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Insights

Acquiring Failed Subdivisions: The Risk of Tyrannical HOAs

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Developers and builders who wish to acquire a failed developer's residential subdivision, when there are existing homeowners in the subdivision, should BEWARE that a statutory turnover of HOA control may have occurred!

It is generally recognized that, under Florida law, members of a residential homeowners' association (HOA) other than the developer member, are entitled to elect at least a majority of the Board of Directors of the HOA within 3 months after 90% of the parcels in a community have been conveyed to the homeowners (or a lower percentage if provided by the Declaration of Covenants for the subdivision). This occurrence is commonly referred to as the "transition of association control," in that it allows the homeowners other than the developer to control the HOA's Board of Directors and thereby direct the activities of the HOA.

What many people don't know is that such a transition is also triggered by the occurrence of any one of the following events specified in Florida Statutes Section 720.307: (i) the developer abandons its responsibility to maintain and complete the infrastructure as specified in the governing documents, (ii) the developer files a bankruptcy petition, (iii) the developer loses title to its property through a foreclosure action or deed in lieu of foreclosure (unless the successor owner has accepted an assignment of developer rights and responsibilities), or (iv) a receiver for the developer is appointed and is not discharged within 30 days (unless the court determines that transfer of control would be detrimental to the association or its members).

If one of these trigger events occurs, control of the HOA would pass to the members or parcel owners other than the developer, who then have the right to elect a majority of the Board of Directors of the HOA. A specific subsection of Florida Statutes Section 720.307 states in relevant part that, "*[f]or the purposes of [Section 720.307], the term 'members other than the developer' shall not include builders, contractors, or others who purchase a parcel for the purpose of constructing improvements thereon for resale.*" This means that any successor developer, builder, contractor or other

party that purchases a vacant parcel for construction of a home on the parcel will not be entitled to vote in the election for a majority of the HOA's Board of Directors.

These statutory provisions create a potentially significant issue when a failed or abandoned community is purchased by a new developer or builder who intends to perform deferred maintenance, complete the build-out of the subdivision and sell the remaining parcels to homeowners. For example, suppose that Builder A is an initial developer that records a Declaration and establishes an HOA for a new community of 100 homesites, but then goes bankrupt, is foreclosed, or abandons the community after building and selling only 5 homes. Suppose then that Builder B wishes to buy the rest of the community and finish it. If the statutory trigger for transition of association control has already occurred, Builder B will not be able to exercise certain developer rights that, under the terms of the recorded Declaration, would otherwise arise by virtue of the developer's control of the Board of Directors of the HOA.

Why is it important for Builder B to maintain control of the HOA Board as a successor to Builder A's developer rights? There are several reasons. By holding such rights, among other things, Builder B could control the Board of Directors of the HOA and thereby establish the HOA's budget and administer the common areas of the community, and choose to fund deficits in the HOA's operating budget in lieu of paying regular assessments on its homesites. The Declaration may provide for other rights to be exercised by the developer while it is in control of the HOA's Board, such as appointing the members of the Architectural Review Board or Committee responsible for approving new construction (and thereby ensuring that Builder B's proposed homes are approved), and obtaining the benefit of developer-friendly provisions in the Declaration that typically grant special privileges to developers for the purpose of facilitating ease of completion of the subdivision (such as the right to amend the Declaration, grant easements within the subdivision, utilize common areas for marketing, build and operate model homes, and similar matters). Sometimes a Declaration gives a developer these additional rights so long as it owns at least one homesite, but sometimes they are tied to developer control of the HOA Board.

In our scenario involving Builder A and Builder B, given these statutory provisions, Builder B would own 95% of the homesites but have no voting rights in the HOA that could be exercised to elect a majority of Directors to the HOA's Board. Instead, the owners of the 5 homes already sold by Builder A would vote for a majority of the Board. While such a Board might be composed of benevolent homeowners willing to be reasonable in addressing Builder B's concerns about the HOA's budget, the condition of the common areas, the types of homes that it wants to construct and sell, the need to build and operate model homes, the need to maintain marketing signs and similar matters that are essential to a builder's completion of a residential community, Builder B may fear that the Board might instead view Builder B with suspicion, perhaps even as a deep pocket capable of paying exorbitant amounts in HOA assessments to cure every possible ill in the subdivision, or even fund substantial enhancements that the Board may wish to make to the common areas. It is not beyond belief that Builder B could be tyrannized by a minority of homeowners for the entire time that it takes Builder B to complete the subdivision and sell off all 95 of its homes. Such a situation could be disastrous for any developer or builder seeking to acquire, rehabilitate and complete the development, and there is no way for Builder B to know in advance what might happen. In sum, such an authoritarian HOA could significantly impede a rescuing developer's efforts to complete a failed project.

Despite that such a consequence may not have been intended by the legislature, the provisions of the Florida Statutes governing this situation can have profoundly negative effects on a successor developer's attempt to "rescue" a failed subdivision. There may be options available to reduce the risks associated with these circumstances, but they depend on the specific facts involved, the status of the HOA, the history of the project and the provisions of its governing documents, and each presents its own unique concerns. A developer seeking to acquire a failed developer's residential subdivision should consult a real estate attorney before signing a purchase contract, in order to reduce the likelihood that it will find itself at the mercy of a tyrannical HOA upon

closing.