

Developer Transition:

Maximize Revenue, Manage Common Area & Move Ahead with Successor Developers of “Broken Projects”

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With what may be the long-anticipated turnaround in the real estate market, developers are taking steps to begin building again. This includes brand new developments as well as existing projects where building had stopped during the downturn. This article briefly examines the topic of a “broken project” including some of the things that a community association may do to manage it.

What is a “Broken Project”?

A broken project is a development that was started by a builder with sales of homes to the public. During the sales program, the developer either ran out of cash or decided the project was not “penciling out” and stopped building. The association, already formed, was possibly left with common area to maintain or other expenses but with too few lots and/or units paying assessments to offset those costs.

Minimize Costs, Maximize Revenue

While limiting its costs, the association should try to maximize its revenue. The association should determine if any bond or other security was posted by the builder as required by the Bureau of Real Estate (BRE) or the local government with jurisdiction over the project. For example, the BRE requires a developer to guarantee certain obligations by posting a bond or other form of acceptable security in favor of the association. If the builder fails to fulfill certain promises, such as paying assessments on the residential lots and/or units that it continues to own or completing or maintaining certain facilities, then the association may be able to make a demand on the bond or other security and use the cash to pay for the obligation that was secured.

Common Area Maintenance Provisions, Turnover Requirements

The association should review the CC&Rs and any other agreements between the original developer and the association for provisions relating to the maintenance of the common area facilities (*e.g.*, who maintains what for how long and who pays for it), easements in favor of the association for use and maintenance, and “drop dead dates” for the mandatory turnover of common area facilities to the association. Depending on what is in these documents, the association may decide to maintain certain common area improvements even though it may not be necessarily obligated to do so. For example, the association may wish for its members to have continued use of a clubhouse that was built and maintained by the original developer. However, the successors to the original developer are difficult to contact or unable/unwilling to maintain the facilities in accordance with the agreements that the

original developer had entered into with the association. The association must confirm whether its insurance coverage is adequate and if it has the authority to collect assessments from its members to pay for all of the expenses related to using and maintaining these facilities. The association must keep an accurate accounting of all payments relating to the maintenance and other costs of facilities that it is not actually responsible for. This becomes important when a new builder wishes to re-start sales.

Protecting Association Interests & Moving Ahead with Successor Developers

When a successor to the original developer acquires the unsold lots and/or units, and remaining common area, it will be anxious to start building and selling. This is the opportunity for the association to work with the current developer because it is in the best interests of all concerned to build the project out as originally marketed to the owners or as reasonably close to it considering any changed market conditions. The association should not shortchange itself: Depending on how the governing documents for the project are worded, the association may have the ability to decide on construction access, architectural control, annexation, the nature of new common area improvements, association budgets et cetera. These may all be negotiating points with the current developer including addressing any long-standing common area maintenance concerns and whether the association will be reimbursed for past expenses that it was not obligated to pay for. All of these matters should be memorialized in an enforceable written agreement between the parties such as an annexation agreement and/or a development agreement.

Construction Defect & Other Considerations

There may be many other important matters for an association to consider, including whether there are any potential construction defect issues involving the original developer and/or its successors. For example, claims must be timely filed or they will be barred. All of these matters will require a careful analysis of the facts and the applicable law. This is not an exhaustive list of all issues that may arise in a broken project. It is strongly recommended that an association consult with an attorney while managing and fixing a broken project to ensure it is making decisions that are in the best interests of the association.