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**CONSIDERATIONS IN THE  
DEVELOPMENT  
OF  
COLORADO COMMON INTEREST  
COMMUNITIES**

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## **CONSIDERATIONS IN THE DEVELOPMENT OF COLORADO COMMON INTEREST COMMUNITIES**

1. What is a Common Interest Community (CIC)? A CIC is a community with mandatory assessments. If a community has mandatory assessments, then the Colorado Common Interest Ownership Act (CCIOA) typically applies in one of two ways. One application is to CICs and their owner associations, if the CIC existed prior to the date CCIOA came into effect, July 1, 1992 (“pre-CCIOA communities”). The other application is to CICs created after that date (“post-CCIOA communities”). These new communities and considerations of the developer/declarant in forming these communities is the focus of this article.
  
2. The Common Interest Community vs. a Community Without a Mandatory Community Association. Does a need or desire exist to provide maintenance and services funded with mandatory assessments? Consider these factors:
  - a. Does the development plan require maintenance of common ground, open space or facilities, or require certain services such as security or trash removal?
  
  - b. Is there a need or desire to preserve the nature and character of the development through the enforcement of covenants which control the practices of owners (such as architectural controls or standards)?
  
  - c. Is the building type such that the owners must share structural features such as access ways, hallways, and walkways in garden type or high-rise units?
  
3. Specific Considerations for Development of a Common Interest Community.
  - a. State Subdivision Regulation and Registration of Certain Developers.
    - i. State statutes require registration of developers in certain subdivisions.
      1. Generally, any subdivision into twenty or more interests intended for residential use, and offered for sale, lease or transfer. See C.R.S. §12-61-401(3).
  
      2. Includes twenty or more units in a conversion or a cooperative.
  
      3. Excludes certain subdivided lots, campground sales, bulk sales or transfers to developers, land on which improvements have been or are to be constructed for or at the cost of the construction. See C.R.S. §12-61-401(3)(b)(II).
  
    - ii. If registration is required, upon prior limited approval (prior to a full approval), reservation agreements can be entered into, if deposit funds are held by a third party and are refundable.

- iii. Application for Registration of Developers includes the following:
1. principal office in home state;
  2. principal office in Colorado;
  3. names of natural persons that are principals with a 25% interest the developer's entity that owns the project;
  4. length of time in business and the locations where the applicant has been engaged in real estate sales and/or development;
  5. felony disclosures;
  6. states in which a license or similar registration or regulation have been complied with by the applicant;
  7. any past violations with Colorado or other similar state agencies; and
  8. information specific to the subdivision, including:
    - a. location;
    - b. names;
    - c. evidence of registration;
    - d. copies of documents evidencing title/ownership;
    - e. copies of loan documents;
    - f. copies of leasing/sales contracts to be used (forms for sale of the Colorado Real Estate Commission must be used, unless the sales contract is prepared by an attorney);
    - g. statement regarding any proposed installment sales;
    - h. statements regarding access and utilities;
    - i. statement as to surveys made, if any, and recommendations
    - j. statement on whether a common interest community will be created; and
    - k. statement on any owners association and funding of that owners association.
- b. The Impact of Physical Design. Competent land planning can create better communities and increase the declarant's profit. By the careful clustering of units, the declarant can save on drainage and sewage systems, and shorter utility runs. The declarant can also save on per unit land costs because of the higher level of density. These savings can be used to provide more amenities and lower unit costs, both of which should increase marketability. The costs of operating and maintaining these amenities, however, might significantly detract from the sales appeal of the individual units. Therefore, the declarant should make the following basic decisions before committing to a land plan:
- i. Will the open space and natural amenities have a significant bearing on the association budget?
  - ii. Are they accessible to maintenance?
  - iii. What will be the time and dollar investment required to retain their value and attractiveness?
  - iv. What types of services and amenities are desired and how will these services be financed by the association?

- v. Site plan decisions determine what land, if any, is to be shared by the owners, and decisions on housing type can mandate the creating and operating of an association.
  - vi. The declarant must decide which common grounds and services are to be maintained and serviced by what vehicle – a municipality, a private club, or a community association, or a special district.
  - vii. Are they important enough to the project over the long run to justify their operating costs?
  - viii. Are all the elements of the project necessary or basic to the success of the project? The declarant must carefully examine the need to construct any ancillary facilities which might not be in demand by the market because they might not be used enough to warrant the additional cost to the residents and further capital expense to the declarant. The declarant not only has to decide which amenities to include, but as with the natural features, the declarant must decide how these elements will be owned, maintained, operated, and funded.
  - ix. The declarant should institute a financial program that sets aside funds in reserve for the repair and replacement of facilities and should determine how much of the assessments will be earmarked for these future capital expenses based on the extent of the common property, the type and quality of construction, the design life of the facilities and their replacement costs.
  - x. Underestimation or "low balling" of the assessments of an HOA community or condominium development has been one of the most serious abuses in the field and the declarant may be open to a serious legal challenge for failure to estimate operating expenses properly. A capital budget, full occupancy budget, and phased development budget should be prepared after taking into consideration the association's responsibilities and operational design. After a determination of major capital equipment and facilities, a system should be established to accumulate reserves for capital replacement. The operating budget(s) and owner and declarant assessments should also be designated after a re-examination of the project site plan, facilities and unit design in order to keep the association operational and capital costs to a minimum.
- c. Associations and the Risk of Claims from the Association and its Members. Associations have the ability and many have had the inclination to sue the declarant.
- d. Local Government. Local governments require open space and out-lots but will not take on the responsibility to maintain these areas, requiring an owner's association to perform such functions. Local governments have also demonstrated a growing concern for the administration, maintenance and improvement of commonly shared properties after the declarant leaves the scene.
- e. Lender Requirements Will Need to be Met. Common interest communities have presented unique problems for the mortgage lending industry. Conventional appraisal and financing techniques and principles are not sufficient to handle developments with an association, common property and the enforcement of the rules and regulations to which each owner is bound through covenants and upon which the future viability of the

development may rest. To a lender who may hold a mortgage for 30 years, the association clearly takes on significant importance. The lender is often concerned with reviewing not only the individual unit, but the entire financial, legal and operational basis of the association and the common property.

- i. Individual lenders and the secondary mortgage markets share these concerns. Each of the secondary mortgage markets has developed guidelines or requirements which must be met before their agencies will become involved in a common interest community project.
  - ii. The declarant must decide how to finance unit sales and construction of improvements. While the decision may be premised on available financial sources, the market will also be a consideration. In financing unit loans in a condominium, planned community or cooperative development, the declarant must also make a determination based on which agency's requirements the declarant is prepared to meet.
- f. Compliance with State Subdivision Laws. For communities with more than 20 units, the developer should register and comply with the Colorado Division of Real Estate, and comply with subdivision laws and regulations of the State Department of Real Estate.
- g. Drafting of Common Interest Community Documents. Drafting association legal documents is an additional requirement when the declarant elects to convey units with an association. The legal forms and documents must be tailored to include the rights, responsibilities and duties of unit owners and the association. Additionally, descriptions of the individual property, the common elements and any private and public dedications must all be exactly worded and written. All documents must conform to local, state, and, where appropriate, federal statutes. The legal documents must be definitive for protective purposes, but be flexible enough to permit the declarant, and then the residents, to operate the association. The structure of the association must be carefully set forth by these documents prior to sales.
- i. There are several basic operating concepts which exist for the community association that must be included in the legal documents. They are:
    1. the automatic membership provision when a unit is purchased;
    2. the allocation of voting rights;
    3. the allocation of a proportionate share of the financial responsibility for common expenses (to be paid to the association);
    4. the ownership of the common elements;
    5. the provision for perpetual rights of access to the common elements and facilities as long as the resident owns property in the community;
    6. the lien rights of the association upon individual units should the owner fail to pay the mandatory assessments (now covered under applicable parts of CCIOA); and
    7. the provision for the process of governance of the association (also now covered under applicable parts of CCIOA).
  - ii. Typical legal documents for a CIC include:
    1. Declaration;

2. Map and/or plat (a map or plat is not required for cooperatives);
  3. Articles of Incorporation to the community association;
  4. Bylaws;
  5. Rules, Regulations, Policies and Procedures;
  6. Minutes of meetings of the executive board and of the members; and
  7. Design or Architectural Standards.
- h. Before drafting any documents, determine the applicability of CCIOA to the proposed Common Interest Community.
- i. New Condominiums. The entire Act applies to all new condominium projects "created" on or after the effective date. New condominiums cannot be excluded from application of CCIOA by size of the project, by the amount of the average annual assessment, by restriction of permitted uses (i.e. by restriction to uses of only a commercial nature) or by combination of residential and commercial uses in a mixed use condominium project. The application of CCIOA to new condominiums is simple – all of CCIOA applies, regardless of the type, size and nature of the uses in the new condominium project. [C.R.S. § 38-33.3-115]
  - ii. Effect of the Colorado Condominium Ownership Act on New Condominium Projects. Most of the current Colorado Condominium Ownership Act is superseded by CCIOA. [C.R.S. § 38-33.3-115]. The sections of the Colorado Condominium Ownership Act which remain applicable are "Time-sharing – Definitions," "Special Provisions Applicable to Time Share Ownership," "Notification to Residential Tenants" and "License to Sell Condominiums and Time-shares." [C.R.S. §§ 38-33-110 to 38-33-113].
  - iii. New Planned Communities. The Act applies to new planned communities, including new planned communities limited to residential uses, and exempts out certain new small and limited expense planned communities, new commercial use planned communities, certain new mixed use planned communities and certain new large planned use communities. [C.R.S. §§ 38-33.3-115, 116, 121 and 116.3].
  - iv. New Residential, Small and Limited Expense Planned Communities. The Act applies to new planned communities which are restricted to residential uses, except certain new small and limited expense planned communities. [C.R.S. § 38-33.3-115, 116 and 121].
    1. New small and limited expense planned residential communities are not subject to the entire Act if they meet either of the following criteria:
      - a. the project does not contain more than 20 units and is not subject to any "development rights;" or
      - b. the average annual assessment for residential units (exclusive of any optional user fees and insurance) does not exceed \$400.00 (in 1998 with CPI increases each year).

2. Qualified small and limited expense residential planned communities are only subject to three sections of CCIOA:
    - a. Section 105 ("Separate Titles and Taxation");
    - b. Section 106 ("Applicability of Local Ordinances, Regulations, and Building Codes"); and
    - c. Section 107 ("Eminent Domain").
  3. New small and limited expense residential planned communities may also be bound by the entire Act if their declaration so specifies.
- v. New Commercial and Mixed Use Planned Communities. The Act does not apply to new commercial planned communities if uses are restricted to commercial uses. [C.R.S. § 38-33.3-121]. The Act applies to a new mixed use planned communities, if the real estate that comprises the residential units would be a "Planned Community" in the absence of the commercial use units or if the declaration expressly subjects the project to the terms of CCIOA. [121].
- vi. New Large Mixed Use Planned Communities. Parts of CCIOA do not apply to new large mixed use planned communities created after July 1, 1994. SB 94-216 (amended by SB 95-198) exempts large developments from some CCIOA requirements. Large mixed use planned communities are exempt from parts of CCIOA if: (a) the development is started after July 1, 1994; (b) the development has at least 200 acres; (c) the development has zoning for at least 500 units; and (d) the development has zoning for at least 20,000 square feet of commercial use.
1. Exempt large planned communities have flexibility from certain CCIOA requirements that require a developer/declarant to:
    - a. disclose reserved development rights (i.e. rights to expand the community by phasing, converting common property into units, moving tennis courts, etc);
    - b. set forth restrictions on use or occupancy;
    - c. specify who gets to use limited common properties (i.e., who gets to use patios, porches, or a neighborhood or village swimming pool); amend the governing documents when development rights (i.e. expansion rights) are exercised; and
    - d. turn over control of the association, if two years pass without a sale or two years pass without an annexation expanding the community.
- vii. New Cooperatives. The Act applies to new cooperatives, except new commercial use cooperatives and certain new small residential cooperatives that do not contain more than 20 units and are not subject to any "development rights." These particular new small residential cooperatives are only subject to two sections of CCIOA; Section 106 ("Applicability of Local Ordinances, Regulations and Building Codes") and Section 107 on ("Eminent Domain").

New commercial use cooperatives are not subject to any part of CCIOA. [C.R.S. §38-33.3-116]. Both new commercial use cooperatives and new small residential cooperatives may be bound by the entire Act, if their declaration so specifies. [116].

4. CCIOA Requirements and Special Factors.

- a. Defined Relationships. CCIOA organizes and establishes the relationship between the declarant and the association's operations.
- b. The Rule Against Perpetuities No Longer Applies. Declarations no longer are required to have strange terms of existence, i.e. for the life of a given person or for a term of 20 years, with automatic renewals every 10 years, etc.
- c. Declaration Requirements. The declaration must contain certain provisions outlined in Section 205 and other sections of CCIOA (i.e. if the declarant desires to increase the percentage of owners that may veto a budget above a majority of owners, then the declarant must state that higher percentage).
- d. Plat and Map Requirements. Plats and maps must also contain certain provisions set forth in Section 209.
- e. Allocation of Interests. Declarations must allocate the following interests: voting; common expense liability; and ownership (condominium vs. planned community vs. cooperative). A formula is required and the formula cannot favor the declarant or an affiliate of the declarant. For example, a reduced assessment rate on declarant owned units is not possible, nor is weighted voting benefiting only the declarant.
- f. Assessments, the Annual Budget and the Budget Process. The allocation of each unit's responsibility for common expense assessments is based on the allocated interests (the formula set forth in the Declaration). By applying each unit's percentage of expense liability to the budget, the annual assessment for each unit is obtained.
  - i. An initial budget should (must?) be prepared to represent to buyers what their annual assessment will be.
  - ii. CCIOA requires the budgets to be approved in a very specific manner. The process for the initial budget can be completed by the declarant or through member approval of the organizational minutes.
  - iii. The process to be followed after the initial budget is as follows:
    1. The Association must budget at least annually.
    2. The executive board of the Association is to prepare and approve a proposed budget.
    3. Within 90 days after the Board's adoption of the proposed budget, the Board is required to mail or deliver a summary of the proposed budget to all owners and set a date for a special meeting of the owners to consider ratification of the proposed budget.

4. The meeting shall occur within a reasonable time after mailing or other delivery of the budget or as allowed by the bylaws.
  5. At the meeting, unless a majority of the owners reject the proposed budget (or such higher percentage as established in the Declaration) the proposed budget is ratified and becomes the approved budget of the Association. CCIOA does not require that a quorum of owners be present at the meeting, if it is just a budget meeting, but does require a quorum if the meeting is also an annual meeting at which other business will be conducted.
  6. In the event the proposed budget is rejected by a majority (or higher percentage) of owners, the budget last ratified by the owners is continued until such time as the owners ratify a subsequent budget proposed by the executive board.
- g. Development Rights – Reserved Rights – Special Declarant Rights.
- i. The declaration must contain a description of any development rights and Special Declarant Rights reserved by the declarant, together with a description of the real estate to which each of these rights applies and a time limit within which each of those rights must be exercised.
  - ii. The exercise of these rights requires a recorded instrument, as an amendment to the declaration, the map or plat, or to both the declaration and the map or plat.
  - iii. If the declarant fails to exercise any development rights within the stated time limits and in accordance with any conditions or fixed limitations described in the declaration, the development rights lapse.
  - iv. The declarant may, at any time, record an instrument surrendering development rights.
  - v. Special Declarant Rights and Development Rights may be transferred only by a recorded instrument evidencing the transfer. The instrument is not effective unless it is executed by the transferee. If you are involved with the rights of a successor declarant, carefully read Section 304 of CCIOA regarding rights, liabilities and obligations of a successor declarant.
- h. Restrictions on Contracts. Prior to CCIOA, some abuses occurred by declarants creating sweetheart contracts for themselves or for an affiliate, as the management agent of the association, or through a lease of recreational facilities. These types of contracts are now restricted by CCIOA. Contracts entered into by the association, during declarant control, must now be subject to following:
- i. the terms can't be unconscionable;
  - ii. an obligation of good faith will be implied;

- iii. management contracts, employment contracts, and leases of recreational facilities or parking areas can be terminated on 90 days' notice;
  - iv. contracts between the association and a declarant or an affiliate may be terminated on 90 days' notice; and
  - v. any contract or lease that is not bona fide or is unconscionable contract may be terminated on 90 days' notice.
- i. Standards of Care. CCIOA provides that if an officer or a member of the executive board is appointed by the declarant, then in the performance of their duties, those officers and members of the executive board are required to exercise the care required of fiduciaries to the unit owners. If an officer or a member of the executive board is not appointed by the declarant (i.e. elected by unit owners), then those officers and members of the executive board are liable only for wanton or willful acts or omissions.
- j. Alterations of Units (C.R.S. §38-33.3-212), Relocation of Boundaries (C.R.S. §38-33.3-212) and Subdivision of Units. To the extent allowed for in the declaration for a CIC, alterations are allowed to units (C.R.S. §38-33.3-211), boundaries of units can be relocated (C.R.S. §38-33.3-212) and units can be subdivided. This can allow flexibility to the developer/declarant, and to the owners association, after declarant/developer control and rights have expired.
- k. Reservation for Sales Uses. Developers/declarants can use common elements for sales offices, if rights for sales offices are reserved in the declaration.
- l. Adding Now Unknown Real Estate. In addition to property described in the declaration that is subject to annexation, the developer/declarant can also add, if this right is reserved in the declaration, up to ten percent of the total area of real estate described in the declaration, but not in excess of maximum number of units allowed under the declaration in the common interest community.
- m. Other CCIOA Restrictions on Declarants.
- i. No Unconscionable Terms. Unconscionable terms or provisions cannot be included in governing documents of a community or contracts relating to the community. [C.R.S. §38-33.3-112]
  - ii. Good Faith. CCIOA imposes a duty of or obligation of good faith on all contracts or duties governed by CCIOA.
  - iii. Maximum Number of Units. The declarant must state the maximum number of units the declarant reserves the right to create.
  - iv. Allocated Interests. Allocated interests [assessment liability, votes and ownership of common elements (in condominium communities)] cannot discriminate in favor of the declarant.
  - v. CCIOA restricts discrimination in favor of the declarant.

- vi. Development Right Expenses. Only the declarant is liable for expenses in connection with parts of the community that are subject to reserved development rights. [C.R.S. §38-33.3-307(2)]
- vii. Liability of Declarant. The association is not liable for the civil wrongs (torts or personal injuries) of the declarant. [C.R.S. §38-33.3-311(1)]
- viii. HOA Funds. The declarant is liable for all funds of the association collected during the declarant control period which were not properly expended. [C.R.S. §38-33.3-311(2)]
- ix. Expenses Until HOA Assessments. The declarant must pay all expenses of the association until the association makes a common expense assessment. [C.R.S. §38-33.3-315(1)]
- x. Affiliates. The definition of "declarant" in CCIOA includes affiliates of the declarant. So, the above restrictions may also apply to affiliates of the declarant.
- xi. No Waiver. Declarants cannot avoid the restrictions of CCIOA. [104]
- xii. County Assessor. Declarants are to provide copies of the recorded declaration for the county assessor for condominium and planned communities.
- xiii. Large Planned Communities and Common Elements. In large planned communities, the declarant must give a general description of every common element that the declarant is legally obligated to construct and a general description of the type of any common element that the declarant anticipates may be constructed within the large planned community. An approximate date of completion must be given for each common element that the declarant is legally obligated to construct. The association for the large planned community cannot assess members for the construction, maintenance, or operation of any common element that is not described as those which the declarant is legally obligated to construct or that the declarant anticipates may be constructed unless such assessment is approved by the vote of a majority of the votes entitled to be cast in person or by proxy, other than by declarant, at a meeting duly convened as required by law.

5. Transition of Control.

- a. Generally. Before CCIOA, "transition" from declarant control to owner control was a haphazard and informal process. CCIOA has sought to change this. CCIOA requires the declarant to gradually turn over control of the association as units are sold or time expires.
- b. Officers. At all times, the executive board elects the officers.
- c. Election of Initial Owner/Board Members. Under CCIOA, three special meetings are anticipated (required?) during the declarant control period. More meetings may be advisable and fewer may be possible, but fewer meetings are not recommended.

Preparations and planning for these special meetings should begin before the first sale and then be implemented through the declarant and/ or management of the association.

- i. The first meeting is to occur not later than 60 days after the conveyance of 1/4 of the units that may be created to owners other than the declarant. At that time, at least one member, but not less than 1/4 of the members of the executive board, must be elected by owners other than the declarant.
  - ii. The second special meeting is to be held not later than 60 days after the conveyance of the units that may be created to owners other than the declarant. At this meeting, not less than 1/3 of the members of the executive board must be elected by unit owners other than the declarant.
  - iii. The third special meeting is to be held not later than the termination of the period of declarant control. At that meeting, unit owners are to elect an executive board of at least three members, a majority of whom must be unit owners other than the declarant.
- d. Outside Limits on Declarant Control in Most New Communities. The Declarant control period in communities subject to CCIOA terminates 60 days after the earliest to occur of the following events:
- i. 75% of the units that may be created have been conveyed to owners;
  - ii. Two years after the last conveyance of a unit by the declarant in the ordinary course of business (i.e. sales coming to a stop for a two-year period); or
  - iii. Two years after any declarant right to add new units was last exercised.
- e. Third Meeting and Requirement for that Meeting. Within 60 days after the earliest of one of these events to occur (from the list above), the third meeting must be held and certain records must be turned over and an audit of the association performed.
- f. Outside Limits on Declarant Control in Large Planned Communities. In new large planned communities (those started after July 1, 1994; with at least 200 acres; zoning for at least 500 units and zoning for at least 20,000 square feet of commercial use space), the declarant may maintain control until earlier of 60 days after any one of the following events:
- i. Sale of 75% of the maximum number of units that may be created under zoning or development approvals;
  - ii. The lapse of six years after a conveyance by the declarant in the ordinary course of business;
  - iii. 20 years after recordation of the declaration; and
  - iv. Within 60 days after one of these events, a meeting of the members must be held (to elect a board a majority of which are owners) and records and an audit must be provided to the association.

- g. Declarant Surrender of Control. The declarant may voluntarily surrender the right of appointment and removal of the executive board members before the termination of the declarant control period. CCIOA provides that the declarant may require, for the duration of the period of the declarant control period that certain actions of the executive board, which the declarant has previously set forth in a recorded instrument, be approved by the declarant before they become effective. This would typically be in the area of a design review committee, assessments, etc. CCIOA gives the declarant this power to veto certain actions of the executive board as long as the veto is executed properly.
- h. Turnover of Documents. Within 60 days after the end of declarant control, CCIOA also requires the declarant to turn over miscellaneous documents, records and an audit of the association. For new communities that are managed by an independent community manager, many of the following documents have already been "turned over." The items to be turned over include the following:
- i. the original or certified copy of the recorded declaration, as amended and/ or supplemented;
  - ii. the association's articles of incorporation, bylaws, minute book, other books, records and all rules and regulations that may have been promulgated;
  - iii. an accounting of association funds and financial statements from the date the association commenced receiving funds and ending on the date on which the declarant control period ends (the "Transition Audit");
  - iv. the association's funds or the control thereof;
  - v. all of the tangible personal property of the owners and the association held or controlled by the declarant;
  - vi. copies of the plans and specifications used in the construction of the improvements in the common elements;
  - vii. all insurance policies currently in effect;
  - viii. copies of all certificates of occupancy that may have been issued for common element improvements;
  - ix. all other governmental permits;
  - x. all warranties of contractors, subcontractors, suppliers and manufacturers that are still in effect;
  - xi. a roster of the unit owners and their mortgagees, together with addresses and telephone numbers;
  - xii. employment contracts and service contracts in which the association is the contracting party.

- i. Additional Items for Consideration for Turnover. From our experience, the declarant should or also furnish the association with the following to complete transition:
  - i. all documents needed to support any special meetings of the association held to elect members of the executive board (to include notice, proxy, certificate of mailing, control list of the members, attendance records);
  - ii. the resignations of the declarant-appointed members of the executive board and officers;
  - iii. Certificate of good standing for the association from the Secretary of State dated just prior to transition;
  - iv. signature cards for all association bank accounts and appropriate banking resolutions;
  - v. prior and current budgets;
  - vi. prior year's income tax returns (Colorado and Federal);
  - vii. tax ID numbers;
  - viii. Change of address cards for the billing of all services rendered to the association (trash, utilities, etc.).
  
- j. Transition Audit. The most significant of transition requirements may be the Transition Audit (item 3 above). The Transition Audit must be performed by an independent CPA and the delivery of the audit must be accompanied by a letter from the CPA expressing the CPA's opinion that the association's financial statements fairly reflect the financial position of the association in conformity with general accepted accounting principles; or a disclaimer of the CPA's ability to attest to the fairness of the presentation of the financial information in conformity with general accepted accounting principles and the reasons therefore. CCIOA states that the expense of the Transition Audit shall not be paid for or charged to the association. Depending upon the length of the time the community takes to sell out, this audit could be expensive. If sales are not completed within a year or two, it is advisable to then perform annual audits, even while the association is controlled by the declarant.
  
- k. Owner Participation during Declarant Control. Having one or more unit owners on the executive board prior to the time that the unit owners obtain control of the board is only one manner of involving unit owners in the governance of the project. At all times, participation of owners should be provided for and encouraged by the declarant as another step in training the owners to take over the operational responsibilities of the association.
  
- l. Involvement, Information, Communication. During the period of declarant control of an association, we recommend the use of owner committees to assist the executive board in making decisions and to assist in a smooth transition. Unit owners can be placed on various committees of the association. These committees can have responsibility for architectural control, maintenance of the common property, preparation of budgets and

monitoring of the financial status of the association. This can assist in creating a better environment for the relationship between a declarant and the owners. Often communities are developed with owners feeling the declarant, developer or builder acted only in their own interests. A declarant, developer or builder may even give the impression to owners that they cannot wait to get out of the association to transfer all association responsibility to the owner-elected board. This creates hard feelings, ill will and potential lawsuits. We have found that by involving owners in the community early on, a feeling of confidence and teamwork may evolve. This would give owners the opportunity to learn about their community before turnover to their control, so there will be some experience in the community at that time. Committees also help assure future success of the community. Declarants often desire to maintain control of the association for as long a period as they can, particularly if they plan or expect any changes in the final stages of the development or the final sales of units. Yet, if everything is going well, declarants often consider releasing control earlier. In any event, having owner involvement through an ad hoc committee of owners or other means can be a tremendous benefit to the declarant, the owners and the association.

- m. Reserve Study. There are no statutory requirements for the declarant to engage an expert to prepare a reserve study; however, such action may be prudent. First, the reserve study can assist the declarant in the budgeting process. Second, if there are any construction issues, the reserve study may identify those issues and allow the declarant to address them before the transition of developer control of the Board. Finally, involving owners in review of the reserve study allows the owners to participate in a proactive process regarding preservation of community assets.
- n. Misinformation -- A Cause of Transition Problems. A declarant can limit the potential for problems with the association once the unit owners have obtained control of the executive board if the declarant communicates effectively with the unit owners prior to that time regarding the manner in which the association is being operated for their benefit. One of the biggest causes of problems for the declarant is misinformation which leads to unfounded rumors concerning the governance of the association being circulated among the unit owners. Misinformation usually leads to distrust of the declarant and a belief by the owners that the declarant is attempting to hide something from them or to control the association solely for the declarant's benefit and not for the unit owners.
- o. Looking Forward vs. Backward. If the unit owners have been involved in the governance of the association from the beginning of the project, they are less likely, in many instances, to delve deeply into the past operations of the association. Once they have obtained control of the executive board, owners frequently seek to determine whether the declarant did something illegal or improper during the time the declarant controlled the executive board.
- p. Transition as a Process Rather than an Event. Transition is used by many as the event of the control of the governing board of the community association being transferred from the declarant to the unit owners who purchased units in the common interest community. If transition in a common interest community ends up being a single event, then the transition has been handled poorly by the declarant of the project. Transition should be a process which occurs over a period of time during which the unit owners gradually become involved in the governance of the community. The culmination of the process is the transference of control of the executive board from the declarant to the unit owners.

- q. Transition in Communities not Subject to CCIOA's Transition Process. In situations where the CCIOA transition process does not apply, the governing documents for some associations will provide for a gradual phasing in of unit owners on the executive board. Even where such a process is not mandated by statute or the governing documents of the project, such a procedure is advisable in almost every community association.
- r. Actions to be Taken by the Owner-Controlled Executive Board.
  - i. Retention/Selection of Managing Agent. One of the first actions of the new owner-controlled executive board should be to make a decision on the managing agent for the association. As with other experts retained by the declarant-controlled executive board, the new executive board should consider any current managing agent and the relationship of that managing agent to the declarant in determining whether the management agent should be retained or a new managing agent hired.
  - ii. Physical Inspection. The association should consider engaging an expert or an engineer to review the plans and specifications for the project and make a physical inspection of the project to determine whether the plans and specifications were followed in the construction of the project and whether any construction defects exist through poor workmanship or defective materials.
  - iii. Written Report after Inspection. The executive board should consider obtaining a written report from the engineer and should then determine, in consultation with the association's legal counsel, whether any claims should be made against the declarant for any construction defects which are found to exist in the project.
  - iv. Retention/Selection of Attorney and Accountant. The new owner-controlled executive board should make a decision on the attorney and the accountant to represent the association in the future. In some instances, the declarant's attorney may also have been engaged as the association's attorney during the declarant-control period. That counsel may be appropriate to retain, if they are viewed as qualified and available for matters unrelated to disputes with the declarant. For any disputes the association may have with the declarant, new independent counsel will be needed. In any event, if the new executive board wants to make a change, the existing attorney and accountant for the association should be given consideration. In many instances, the declarant, during the time the declarant controlled the executive board, will not have retained legal counsel or an accountant for the association. In those instances, the executive board needs to move promptly to hire counsel and a new accountant for the association.
  - v. Association Records. The executive board should make sure that all records of the association have been obtained from the declarant.
  - vi. Review of Insurance. The owner-controlled board should consider reviewing all of the insurance policies of the association through an insurance agent and other experts to determine whether the insurance policies in effect conform

to the governing documents of the project and to otherwise make sure that the association has adequate insurance coverage. Particular attention should be paid to directors and officers (D & O) insurance.

vii. Review of Financial Information.

1. The owner-controlled board should consider having the accountant for the association review the transition audit provided by the declarant and all financial information of the association for the time during which the declarant controlled the executive board.
2. The accountant could then be instructed to determine whether the declarant has paid all assessments and other amounts required to have been paid by the declarant during the period of declarant control of the association.
3. The accountant could also be instructed to determine whether the amounts budgeted during the period of declarant control were adequate to pay all of the common expenses of the association or whether the declarant kept the assessments artificially low to encourage sales.
4. Finally, the accountant could be asked to advise the executive board of any accounting irregularities found during the accountant's review of the financial records and to advise the board as to whether the financial records are complete.

viii. Legal Document Review. The owner-controlled executive board should consider requesting the association attorney review the governing documents of the association to determine whether there are any unusual provisions in the governing documents or any provisions which should be amended in order to avoid future problems.

ix. Reserve Study. The executive board should consider engaging an expert to prepare a reserve study to determine whether the declarant-controlled executive board budgeted for and funded adequate reserves for the repair and replacement of the common elements of the project or if the association desires to change reserve funding.

x. Conveyance of Common Areas. If the project is a planned community, the executive board should confirm that all common areas have been conveyed to the association by the declarant in accordance with the governing documents of the project and any applicable state law. The executive board should consider obtaining title insurance for the common areas conveyed to the association.

xi. Review of Prior Enforcement Actions. The executive board should review all enforcement actions taken by the declarant-controlled executive board or any violations which the declarant-controlled executive board failed to enforce to determine whether any enforcement actions need to be filed by the association and to evaluate whether particular types of violations may have been waived through non-enforcement of the restrictions by the declarant-controlled executive board.

- s. Communication is the Key to Successful Transition.
- i. The key to a successful transition from declarant to owner control of a community association is communication between the declarant and the unit owners.
  - ii. Communication with the unit owners should begin with the sale of the first unit. The goal of the communication with the unit owners should be to educate the unit owners about the role and operation of the association and to establish trust between the declarant and the unit owners.
- t. Longer Periods of Declarant Involvement. There is no question that the declarant should prepare for a lengthier and more complex involvement if a community association is to be used. The declarant is undertaking a second level of operations which affects planning, design, and construction programs - the responsibility of setting up and initiating the operation of the community association. The declarant is responsible for the preparation of association legal documents, the disclosure of adequate information to prospective buyers, the preparation of the first association budget and must also recruit resident leaders and prepare them to take over the association.
- i. The Transition Phase. The declarant controls the association during the early stages of the development. Transition is more fully reviewed in another part of this outline.
  - ii. The Governance Phase.
    - 1. The association reaches maturity (the governance phase) with the election of an owner majority to the board. The entire operation of the association (physical, financial and administrative) will be controlled by the owner-elected board; board members will set policies, enter into contracts, implement or change controls - in general, decide and shape the course of the association and the community.
    - 2. How well these elected representatives function on behalf of the association will in part be determined by the previous actions and guidance of the declarant, and in part by the desire of owners to maintain the value of their units and the common property.
    - 3. During the governance phase the declarant prepares to exit. As the declarant ties up loose ends, the declarant needs to be particularly sure that all association transactions have been properly completed, that all records related to the association (corporate and financial) have been transferred, that all contracts, plans, specifications, and insurance policies for common facilities have been passed on, and that no other outstanding debts or issues remain. The association is now ready to function on its own.
  - iii. Assessments, the Annual Budget and the Budget Process. The allocation of each unit's responsibility for assessments is to be based on a formula set forth in the declaration. By applying each unit's percentage of expense liability to the

- iv. budget, the annual assessment for each unit is obtained. Assessments and budgeting are more fully reviewed in another part of this outline.
- u. Transition Summary. The transfer of control of a community association from the declarant to the unit owners involves many components, including:
  - i. the transfer of control of the executive board to the unit owners;
  - ii. acceptance of responsibility for the maintenance of any common properties still maintained by the declarant;
  - iii. the transfer of control of the financial operation of the community association; and
  - iv. the turnover of documents pertaining to the operation of the association from the declarant to the executive board controlled by the unit owners.
- 6. Conclusion. In the final analysis, community development with an owners or community association may be required by the physical design; by the nature of the local land use or subdivision process or by demand from owners for "protective covenants." In any event, most new developments include covenants and a community association, and CCIOA requirements and choices should be reviewed and implemented.