# DEVELOPER TURNOVER, ACTIONS AND DISPUTES

Prior to turn over of control from the developer to the unit owners, the developer wears "two hats":

1) He is a seller of units and 2) He appoints and/or serves as your Board of Managers. As a seller of units, the developer is typically a "limited purpose LLC" which most likely has no assets whatsoever other than the units that it is offering for sale. As a member of the Board of Managers, on the other hand, he is primarily acting in his individual capacity, and as such, his personal assets are potentially available to the Association to satisfy the various claims set forth below. The developer has different duties and responsibilities relative to each of these roles and it is important for the unit owners to understand their respective rights relative to each.

## THE DEVELOPER AS A SELLER OF UNITS.

A) The developer's obligations to the unit owners.

1. You probably received a written warranty. (This is called an express warranty) It typically warrants the units for one year following the sale as well as the common elements for one year prior to some identified point in time i.e. when the common element in question was completed or when the first certificate of occupancy was issued etc. It is important to carefully read the warranty and follow the requirements exactly when submitting a claim. For instance, most express warranty provide that a claim must be submitted within the warranty period by certified mail. The failure to do so may jeopardize your rights under the warranty. As this type of warranty is typically backed solely by the assets of the “limited purpose LLC”, it is important to submit the claim as soon as possible while the developer still possesses unsold units. Once he completes the sale of all the units the developer essentially becomes an "insolvent turnup" and the prospects of recovery become somewhat bleak.

2. Illinois recognizes another warranty, the "Implied Warranty of Habitability". (This is called an implied warranty) The good news is that the warranty extends at least four years from turnover and may be longer if the particular defect could not have been discovered until a later date. The bad news is, that the law allows the developer to insert language in the contract which waives this warranty. The good news is that it is extremely difficult to properly waive the warranty. As the requirements for waiver of the implied warranty of habitability are rather technical, you should have an attorney review the language to properly identify your rights.

3. There are various statutes and ordinances requiring accurate disclosures of known defects and prohibiting the misrepresentation of the condition of the building. Examples are the Illinois Consumer Fraud and Deceptive Business Practices Act, the Chicago Condominium Ordinance (Evanston, Schaumburg and Morton Grove also have similar ordinances). These statutes and ordinances frequently allow the recovery of attorney's fees, require an extended warranty and in some instances, provide for punitive damages against the developer. Some even

require the developer to withhold a portion of his sale proceeds and deposit them into an escrow as a "bond" to guarantee his compliance with his warranty. Once again these are extremely technical in nature and the Association's attorney should be consulted relative to their applicability.

**THE DEVELOPER AS A MEMBER OF THE BOARD OF MANAGERS**

An additional method by which claims may be successfully asserted against the developer is in his capacity as the Board of Managers prior to turn over of control of the Association. Unlike a mere "seller of units", who deals with unit owners and community associations at arm's-length, the developer is acting in the capacity as a member of the Board of Managers and thus owes the unit owners and the Association a fiduciary duty... the highest duty known to the law. Additionally, unlike most of the warranty and contractual claims set forth above, the fiduciary duty is owed not only by the "limited purpose LLC" but also by the individual who is serving as a board member appointed by the developer. This means that the developer's personal assets are potentially at stake.

Examples of the types of claims which may be asserted against the developer in his capacity as a Board Member:

1. The developer failed to create a budget which provided adequate reserves. By law, with rare exceptions, all budgets must provide for reasonable reserves. Developers frequently fail to comply with this task as this necessarily means that assessments must be increased in order to properly fund the capital reserve account. It is more difficult to sell units in an Association with high assessments than with low assessments. Accordingly, the developer will frequently neglect the capital reserve account and there by artificially decrease the amount of monthly assessments in order to make the unit more financially attractive. Additionally, at least with respect to condominiums, the developer is required to pay assessments on all unsold units that are part of the Association subsequent to the first sale. Since withdrawals from the capital reserve account are unlikely to occur for many years, the developer sees little incentive in contributing to a capital reserve account from which he will receive little benefit. In both instances, the developer is placing his personal financial interest ahead of the interest of the Association. As his fiduciary duty requires that he place the interest of the Association at least equal to his own interest, by failing to establish a reasonable capital reserve account, he is in breach of this duty and may be liable to the Association for the resulting damages. This may also form the basis of a complaint pursuant to the Consumer Fraud and Deceptive Business Practices Act.

2. The developer failed to pay assessments on the unsold units. As set forth above, the developer is required to pay assessments on all units which are part of the Association subsequent to the first sale. If the developer appointed board member fails to require the developer to pay assessments on these units, the developer appointed board member may be personally liable for the amount of the resulting shortfall.

3. The developer failed to preserve the warranty claims. If the developer appointed Board member is made aware of defects which should be covered by a warranty but fails to timely protect the Association's interest by submitting the claim... to himself, this may constitute a breach of fiduciary duty resulting in the developer appointed Board member being potentially liable, personally, for the amount of the claim.

An additional advantage of pursuing a breach of fiduciary duty claim, is that there is authority for the proposition that if successful, the claim may also support an award of punitive damages against the developer appointed Board Members. There are a number of other claims which may potentially be asserted, personally, against developer appointed Board Members. Once again, this area is extremely technical and should be reviewed, thoroughly, by the Association's attorney.

**ADDITIONAL ACTIONS WHICH MAY BE NECESSARY**

1. Avoiding contracts entered into by Developer: Frequently the Developer may enter into contracts which bind the Association for extended periods of time and which contain terms which are not advantageous to the Association. Fortunately, certain contracts can be avoided by prompt action by the Association.

For condominiums, the Association can terminate a contract which extends for more than two years from the date of turnover if the unit owners vote to do so within six months of turnover.

For non-condominiums, the Association can terminate a contract which extends for more than two years from the recording of the declaration if the unit owners vote to do so during a period of 90 days prior to the expiration of the two-year period subsequent to turn over.

Obviously, in order to exercise this right, the Association has to obtain copies of all contracts from the developer. As discussed immediately below, the developer has 60 days following turnover to provide this information.

2. The developer's obligation to turn over documents: As discussed earlier, the developer has an obligation, within 60 days of turnover, to provide certain documents to the Association. If the developer fails to do so, there are certain procedural steps which the Association must follow in order to enforce its rights. If 60 days expires without the Association receiving all required documents, the Association must send a notice to the developer, by certified mail, return receipt requested, demanding the documents within 10 days. If the developer fails to provide the documents within that 10 day period, the Association can institute litigation against the developer and recover its attorney's fees. This schedule should be strictly complied with as the Association will be unable to avoid the contracts as discussed above, unless it is aware that they exist.

## REAL ESTATE TAX ISSUES

Occasionally, it will be discovered that unpaid taxes exist. This can occur if the closing took place prior to the issuance of the tax bill or, alternatively, if the developer never paid the taxes on the underlying parcel, prior to the assignment of pin numbers to the individual units.

If the taxes are the result of the fact that the tax bill was not issued prior to closing, your remedy will be exclusively against the developer. Hopefully, your attorney negotiated certain "protections" in the real estate contract such as requiring the developer to escrow funds or, alternatively, prorated the taxes and provided the purchaser with a "credit" for the developer's share of the taxes at closing. If this occurred, most, if not all of the funds needed to pay the taxes will be available or were credited to the buyer at closing. Unfortunately, a title insurance policy will most likely not provide protection in this circumstance as, when the policy was issued, no taxes were due.

On the other hand, if the taxes resulted from the failure of the developer to pay the taxes on the underlying parcel, this matter should be submitted to the title insurance company as coverage may be available.

As set forth above, if the developer is a single-purpose LLC collection of unpaid taxes may be difficult. Accordingly, the best protection for purchasers is to negotiate protections in the initial purchase contract. This frequently requires the assistance of an attorney.

## CONCLUSION

The remedies available to new Boards of Managers are "time sensitive". That is, if they are not exercised promptly they may be lost. Accordingly, unit owners should be advised to immediately inspect their units and the adjacent common elements and timely submit construction related defects complaints to the developer, in the manner required by their purchase contract. Similarly, it is invariably in the best interests of the Association for the Board of Managers to obtain a transition report/reserve study shortly after the initial election. In the event substantial construction defects are revealed, an attorney familiar with asserting claims against developers should be contacted so that the Association's interests are adequately protected.



LAW OFFICES OF
KOVITZ SHIFRIN NESBIT
A Professional Corporation

**Materials Provided by John H. Bickley of Kovitz Shifrin Nesbit**
847-777-7301 jbickley@ksnlaw.com
www.ksnlaw.com