

Smooth Transitions: HOA Turnover Tips for Florida Developers

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Developers who create residential subdivisions in Florida are typically obligated to form a homeowners' association (HOA) to govern the community. Mandated by permitting authorities like counties, cities, and water management districts, the HOA manages the subdivision's common areas, such as open spaces, retention ponds, stormwater management systems, amenity centers, parks, entry features, walking trails, and private streets.

Initially, the developer owns all properties within the HOA's jurisdiction and appoints all members of the HOA's Board of Directors. However, there comes a point when the developer is legally or contractually obligated to transfer control of the HOA to the homeowners, allowing them to elect the directors. This "turnover" process presents a number of challenges and potential pitfalls for developers.

Establishing the HOA

An HOA is a Florida non-profit corporation that is governed by the Florida Not For Profit Corporation Act found in Chapter 617, Florida Statutes, as well as the Homeowners' Association (or HOA) Act found in Chapter 720, Florida Statutes.

An HOA commences its legal existence when the developer files its Articles of Incorporation with the Florida Secretary of State. At that time, the developer appoints the initial Board of Directors, which then appoints its officers, typically a President, Vice President, Secretary, and Treasurer. As such, at the time of its formation, the developer's representatives, being all of the directors and officers, control the HOA.

The Board of Directors then adopts Bylaws, which contain provisions for the regulation and management of the HOA's affairs, consistent with applicable laws and the Articles of Incorporation.

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Thereafter, the directors manage the HOA, and the officers implement their decisions. However, it is not unusual for the directors to approve the HOA's engagement of a professional management company to handle many management functions. In such instances, the management company must be qualified as a licensed community association manager (LCAM) under Chapter 468, Part VIII, Florida Statutes.

Recording the Plat and Declaration

The HOA is formed when the developer records a Plat of its land, identifying it as a subdivision containing residential lots. In addition to lots, this Plat typically includes tracts designated as common areas to be owned and/or maintained by the HOA.

Concurrently with the platting process, the developer records a Declaration of Covenants, Conditions, Easements, and Restrictions (Declaration) among the public records. This Declaration establishes various title restrictions affecting the subdivision, including use restrictions, architectural controls, and an obligation for lot owners to pay assessments to cover the HOA's operating expenses. Additionally, the Declaration establishes easements allowing lot owners to use the common areas.

When the Association is formed and the Plat and Declaration are recorded, the developer owns all lots and is the only member of the HOA. As lots are sold, purchasers also become members.

There are statutory thresholds specifying when lot purchasers have the right to appoint directors. This process, governed by Section 720.307, Florida Statutes, is known as the Turnover Statute. According to this statute, members other than the developer the right to elect at least one director of the HOA when 50% of the parcels in all phases of the community which will ultimately be operated by the HOA (including future unplatted phases), have been conveyed to members other than the developer. The term "members other than the developer" *excludes "builders, contractors, or others who purchase a parcel for the purpose of constructing improvements thereon for resale."*

Triggers for Turnover

Members other than the developer are entitled to elect at least a majority of the HOA's directors when the earliest of the following events occurs, a point commonly referred to as "turnover" of the HOA:

- 3 months after 90% of the parcels in all phases of the community that will ultimately be operated by the HOA have been conveyed to members other than the developer;
- Such other percentage of the parcels has been conveyed to members, or such other date or event has occurred, as is set forth in the governing documents (i.e., the Articles of Incorporation, Bylaws, and Declaration), to comply with the requirements of any governmentally chartered entity with regard to the mortgage financing of parcels;
- The developer abandons or deserts its responsibility to maintain and complete the amenities or infrastructure as disclosed in the governing documents;
- The developer files a petition seeking protection under Chapter 7 of the U.S. Bankruptcy Code;
- The developer loses title to the property through a foreclosure action or the transfer of a deed in lieu of foreclosure, unless the successor owner accepts an assignment of developer rights and responsibilities first arising after the date of such assignment; or
- A receiver for the developer is appointed by a Circuit Court and is not discharged within 30 days after such appointment, unless the Court determines within 30 days that transfer of control would harm the HOA or its members.

Even after turnover, the developer is entitled to appoint at least one director as long as the developer holds for sale, in the ordinary course of business, at least 5% of the parcels in all phases of the community.

After turnover, the developer has the same voting rights in HOA affairs as any other member (i.e., one vote per lot), except that it cannot use them to reacquire control of the HOA or select a majority of directors.

Turnover Process

Turnover is conducted at a special meeting of the HOA members, called in advance by the developer's appointees to the Board of Directors. At this meeting, the homeowners are entitled to elect a majority of the directors, and any directors appointed by the developer (along with the officers appointed by those directors) must resign, subject to the developer's right to retain one Board seat if it meets the criteria mentioned above.

It is not unusual for the homeowners to hire an attorney to represent them at and following turnover, in order to (i) verify the developer's compliance with its obligations under the HOA Act, and (ii) assist them in resolving any issues the members have with the developer or the subdivision.

Turnover does not relieve the developer from liability for matters that occurred prior to the transition. It merely allows the HOA to (i) acquire title to the common areas, (ii) obtain all of the records that the developer is required to provide, and (iii) control the Board of Directors going forward.

Following turnover, the new Board will be able to investigate whether the developer complied with its obligations while in control of the HOA and, if not, determine what claims the HOA may wish to pursue against the developer. Different financial obligations, warranties and construction requirements can apply to a developer in different communities, with potentially different statutes of limitations for each. The new Board of Directors will need to consider these matters, typically with the assistance of its attorney and any consultants it engages, like an accountant, engineer and/or general contractor.

If the developer did not comply with all of its obligations, or if other issues exist, homeowners may seek compensation from the developer. Even the slightest irregularity on the part of the developer can result in a demand that the developer write a check to the HOA to "settle" the matter.

Turnover can be contentious, especially if there are disaffected homeowners who have concerns about the way the HOA was operated or the subdivision was maintained while the developer was in control. Accordingly, it is important for the developer to be prepared for turnover well in advance.

Frequently Encountered Turnover Issues

Books and Records

The Turnover Statute itemizes all of the books and records that must be given to the homeowners either at Turnover or within 90 days thereafter. The developer should carefully review this list well in advance to ensure that they are all available and complete. The Declaration and any Amendments must be the original recorded documents, while the Articles of Incorporation and any Amendments must be certified copies. Other documents can be photocopies, or electronic copies.

The Turnover Statute does not address the possibility that some of the required books and records may be lost or missing. If the developer does not have them all, the attorney for the homeowners can use that as an excuse to demand concessions from the developer.

Deeds to Common Areas

All common areas must be deeded to the HOA. Some developers wait until turnover to do this, but that is not a good idea for several reasons. First, the homeowners may balk at the HOA accepting deeds to common areas if they are unsatisfied with their condition and fearful of liability associated with accepting title to a common area in deficient condition. Second, if there is deferred maintenance or if the common areas are not functioning properly, this gives the homeowners more leverage to demand financial concessions as part of turnover. Third, as long as the developer is the record owner of common areas, it is potentially liable for activities that occur there. For example, if a person is injured or killed on a common area, liability may be asserted against the developer as the owner, as well as the HOA. Also, if the common area is the subject of a code enforcement action, the developer could be cited as well as the HOA.

A better practice is for the developer to deed common areas to the HOA before turnover, while it still controls the Board of Directors. This can be done as soon as the Plat is recorded, which helps insulate the developer from liability for subsequent incidents occurring on the common area and takes deeds off the table as a turnover requirement. However, the homeowners may still have issues with the condition of the common areas at the time of turnover (discussed below).

When deeding common areas to the HOA, it is important for a developer to consider whether they may be subject to mortgage financing. It is common for a developer to finance the acquisition and/or development of a subdivision before it is platted, as a result of which the entire subdivision, when platted into lots and common areas, is subject to the mortgage. Such a mortgage should be released from common areas at the time they are deeded to the HOA. A prudent developer will negotiate with its mortgage lender in advance of closing its financing to obtain releases of common areas in the future, without having to pay for them like lot releases. It is a good idea for a developer to obtain a title report on the common areas to make sure they are free of mortgages and other liens (like code enforcement liens) when they are deeded to the HOA.

Permits

As part of turnover, the developer is required to provide copies of all permits issued to the HOA. A developer often obtains permits in its own name for improvements that are made in what will be future common areas, like amenities and stormwater management systems. These permits should be reviewed well in advance of turnover to verify if they need to be amended or reissued in the HOA's name.

If the developer got a Certificate of Occupancy (C.O.) for a clubhouse in its own name, that does not need to be transferred to the HOA (just like a C.O. on a house does not need to be transferred to a purchaser of the house). However, if the developer got the C.O. in the name of the HOA, that C.O. should be delivered as part of turnover because it is an HOA record.

The stormwater management system for the subdivision requires permits that cover both construction and operation of the system. A prudent developer will arrange for the operational permit to be issued in the HOA's name when the stormwater system is complete (before turnover), but this does not always happen.

If the operational permit was issued in the developer's name and did not provide for the HOA to operate the system, it would need to be amended or reissued before turnover to reflect the HOA as the operating entity under the permit. This triggers a process at the applicable Water Management District (WMD), which can require an inspection of the stormwater system. Such an inspection might reveal deferred maintenance or other permit deficiencies that require correction before the WMD will amend or reissue the permit in the name of the HOA. Dealing with the WMD permit may take some time and should be addressed well in advance of turnover.

Condition of Common Areas

One of the most significant problems encountered at turnover involves the condition of the common areas. If there are defects or deferred maintenance, homeowners are sure to raise those as an issue and require the developer to pay money to the HOA so it can address them after turnover.

To avoid this scenario, developers should obtain reports, well in advance of turnover, on the condition of the common areas from reputable and licensed professional consultants like engineers and general contractors. These reports should be certified to both the developer and the HOA. The developer can then evaluate the reports, question any dubious results, make the necessary repairs if needed, and obtain new reports showing that all the common areas are in acceptable condition, fully functional, and meeting the requirements of all permits and approvals.

This proactive approach will typically be less expensive for the developer than negotiating a financial settlement with the homeowners at or after turnover. If the homeowners do not know the cost to make necessary repairs, they may obtain their own estimates, or they may demand a settlement well in excess of what is actually required.

If the developer does not make necessary repairs, it should obtain binding proposals addressed to the HOA from reputable contractors and share them with the homeowners at turnover. The developer should be prepared to pay the HOA the cost of the repairs identified in the proposals. This approach is not quite as clean as turning over common areas in good repair, since the homeowners must evaluate the defects and deferred maintenance, as well as vet the contractors and their proposals, in order to get comfortable with this as a solution.

A developer should be very careful if considering the use of reserve funds in the HOA's budget to make repairs. Reserves are not supposed to be used to fix defects, and not all deferred maintenance may qualify for the use of reserve funds. The HOA Act, in Section 720.303, Florida Statutes, contains detailed requirements for the budgeting, establishment, and use of reserves. The developer should consult its LCAM and Certified Public Accountant (CPA) if considering the use of reserve funds for deferred maintenance.

Developer's Funding Obligations

In some cases, the HOA's governing documents establish a specific assessment amount that the developer is required to pay to the HOA for lots that it owns during the period before turnover. Alternatively, the governing documents may exempt a developer's lots from assessments entirely, as long as the developer funds HOA budget deficits.

At turnover, the homeowners will focus on whether the developer complied with its HOA funding obligations before turnover. If there is any doubt about that, the homeowners will want the developer to pay any shortfall to the HOA. The independent CPA audit (discussed below) that the developer is required in most instances to give the homeowners at turnover will be an important consideration in that regard.

The sufficiency of HOA reserves (discussed above) will also be of concern to the homeowners, since they will want those funds to be adequate, when combined with additional reserves collected from homeowners after turnover, to repair and replace common area improvements when required in the future.

Developers should consult their LCAM and CPA well in advance of turnover to ensure that all of its funding obligations are being met.

Independent CPA Audit

The Turnover Statute contains detailed requirements for the financial records of the HOA to be audited by an independent CPA covering the entire period since the HOA was formed (or since the last audit if it qualifies), but this only applies to HOA's incorporated after December 31, 2007.

The audit must be conducted in accordance with generally accepted accounting principles and auditing standards promulgated by the Florida Board of Accountancy. The CPA will be required to examine supporting documents and records to determine if HOA expenses were for actual HOA purposes, and to verify that the developer complied with its HOA funding obligations.

Hopefully, the developer and its LCAM will have all the necessary records in good order to facilitate the audit, which will take some time. The audit should be arranged so as to have the results available for the developer to review well in advance of turnover.

Developer's Reserved Rights

The governing documents of the HOA (and the Declaration in particular) customarily contain various reservations of rights by the developer. These are typically interspersed throughout the Declaration, and include such rights as:

- Using and granting easements over the common areas incident to the developer's business activities as long as they do not interfere with the use of the common areas;
- Erecting signage on the developer's lots and the common areas for marketing and sales purposes;
- Using the developer's lots for construction trailers, parking lots, material storage areas, model homes, sales centers, etc.;
- Using and granting utility easements within the subdivision that do not interfere with any dwelling;
- Discharging into the stormwater management system;
- Being exempt from use restrictions;
- Being exempt from architectural controls;
- Granting waivers and variances; and
- Vetoing actions by the HOA or the members that would either amend or extinguish rights, reservations, exceptions or exemptions in favor of the developer, or be detrimental to the sale, operation or management of developer's lots, or otherwise damage the developer's business interests in the subdivision.

This list of reserved rights is not exhaustive. The issues the developer needs to consider before turnover are (i) whether the reserved rights encompass everything the developer wants, and (ii) how long reserved rights last. If the Declaration does not specify (and many don't), the homeowners are likely to assert that once turnover occurs, all of the developer's reserved rights terminate. It is therefore important for the developer to examine the Declaration before turnover to identify any reserved rights that should survive turnover until the developer sells its last lot, and also consider whether any additional rights should be reserved.

Most Declarations contain provisions which allow the developer to amend the Declaration. Such Amendments are subject to conditions contained in the HOA Act, and perhaps in the Declaration as well, so both need to be reviewed by the developer and its attorney. In anticipation of turnover, the developer may be entitled to amend the Declaration unilaterally to reserve the rights it wants, and to provide that all reserved rights survive turnover until the developer sells its last lot. Note that Section 720.3075, Florida Statutes prohibits the developer from

unilaterally amending the Declaration or other governing documents of the HOA after turnover.

The problem with such an Amendment is that if it is done right before turnover, the homeowners may perceive it as the developer “trying to get away with something,” even though it may be permitted. This obviously has bad optics, which may impact a developer’s willingness to amend the Declaration, so the developer will need to balance the optics of an Amendment against the importance of the reserved rights it wants to keep after turnover.

Conclusion

HOA turnover in Florida is a highly regulated process that requires the developer’s attention long before it occurs. The potential issues discussed above are not all of those that a developer may face. Every subdivision, and every set of HOA governing documents, is different. In addition to obtaining assistance from its LCAM and CPA, as a turnover trigger date approaches the developer should seek the advice of an experienced real estate attorney in order to help minimize the issues it will face at turnover.

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