community must be consulted, too.

In the District of Columbia, Maryland and Virginia, the laws about transition are somewhat different. And, the laws vary depending upon the form that the community association takes. Following is a brief review of those statutes, taken from a recent presentation for the *Lawyers' Roundtable*, an interest group developed by the Chapter to serve as a discussion group for lawyers who are members of the Chapter.



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# District of Columbia

The District of Columbia Code contains limited provisions addressing transition from developer to homeowner control in community associations. The District of Columbia Condominium Act contains a few relevant provisions that relate to such transition, however, there are no regulatory statutes governing homeowners associations. There are a small number of homeowners associations in D.C. As there are no current statutory controls, for the most part, such associations are strictly governed by the recorded covenants for the association and the transition requirements, to the extent addressed, are governed by such recorded covenants. As a result, the summary below focused on the statutory provisions applicable to condominiums.

As with most jurisdictions, one of the primary provisions of the District of Columbia Condominium Act relating to the transition from developer to homeowner control is the warranty provision. Section 42-1903.16 of the Act outlines the statutory warranties applicable to condominiums. Such provision provides for a two (2) year warranty on units and common elements of the Condominium against structural defects. "Structural defect" as referred to in this provision means "a defect in a component that constitutes any unit or portion of the common elements that reduces the stability or safety of the structure below standards commonly accepted in the real estate market, or restricts the normally intended use of all or part of the structure and which requires repair, renovation, restoration, or replacement." This warranty period runs as to the unit from the date of conveyance and as to the common elements, generally when such components have been completed. Different time periods apply if the common elements are made additional land and are made part of the condominium later than the date of their completion. Any action to enforce the warranty must be commenced within three (3) years from the expiration of the warranty period and the owner or the association must show that the defect occurred within the warranty period. Notwithstanding these requirements, if the condominium is a conversion, the units may be sold as-is and the warranty may be limited to those portions of the condominium that the developer constructed as part of the conversion renovation.

Although the statutory warranties are limited to "structural defects" as defined above, the District of Columbia has recognized other potential legal causes of action, such as negligence, breach of other warranties (typically applicable to the sale of goods), misrepresentation, subject to satisfactory proof being made. The limitations period typically applicable to such claims is three (3) years from when the claim accrued. The District of Columbia courts have also recognized that accrual of such other causes of action (other than warranty enforcement) may be when the owner or association discovered or, applying reasonable diligence, should have discovered the basis for the claim.

One unusual provision in the District of Columbia Condominium Act is that the developer is required to post security in the amount of 10% of the estimated construction costs to cover warranty claims for the duration of the warranty period. This provision contains a procedure whereby this security can be reduced over time as the warranty periods applicable to the units expire, recognizing that these warranties will not all expire at the same time. The Condominium Act provides that rules are to be adopted to implement procedures regarding enforcement of the warranties through the use of the posted security,

however, to date, such rules and procedures have not yet been finalized and adopted. Notwithstanding, the requirement of security provides some protection for the developer and the owners and/or association in the event of warranty claims.

Although the trend in many jurisdictions has been to subject condominiums to governing documents which prescribe a warranty dispute resolution procedure which may include, but is not necessarily limited to, non-binding mediation or non-binding or binding arbitration, Section 42-1903.08 of the District of Columbia Condominium Act provides that the condominium instruments may not limit the owner of the unit owners association's power to deal with the developer in any way that is more restrictive than its power to deal with other parties. Based upon this provision, there is a reasonable argument that prescribed warranty dispute resolution procedures cannot be required in the governing documents. However, as the Condominium Act contains certain warranty enforcement procedures through the implementation of a security bond as discussed above, there is at least some administrative procedure available for the parties to utilize, albeit insufficiently implemented as of the current time.

Other provisions of the Condominium Act that address the transition process, that are unrelated to the warranty issues, include the following. Section 42-1903.02 of the Condominium Act outlines certain requirements and restrictions during the period that the developer remains in control of the condominium. This Section provides that the governing documents of the condominium may authorize the developer to operate as the board of directors of the association until the board is elected by the unit owners. However, during this period of control, the condominium documents may not be amended to increase the developer's scope of authorization unless approved by unit owners having 75% or 3/4 of the percentage interests in the condominium. Additionally, the time limit for developer control as set by the governing documents shall not exceed three (3) years for an expandable condominium or a condominium which contains convertible land and two (2) years for any other condominium, which periods run from the settlement on the purchase of the first unit. Additionally, upon the conveyance of units to which 25% of the percentage interests apply, a special meeting shall be held during which the unit owners, other than the developer, shall be authorized to elect 25% of the members of the board of directors and upon the conveyance of units to which 50% of the percentage interests apply, another special meeting shall be held during with the unit owners, other than the developer, shall be authorized to elect 33 1/3% of the board of directors. Thus, the concept is provides for incremental involvement of the homeowners up until full transition by the developer.

An additional provision applying to the transition process is also contained in Section 42-1903.02 of the Condominium Act. This provision limits any contracts entered into by the developer on behalf of the association to a period of two (2) years and further requires that it be terminable by the association or its board of directors upon 90 days written notice. Thus, as with other jurisdictions, the association has the ability to terminate contracts entered into by the developer on its behalf.

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# Maryland

## Warranty

The most relevant part of Maryland law in the context of developer transition pertains to warranties. The law differs between condominiums and home owners associations.

Embodied in Section 11-131, Real Property, MD. ANNOT. CODE (Condominium Act), the relevant law has a further breakdown for condominium unit owners versus the associations. For unit owners, the warranties run for one (1) year from the date of "transfer" and supplement other property sale warranties contained in Section 10-203, id. (Sales of Property). The warranties cover such things as the walls, floors, ceilings and HVAC systems.

For condominium common areas, the warranties run for three years and notice must be given within the warranty period. If not resolved during transition, a suit must be filed within one year of the **expiration** of this warranty. More elaborate than most, this warranty covers defects in work or materials on "structural elements", and is based upon "industry standards".

On the other hand, the warranties for HOA(s) are embodied in a separate HOA act. Section 11B-110, Real Property, MD. ANNOT. CODE (HOA Act) supplements implied warranties in Section 10-203 and express warranties in Section 10-202 covering "private dwellings" that pertain to the individual home. In contrast to the condominium act, any alleged breaches of implied warranty must be based upon defects in either work or materials that violate "engineering standards" and only with respect to common areas. Also in contrast with the con-

The most relevant part of Maryland law in the context of developer transition pertains to warranties. And that law differs between Condos and HOA(s).

do act, any claims can be asserted by individual homeowners or the associations. In this sense, the warranty is more flexible but, raises issues of actual resolution and release of claims with respect to who is agreeing and has binding authority.

On the other hand, this warranty is much more restrictive in time. The claim must be filed within one (1) year and again, suit within one (1) year of the expiration of that period. However, please keep in mind that there is also the option of a negligence action based upon breaches of industry standards and in this event, the discovery rule does apply. Eg. No running of the three (3) years for a negligence action until the defect is discovered. See Section 5-101, Courts and Judicial Proceedings, MD. ANNOT. CODE, as well as the Poffenberger

case, found at 431. A. 2d 677 (1981). A claim or count in negligence may be an important option, especially with respect to HOA(s), since the warranty period for common areas starts to run with the transfer of the first lot or, for unfinished common areas, from the time they are improved or available for use. The language is quite specific in this regard.

## Other Relevant State Laws

There is really no definition of "transition" itself, except in the context of elections conducted under the Condominium Act. In that statute, an election must be held for a board of directors within sixty days of fifty percent of the lots being sold. Beyond that, the provisions of the association documents, such as the declaration or master deed that address number of lots sold before other classes of membership other than the Declarant, can take any number of actions.

As for the other management items, it is important to timely transfer records, bank accounts, insurance policies and the like. Section 11-132 of the Condominium Act requires the transfer of such records, which should include deeds to common areas and contracts with any vendors. Section 11-114, id. Specifies the types of insurance you must insure is in place. When looking at these records, new boards and their managers should make sure the developer has paid all arrearages on the units it owned and property taxes to the relevant county and municipal governments. You don't want any unexpected surprises when the land is sold at auction and a local convenience store is erected!

To summarize, with respect to important records, it is important to obtain:

- deeds to common areas
- evidence of payment of developer assessments
- evidence of property tax payments
- certificates of insurance
- board and committee minutes (you will need to make sure you fill all relevant positions required in the association by-laws)
- vendor contracts for management, maintenance, landscaping or professionals such as lawyers and accountants
- Existing rules and regulations, which for condominiums must be approved pursuant to Section 11-111, Real Property, MD. ANNOT. CODE (Condo Act) and enforced pursuant to Section 11-113, Real Property, MD. ANNOT. CODE (Condominium Act).
- a recorded (in land records) packet of documents for resale certificates and packets required by Section 11-135 (Condominium Act) and Section 11B-106 (HOA Act).
- Note: There may also be relevant county or city laws. For example, in Montgomery County, Section 10B-8, 3(b)(1) could afford jurisdiction by the common ownership commission to hear a dispute where a developer in charge of an association refused to hold elections and transfer of control. Very important, indeed.

*Charles Chester, who provided the portion of the article addressing Maryland law, is an attorney representing management companies and their associations in both Maryland and DC. He has offices in both the DC and Baltimore areas.*

# Virginia

The Virginia law on transition is more comprehensive with regard to condominiums than with regard to property owners associations. The Virginia Condominium Act, the model for the Uniform Condominium Act and its younger cousin, the Uniform Common Interest Ownership Act, takes on developer control quite directly. The Virginia Property Owners' Association Act, which was never intended to address development issues, has been amended over the years to include some requirements with respect to transition. However, the provisions of the Property Owners' Association Act are not as supportive to the association as it finds its way through transition. Thus, any discussion of transition must begin with a division of these two separate ownership forms.

## Condominiums

The Virginia Condominium Act establishes a time limit on the control of the association by a Declarant that is tied to the development plan for the condominium and the sale of units in the condominium.

If the condominium is being developed in a single phase, the Declarant can reserve the right to control the affairs of the association for two years, or until units to which 75 percent of the common element interest are assigned have been sold, whichever occurs earlier.

If the condominium has convertible land, the Declarant can reserve the right to control the affairs of the association for three years, or until units to which 75 percent of the common element interest are assigned have been sold, whichever occurs earlier.

If the condominium contains additional land, the Declarant can reserve the right to control the affairs of the association for five years, or until units to which 75 percent of the common element interest are assigned have been sold, whichever occurs earlier.

The trigger date is the conveyance of the first unit – if phased, the first unit conveyed in that phase. The statute allows the Declarant to relinquish control earlier, as most documents provide and in this market, that occurs with some frequency. But, clearly, the statute established a plan – that the Declarant should let go at some finite time.

In addition to establishing a time frame for transition, the Virginia Condominium Act also instructs the Declarant on what he must provide to the unit owners association upon transition. These provisions are mirrored in the Property Owners' Association Act. These requirements were not in the Condominium Act when it was initially enacted in 1974 – but were added later, perhaps in recognition that developers were not doing transitions in the way that was most helpful to the community association.

The Condominium Act and the Property Owners' Association Act require the Declarant to deliver certain documents to the association within 45 days after expiration of the Declarant control period. Those documents include:

- All association books and records, including minutes, rules, regulations, amendments.
- A statement of receipts and expenditures from the date the condominium instruments were recorded.
- A copy of the latest approved plans and specifications for the improvements (as-builts, if available).
- All association insurance policies currently in effect.
- Written unexpired warranties of contractors, subcontractors, suppliers and manufacturers.
- Any contracts to which the association is a party.
- A list of manufacturers paints, roofing materials and other similar materials if specified for use on the property.

- If the association is managed, however, this duty falls on the management agent. So management agents of communities in transition should be aware of and adhere to these important details.

The third and final component in the *trifecta* of protections afforded by the Virginia Condominium Act to communities emerging from developer control is the structural warranty. Like its sister jurisdictions, Virginia has a warranty requirement. The warranty cannot be waived or diminished.

The Declarant of a condominium developed in Virginia must warrant or guarantee against structural defects each of the units and the common elements for two years. The unit warranty runs from the date of conveyance of the unit. The common element warranty runs from the date the first unit is conveyed, and if a phased condominium, the warranty runs from the conveyance of the first unit in that phase. In the case of the unit, the Declarant must also warrant that the unit is fit for habitation and constructed in a workmanlike manner so as to pass without objection in the trade.

Actions to enforce the warranty must be commenced within 5 years after the date the warranty period began. These dates are important dates that must be considered with the unit owners come into control of the association. In fact, the status of the warranty should be one of the first items of business taken up by the newly elected unit owner board – to include a discussion of the economics of investigating, exploring and preserving the warranty rights.

## Property Owners' Associations

The Virginia Property Owners' Association Act does not afford to purchasers of lots the same level of protections that the Virginia Condominium Act affords to purchasers of units. Conceived of as primarily a disclosure statute – to ensure that purchasers of lots in community associations were informed that they were buying a lot subject to covenants and restrictions – the Property Owners' Association Act imposes few other requirements on the developer of a property in a homeowner or property owners association:

- There is no time limit on the control of the association by the developer.
- There is no structural warranty obligation.
- There are requirements, as cited above, that the developer provide to the association certain information about the association upon transition. But that is where the developer's obligation ends.
- The property owners association may be successful in working with and through their local government agencies to require the developer to address completion of common area improvements like curb and gutter, landscaping, paving. But, these are exclusively requirements of the locality that may be protected by public improvement or performance bonds – the release or reduction of which is controlled by the local government agencies.

And, perhaps of more concern is that the limitations on the control of the association by the developer are governed by the provisions of the governing documents. While not a prevalent practice in the northern Virginia market, in other parts of the state, there are developers

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- Dehumidify the building
- Emergency cleaning services

Once the structure has been stabilized, the reconstruction process can start immediately. Here are some things you can do to ensure that the project gets off to a smooth start and progresses in a timely manner:

With the help of a restoration contractor, create a "staged recovery" plan:

- Assess/identify which units or common areas can be "fast tracked" (i.e. units/areas with less damage)
- Investigate permit requirement for units with cosmetic or superficial damage
- Evaluate impact of permanent repairs on ingress/egress for units to be fast tracked
- Identify construction phases for remaining units based on extent of damages
- Don't let the big picture slow down the fast track

Understanding the "scope of work"

- Your objective is to restore the building to equal or better condition to that which existed before the disaster
- Make sure you can understand the documents and don't be afraid to ask questions.
- Walk the job with the contractor and the insurance adjuster before work commences
- It is better to challenge/question the scope of work early rather than late
- The most important investment of your time is to ensure the completeness and comprehensiveness of the scope of work

Effectively managing unit owners can often be the most challenging part of recovering from a fire. Multi unit losses can quickly turn into chaotic scenarios without pro-active leadership, communication, and coordination with unit owners:

- Communication early and often. Take advantage of technology such as the web and put postings and critical information on the community's website.
- Track the residents. If displaced from their units, make sure you have all temporary contact information.
- Make sure they understand what the master policy will cover and what they are responsible for. Ensure there is an early understanding of betterment definition. (Typically, the master policy is only responsible for restoring the building to a condition that mirrors the property when it was originally conveyed by the developer).
- Establish and inform the residents of building/project standards and timeline
- Once work is complete, obtain signed satisfaction certificates from each owner.

Many of the suggestions listed above are general. This list can and should be customized to fit the specific needs of each community. As we are now in the winter months (more fires occur in the cold season), it is especially important to be prepared. Emergency planning is a value-added service that community management companies can and should provide to their client communities.

If you have not already done so, invest a small amount of time into creating a disaster management plan. That way, in a time of crisis, you can shine in your role as manager and leader.

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## Developer Transition in the District of Columbia... from page 15

Although there are limited provisions of the District of Columbia Condominium Act that specifically address transition from developer to homeowner control and transition related issues, it is important to point out that while the developer is in control of the condominium unit owners association and its board of directors, the developer board of directors has the same requirements, obligations and must meet the same standards that are applicable to the condominium association when it becomes unit owner controlled. Therefore, the same fiduciary duties applicable to homeowner boards of directors are also applicable to developer-controlled boards of directors.

The above summary describes some mechanical requirements and protections that are required by law to address the developer to homeowner transition process applicable to condominiums in the District of Columbia. However, it is not intended to be exhaustive of all requirements but rather, illustrative of the process and its requirements and restrictions. Certainly, communication, proper record keeping, good relations and the employment of good business judgment also play substantial roles in the transition process.

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## Developer Transition in Virginia... from page 15

who retain control of association operations for extensive periods of time – in some cases until the last lot is sold. This is too much of a good thing! It leads to frustrated homeowners and either disinterested, or over-interested developers.

So what do these communities do? They find ways to work with their local government officials and with the developers of their communities. They may need to seek out the developer and work with him to consider transition. Sometimes the seeking may turn into demanding. There is no one good way, no precise formula. Each community has a personality and the transition is shaped by that personality, particularly if there is no statutory backdrop to provide the answers.

### Conclusion

Community Associations Institute offers a number of helpful resources for communities embarking on transition. Those publications are available through the Chapter website and include not only a GAP report, but a Best Practices Paper developed in collaboration with the National Association of Home Builders.

Consider those resources, as well as the experience of management, association legal counsel, reserve specialist and other professionals who can provide guidance to your community as you begin this important journey. There is no more significant time in the development of the community – transitions handled well set the tone of the community for years to come.

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