

Taking Control

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ISSUE What steps should a board of managers consider after taking control from a sponsor of a newly established condominium?

BACKSTORY Many of our recent clients are newly established condominiums addressing the same basic problem. The sponsor managed the building and controlled the board until control passed to a board of unit-owners unrelated to the sponsor. The new board quickly discovers that building common areas have major construction defects; residential unit-owners are complaining of additional defects; the condominium budget is not balanced, leaving insufficient funds to pay expenses for operations; the reserve account is underfunded; and the sponsor is in no way helpful.

Construction defects may be as minor as completion of "punch list" items within common areas of a building or within units or may be as major as defective foundations and/or windows, leaking roofs, and/or deficient electrical and plumbing systems. Sponsors often make minor repairs while selling units but do not necessarily correct nor disclose the underlying nature of the problematic conditions.

Fiscal problems start when there is simply not enough money in the bank to pay the bills, and insufficient funding for major repairs. A sponsor may not make proper contributions to reserve funds, might misuse reserves, and/or improperly budget expenses. A newly constructed building or fully renovated building may not provide for the separate metering of certain utilities, or may rely upon a sponsor-engaged engineer's report estimating projected costs for allocations of certain utilities -- possibly in the most favorable light for a sponsor.

A careful review of such allocations by a professional may result in the reallocation of certain expenses permitted under the offering plan but ignored by inexperienced boards. One of our clients will save tens of thousands of dollars a year because of the installation of submeters that determine the proper allocations of certain utilities and allows for the reallocation of expenses between the residential unit-owners and owner of the commercial units. Often, the sponsor or a sponsor-related entity retains ownership of the commercial units of a condominium and has no incentive whatsoever to take any measures that may increase any costs allocable to its units.

COMMENT What to do? Act and act promptly. A board of managers must work fast to confirm that the building is safe and the condominium fiscally viable. Further, a board will want to assure itself that the building was constructed and delivered as promised in the offering plan, and that the sponsor-controlled board acted responsibly and in good faith during the period of time it managed the affairs of the condominium.

Any plan of action for the new board will likely include engaging a professional team consisting of a law firm, accounting firm, and engineer/architectural firm, each experienced in such matters to investigate and diagnose potential issues. Once these professionals conduct their assessment, a board of managers may make an informed and timely determination as to next steps, such as beginning a lawsuit, filing a complaint with the attorney general's office, or preferably, though not always effective, engaging in dialogue to resolve any misunderstandings or bring about an amicable resolution to open issues.

Such situations may prove overwhelming to newly elected volunteer board members, who, like their fellow unit-owners, are frustrated and feel cheated by a developer that failed to deliver what was promised. Good management is essential, as an experienced managing agent will be familiar with these types of issues and able to assist board members in putting together a strategic plan to handle such matters. Time may be of the essence. Offering plans often contain provisions that limit warranties and guarantees as well as the time frame during which unit-owners and boards may make claims, particularly relating to alleged construction defects.

Regardless of the legitimacy of the complaints, sponsors will not voluntarily step up and address them unless formal action is taken. Mere letter-writing and dialogue will too often result in promises on top of promises but no real action. Often, the attorney general's office is able to mediate a resolution. Sometimes, a board and unit-owners must be willing to take the fight to the sponsor and sue.

Unfortunately, there is no easy answer and the costs of a solution at times may exceed the value of the potential benefit that may be obtained. Accordingly, boards should carefully analyze the nature of the issues and disputes it may have with a sponsor and the economics of its options to obtain relief in order to make an informed and sensible decision on whether and how to seek relief.

— Ronald J. Gold