

A New Trend:

Selling the Recreation Facilities to the Master Association



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Many master developers desire to sell, over time, major recreational facilities to master community associations. Selling such facilities allows a master developer to (1) justify the construction of more elaborate facilities than would be feasible if the facilities were gifted to the master associations, and (2) recover, over an extended period of time, at least a portion of its construction costs. Moreover, the developer can partially or wholly forgive the note obligation for the facility to help facilitate the settlement of any future dispute between the association and the master developer. The sale of a facility to a master association in California may be accomplished in one of two types of transactions: (1) lease-purchase with title transfer upon final principal and interest (if any) payment, or (2) sale with title transfer subject to a secured or unsecured promissory note. Typically, these transactions result in an additional cost to the home buyer ranging between \$20.00 and \$35.00 per month.

Such transactions are subject to several requirements and limitations. Only a developer of a master planned development, as defined in the California Department of Real Estate (DRE) Regulations, may sell such facilities and the purchase price may not exceed the cost of construction. The facility must be accessible to all homeowners in the community, located on a separate lot or parcel and transferred to the master association free of blanket encumbrances with assurances that foreclosure or acceleration of blanket encumbrances will not adversely affect the rights of the association.

The proposed transaction arrangement by which the facilities are sold must be submitted to the DRE prior to their use by the homeowners. To be approved, the proposed transaction agreement must meet several requirements, including: (1) identifying the party responsible for

maintenance, reserves, insurance and operation of the facility, and (2) describing the procedure to be implemented in the event of condemnation or destruction of the facility. Additionally, lease-purchase agreements must provide that the master developer will be responsible for facility property taxes.

Payments by the association shall not be due, and homeowners shall not be charged, until the facility has been completed and placed into use, as evidenced by a Notice of Completion (defined in California Civil Code Section 3093). If the facility is not complete upon the first close of escrow in the development, the developer must post a completion bond to guarantee its completion. The payment term under the transaction agreement may be flexible, but may not exceed ten years, and payments by the master association must commence no later than three years after completion of the facility, unless otherwise approved by the DRE. Once commenced, such payments must be made in substantially equal monthly payments sufficient to fully amortize the master association's obligation.

The Master Declaration of CC&Rs and master association budget must also meet certain criteria. The facility to be sold must be (a) defined as "common area" or "future common area" in the CC&Rs. The CC&Rs must include specific language binding the association to fund the facility, giving the board of directors the power to address operational issues related to the facility and providing that the assessment component attributable to the transaction shall be subject to all collection remedies of the association for regular and special assessments. The CC&Rs and budget must both provide for reserves for the facility, the payment of which must commence upon the recordation of the Notice of Completion and the establishment by developer of a segregated sinking reserve fund for the benefit of the association to cover defaulting homeowners' payments.

The developer is also obligated to disclose the sale of the facility to potential purchasers by (1) describing the transaction in the "Special Notes" section of the Public Report in all capital lettering, and (2) creating a separate disclosure to be approved by the DRE and signed by each homeowner in the development that describes the facility, the terms and conditions of the transaction, the purchase price, the amount of monthly assessments attributable to the transaction and the time frame in which the facility will be paid off and conveyed to the association. 