INDEPENDENT TURNOVER AUDITS
From Finances to Engineering, Ensure a Healthy Beginning for Your Association

Congratulations! Your community association has reached the Florida statutory threshold of 90% member owned. The developer is now stepping off the board of directors and handing the brand new not-for-profit "baby" association to the membership. Whether you are an owner in a condominium association or a homeowners' association, turnover from developer control is arguably the most important event in your association's short history.

Both types of associations are entitled to elect a majority of their respective board of directors within three months after 90% of all parcels "in all phases of the community" or all "units that will be operated ultimately by the association" have been sold.[1] It is at this first association membership meeting that the owners elect owner-directors and the developer formally relinquishes control of the association to the association membership. The turnover triggers between condominium associations and homeowners' associations vary slightly. However, triggers such as a developer abandoning the property, filing for bankruptcy or receivership, or defaulting on a mortgage note are not common and present a series of other issues and complications that are beyond the scope of this article.[2] There are also provisions within the Condominium Act that entitle the membership to representation on the developer controlled board as certain sales thresholds are met.[3] However, the most common turnover trigger for both types of associations is when the developer has successfully sold at least 90% of the parcels or units within the community or, for a condominium association, within three years after 50% of the units have been sold.[4]

At the same time as the membership takes control of a condominium association, or within 90- days after the membership takes control of a homeowners' association, the developer must deliver the certain property, information and documents to the new owner-controlled board of directors.[5] The turnover document list for condominium associations is found at Section 718.301(4) (2019). The turnover document list for homeowners associations is found at Section 720.307(4) (2019).

The statutes provide a comprehensive list of the required turnover documents. However, more often than not, the new board does not receive everything listed in the statutes. It is similar to being handed a box full of wood and screws and asked to assemble an entertainment center without the instructions.

For the new owner-controlled board to proceed forward in the best interest of the association, it should know, 1) what contracts the developer-controlled board entered in to; 2) what ongoing and outstanding financial obligations is the new board being asked to assume; 3) what is the overall financial well-being of the association; 4) did the developer fund reserves and, if so, through what method and in what amount were they funded; 5) did the developer deficit fund and is there any money owed to the

[1] Fla. Stat. § 720.307(1)(a) (2019).
[2] See Fla. Stat. § 718.301(1) (2019); see also Fla. Stat. § 720.307(1) (2019).
[3] For example, the Florida Condominium Act specifically provides that members are entitled to elect a director when 15% of the units within the community have been sold. See Fla. Stat. § 718.301(1) (2019). Further, within seventy-five (75) days of when the membership is entitled to elect a director, the developer must notice and call a membership meeting to hold the election for that member director position. See Fla. Stat. § 718.301(2) (2019).
[4] Fla. Stat § 718.301(1)(a) (2019).
[5] See Fla. Stat. § 718.301 (2019); see Fla. Stat. § 720.307(4) (2019).

developer; and 6) what are the terms and duration of any warranties provided by contractors who worked on the property.

Generally, contracts entered into while the developer is in control of the board are association, not developer, obligations. The newly elected owner-controlled board should receive a copy of every contract or agreement that was entered into prior to turnover. The Florida Condominium Act provides the new owner-controlled board with the ability to cancel certain contracts entered into by the developer on behalf of the association. Specifically, a pre-turnover contract that provides for the "operation, maintenance, or management of the condominium" may be cancelled "by a vote of not less than 75 percent of the voting interests other than the voting interests owned by the developer."[6] Further, any pre-turnover contract which obligates the "association to purchase condominium property or to lease condominium property to another party, shall be deemed ratified unless rejected by a majority of the voting interests of unit owners other than the developer within 18 months after unit owners other than the developer elect a majority of the board of administration."[7] The Florida Homeowners' Association Act does not provide similar contract cancelation rights to the new board. That said, Section 720.309(1), *Florida Statute*, requires that any "grant or reservation made by a any document" or contract that provides for the management or maintenance of the association "must be fair and reasonable." However, whether you are a new board member of a condominium association or a homeowners' association, you should be fully informed as to the extent of your association's pre-turnover contractual obligations; it is the developer's obligation to provide this full disclosure to the new board.

The audited financial statements from the developer-controlled board should provide answers to many of these important questions. Florida law, for both types of associations, specifically requires that the financial statement be provided by and independent certified public accountant within ninety (90) days of the election of the owner controlled board.[8] However, the association should keep in mind that the requirement to hire an "independent" CPA is a developer obligation. Often times, the Developer's audit will state that the association owes the developer monies related to the developer's alleged over funding of the association or over payment of the developer's deficit funding requirement prior to turnover. The association should hire its own CPA to review and audit the pre-turnover financials.

Prior to turnover, the developer has the power to waive its pre-turnover assessment obligation by electing the Assessment Guarantee option under applicable Florida Statute.[9] The Assessment Guarantee, if elected, provides that the developer must deficit fund the association. Deficit funding requires that the developer pay the difference between the amount being received from new owners and the amount it costs to run the association, i.e., the deficit between funds received and the expense of running the association. However, after turnover, the developer becomes another association member and is similarly obligated to make maintenance assessment payments for each unit, whether developed or undeveloped, that it owns. Undeveloped unit are sometimes referred to as "phantom units". A "phantom unit" is a unit that has not been constructed by the developer as of the date on which the developer records the association's declaration. Florida Courts have held that an owner, including the developer, may be liable for assessments on unconstructed units where the assessment is allowed under the association's declarations.[10] If the developer has not specifically excluded

[6] Fla. Stat. § 718.302(1)(a) (2019).
[7] Fla. Stat. § 718.302(2) (2019).
[8] See Fla. Stat. § 718.301(4)(c) (2019); see also Fla. Stat. § 720.307(4)(t) (2019).
[9] See Fla. Stat. § 718.116(9) (2019); see also Fla. Stat. § 720.308 (2019).
[10] See e.g. Schooner Oaks Limited Co. v. Schooner Oaks Condominium Assoc., Inc., 776 So.2d 305 (Fla. 4th DCA

assessment liability for unsold units pursuant to the declarations and Florida Statute, i.e., an assessment guarantee period[11] or a first closing exclusion period,[12] those monies are owed to the association. The issue of assessment liability for "phantom units" is a condominium specific financial issue that needs to be examined by the association's CPA and attorney.

Community association reserve funding can be a complicated issue that involves both accounting and engineering expertise. The purpose of funding reserves is to ensure that an association will have money on hand to maintain and repair specific structural, utility, and amenity common elements located on the property or in the condominium building or buildings. The financial disclosure should illustrate whether the developer established reserves, for what elements reserves were established, whether the reserves were partially or fully funded, or whether reserves were waived by the developer-controlled board.

The establishment of reserves will go hand and hand with the certified report from the architect or engineer concerning their review and certification as to the useful life of the various building elements. However, a certification from an architect or engineer is only a turnover requirement for condominium associations. Similar to the association retaining its own CPA to review the developer's financial audit, the association should also retain its own engineering firm to perform a turnover engineering report and inspection. This is particularly true in the context of condominiums or townhomes as the common elements that an association is responsible for in those two types of residences warrants special attention and inspection. Further, the best way to ensure that an association's reserve designations are adequately funded is for the association to hire a vendor that specializes in providing community associations with a reserve study. A reserve study will confirm the appropriate value for the remaining life of reserve element (roof replacement, painting, pavement resurfacing, etc) and will thereby tell the association how much should be reserved over the life of the element.

The association's engineering inspection and report should also provide the board with an opinion as to possible latent or patent construction defects. There are very important claim limitations related to construction defects that both condominium associations and homeowners' associations should keep in mind. Stated simply, defect claims that the association should have been made aware of through reasonable diligence are subject to a four (4) year statute of limitation. The 4 –year statute of limitations begins to run from either the date of turnover, for open and obvious defects, or from when the association discovers the defect for latent or hidden defects. However, the absolute outside limitation for construction defect claims in the State of Florida is ten (10) years after the certificate of occupancy has been issued, i.e., Statute of Repose.[13] With regard to construction defect claims, the association should strike as soon as possible before the developer, and the developer's assets, disappear into the sunset never to be seen or heard from again.

The issues and potential problems outlined above just scratch the surface of turnover related traps facing a newly elected board of directors. The owner-controlled board should retain an attorney knowledgeable in community association law, a CPA who is familiar with community association accounting practices and the Florida Statutes applicable to that type of association, and retain an

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2000); see also Winkelman v. Toll, 661 So.2d 102 (Fla. 4th DCA 1995).

[11] Fla. Stat. § 718.116(9)(a)(1) (2013).

[12] Fla. Stat. § 718.116(9)(a)(2) (2013).

[13] Other events may toll the Statute of Repose pursuant to Florida Statute. However, an analysis of those various events is beyond the scope of this article. Generally, the most common tolling event for the Statute of Repose is the issuance of a certificate of occupancy by the county or municipality for the building in issue.

engineering firm that is experienced in construction defect issues faced by condominium and homeowners' associations in the State of Florida. The association should also work closely with its management company to ensure that turnover is managed smoothly. One way in which to help ensure a smooth turnover is to have the developer establish a turnover committee made up of non-developer owner-members.

Regardless, after being elected, the new board should work very closely with its attorney, CPA, engineer, and management company to ensure the developer's feet are held to the fire and that the turnover provisions of the Condominium Act and Homeowners' Association Act are strictly complied with. Developers come and go just about as quickly and predictably as the rising and setting of the sun. Your community association should be viable and healthy for many years to come. The viability, health, and longevity of your association starts with turnover.

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*This presentation/information was provided by **Erik Whynot, Esq.**, founding partner of The Whynot Law Firm in Casselberry, Florida. The firm represents all types of community associations throughout the State of Florida on issues ranging from assessment collection and covenant enforcement to vendor contract negotiation, document amendments, and construction defect matters.*

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