SOUTH COAST HOMEOWNERS ASSOCIATION

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IN THIS ISSUE

UPCOMING SOUTH COAST MEETING

"The Uncertain Future of Community Associations"

Speaker: Tyler Berding, Esq

Can community associations survive in California? That's the question that many association directors and managers are facing. Growing shortfalls in budgeted reserves and operating expenses are becoming the rule rather than the exception. California's statutory limits on assessments make remedies difficult. More and more aging community associations are showing the effects of budgets which cannot fund long-term maintenance and repair – to the extent that these properties may become obsolete and potentially valueless to their owners.

What is the impact of poor quality construction or repairs on this problem? How will this problem impact condominium conversions? Is there an end strategy for properties that have reached the end of their useful life? How will this issue affect the availability of low to moderate income housing?

Attorney and author Tyler Berding, principal of the law firm Berding and Weil, LLP of Alamo, California will examine these and other issues and provide answers to your questions and some suggested solutions to the problem.

Note Different Meeting Location

Thursday – November 2 – 7 PM – Goleta Union School District Headquarters Board Room – 401 North Fairview Avenue, Goleta (across from the Goleta Library)

Sponsored by the De Los Amigos Owners Association – Santa Barbara

The Uncertain Future of Community Associations
Thoughts on Financial Reform – Part IV
The Final Chapters

Author: Tyler P. Berding, Esq.
Berding & Weil, LLP

Editor' Note: Starting in 1999, Mr. Berding wrote a series of articles that appeared in the Executive Council of Homeowners (ECHO) Journal reflecting upon the future of common interest developments. Recently, Mr. Berding re-edited the articles into a small book. With his generous permission, we will serialize the book in successive issues of the newsletter to provoke further thought and discussion on the topic. Mr. Berding received an M.A. and Ph.D. in Government from the Claremont Graduate School and his J.D. from the University of California at Davis. He can be reached at tberding@berding-weil.com.

Part I outlined the concepts of obsolescence of association property, inadequate funding to replace property and four stages of life in a community association. Part II examined obsolete associations. Part III explored issues pertaining to underfunding of reserves. Part IV offers thoughts on financial reforms. See page 1 for information on his presentation to us on November 2, 2006.

Thoughts on Financial Reform

Difficult and Desperately Needed

The budgets are done. Directors of community associations have again gone through the painful process of trying to do more with less. Making decisions about financial priorities that they would really rather not have to make. More money in the landscaping budget would certainly make the place look better and improve curb appeal" for those owners who are trying to sell. New pool furniture? How long has it been since replacing the old, worn-out stuff has been discussed as anything other than a luxury? Painting more often? Having some carpentry work done to replace worn trim? Any of these things would make a big difference, but the money just isn't there.

Insurance, accounting, utilities, and making the minimum contributions to reserves for future repairs is often about all that can be done these days in many community associations. The cost of insurance, often after at least one cancellation, has climbed dramatically. Balancing the budget is a yearly exercise, but cutting expense to balance the budget only works while there are expenses that can be cut. Sooner or later someone has to look at the revenue side of the books.

Community associations have only one real source of revenue—owner contributed capital. Unless the association has a business that it can operate, and most do not, there is no other income. Capital is usually contributed through regular assessments, levied at the beginning of each year, and collected monthly. Ideally, the amount of these assessments would be

adequate for operational expenses (insurance, utilities, management, etc.) and contributions to the long-term reserve for repair and maintenance, as determined by the association's reserve study. Most budgets are far from ideal, however.

Regardless of the state of the economy, unless assessments have been increased every year to keep up with, not only cost of living increases, but also to make up for prior under funding of reserves, the association will be falling behind necessary accumulations for future repairs. Boards often perceive present operational expenses as more pressing, and reserves as something that can be conveniently dealt with "later". This would be true if all the board of directors had to do when funds for repairs were needed was to assess the members the necessary amounts, as is possible in some states.

But in California, as in many other states, there are statutory caps on the amount a board can raise without agreement of the members. It might sound like a wonderful exercise in democracy, but more often than not such limitations result in severe under funding of reserves. Members simply don't like to approve special assessments, boards know that, and as a consequence, avoid that funding mechanism. The result is that associations are almost completely reliant on the regular monthly assessment for necessary capital contributions.

Financial Stability Should Not Be Optional

Raising revenues should be the first priority of virtually every well-managed association. The California Civil Code allows a majority of the members voting at an election to reject a special assessment that would exceed five per cent of the prior year's budget. The same is true for an increase in a regular monthly assessment that would be more than twenty percent higher than the year before. These statutory caps on a board's authority were imposed by the California state legislature as part of the original Davis-Stirling Act in 1985. The idea, of course, was to be sure that owners had some control over the financial obligations that would be imposed upon them by their community associations.

"Extraordinary" special assessments or increases in regular assessments are often the way that the board will try to cover serious funding shortfalls. The need for repairs that are unexpected or unplanned is the most serious crisis that can befall a community association. The reason for this lack of financial prudence— owners' perception of their own self-interest as often not compatible with the community's interest—can be devastating. Nevertheless, experience has shown that it is often difficult to obtain owner approval for any additional assessments. The result of failing to approve sufficient capital contributions for necessary repairs is that either those repairs are delayed or performed poorly, increasing the chance of even greater failure in the component. Extraordinary assessments are, therefore, the only way a community association can keep the buildings habitable and marketable. So, the big question is: "What happens if the owners vote no?"

This dilemma would not exist if the board of directors had the authority and the duty to assess what is necessary. A condominium board simply decides once a year on the amount of money that the association needs to operate and perform repairs—and levies the assessment. An owner either pays or a lien is recorded against the property. No vote. No argument. Owners can throw out the members of the board if they don't like what they're doing, but that's the extent of their control. The board cannot avoid a financially prudent, but politically unpopular, decision by blaming it on owner recalcitrance. It is the board's

responsibility to assess what is necessary. The idea is that sufficient capital for repairs is essential in order to maintain value and owner equity, and the board has not only the power, but also the duty, to raise whatever is necessary. This is not something for which there is much room for debate if there is any chance at all of beating the obsolescence odds.

In California, of course, we debate it all of the time. Funding decisions are as often based on politics as on pragmatism. If a board can delegate responsibility for unpopular funding decisions to the owners, that is exactly what it will do four out of five times—deferring to the political will of the owners to avoid raising assessments. Using feared owner backlash as the reason for not being financially prudent is the same as giving children candy for dinner— it's easier.

Proper financial management should not be optional, and members should not be able to interfere with sound economic decisions by the board. If we are to avoid obsolete and uninhabitable communities its time to amend the law and remove the statutory caps. We should give boards the authority and the responsibility for making the right financial decisions, and take politics out of it.

Protecting Owners' Equity

This suggestion that state legislatures raise or remove the statutory caps on the assessments that a board of directors can impose without member approval will be unpopular. Nevertheless, since proper repair and maintenance of a community association is essential to its survival; there is no room for political debate over funding. The board can debate conflicting opinions of construction experts, perhaps, but once it is determined what has to be done, the debate has to stop.

Some industry observers will respond that volunteer, non-professional boards of directors should not be given unlimited authority to levy assessments. Mistakes in calculating long-term funding needs or errors in contracting for necessary repairs have long-term consequences to future generations of owners. If boards of directors are free to make decisions that have such consequences, and are also free to cover those errors with unlimited assessment authority, how can members in a community association be protected from these poor decisions?

The answer, of course, is to insist that boards follow appropriate standards that are promulgated by industry professionals and adopted by state legislatures. The Reserve Standards promulgated by the Executive Council of Homeowners (ECHO) in California is one example. Other standards covering the investment of funds; construction contracting; conflicts of interest; and similar topics would provide better guidance for boards, and a measure against which to apply government oversight. The California Civil Code already provides some of the regulations that community associations must follow. Those code sections, however, are not adequate in detail, nor do they provide sufficient disincentives to prevent a board from ignoring the guidelines. If volunteer, non-professional boards of directors are to manage sophisticated, multi-million dollar physical plants, they must have clear guidelines to follow and there must be recognizable consequences for failing to do so.

Why this insistence on professional standards and government oversight? Simple. An owner's equity in a community association property is like any other investment—it is a share

of valuable property, a security, if you will. In many cases it will be the most valuable security that an owner will ever possess. It can be bought, held, and conveyed to others. Why shouldn't shares of ownership in a community association be treated like any other financial investment—stocks, bonds, or other securities—with uniform rules of management and government supervision?

The value of an owner's share in a community association will be directly affected by the condition of the property that secures it, so why should management standards for such property be any less stringent than those required for other investments? They shouldn't be, of course, and it is the responsibility of the industry and government to recognize that these investments are losing value with each successive decision to defer an essential repair of a building component beyond its reasonable service life. They lose value when a board decides to mortgage the interests of future generations of owners by using borrowed capital to excess instead of insisting on obtaining owner-inability to raise additional needed capital is contributed capital. They lose value every time the financial statements disclose less than full funding of necessary reserves. And, they lose value when a board's fixation on enforcement of minor rules violations and other similar distractions causes it to lose sight of the bigger picture—protecting owners' equity through sound fiscal management.

An individual owner of equity in a community association, like the owner of shares in a public corporation or a mutual fund, is almost powerless to influence its value and must rely on the directors of the association to make decisions that will enhance the value these shares. Any discussion of reforming community association law must recognize the similarity of interests in such projects to other types of investments and provide similar safeguards.

Deferral of Special Assessments as A Management Tool

It is a laudatory goal to give boards, acting under proper regulation, full authority to raise necessary capital. As a short-term legislative objective, however, it is probably dead on arrival. We have a long way to go as an industry before some reforms, no matter how commendable, have any chance at political success. In the meanwhile, how can we give boards of directors some additional management tools to help them achieve financial stability for their community associations? It has been well documented here that associations lack sufficient capital to meet long-term repair and other obligations. When the average reserve account has only fifty-four percent of the funds it should have, something is clearly amiss. Such shortfalls might be simply the result of miscalculations of need over many years. In other cases it might represent a board unwilling to do its duty. In still others, it could be that the board of directors has anticipated the electorate's intolerance for higher assessments and deferred funding to future owners. Regardless of the reason, the inability to raise additional needed capital is dangerous to the economic health of the project.

What many boards need is an acceptable way to encourage reluctant owners to contribute additional capital. Owner reluctance to approve special assessments or extraordinary increases in regular assessments is usually born of worries over cash flow. Owners on a fixed income, almost by necessity in some instances, have to reject obligations, which exceed their monthly cash flow, or their available cash on deposit. Others simply cannot stretch their monthly paychecks sufficiently to shoulder any additional financial burden. Still others see no immediate benefit accruing to them from improving the condition of reserve funds, much of which will not be used for improvements for many years. Regardless, it all

results in the same thing—owners will routinely fail to approve requests from the board of directors for additional capital.

If, on the other hand, owners could defer payment of these obligations to a later date, perhaps even until the sale of their property, they would be far less reluctant to give their community association critical fundraising authority. Reserves are used to protect owner equity by funding maintenance and repair programs. As such, deferring payment of an owner's share until that equity is realized at time of sale is logical. Such deferrals could earn a reasonable rate of interest for the association, but would have to be protected by a continuing lien on the owner's property so that the association would be assured of collecting the sums due at the end of the deferral period, not unlike the manner in which a municipality's collection of property tax is protected. Actuarial analysis could determine the rate of turnover of individual interests and thus predict the cash flow that the board of directors could expect each year from these deferred assessments. A model statute appears below.

Model Assessment Deferral Statute:

"The collection of any regular or special assessment levied by a community association, including any assessment for which membership approval is required, may, at the discretion of the board of directors, be deferred in whole or in part upon such terms and conditions as the board may approve. Any assessment deferred pursuant to this section may include, for the period of such deferral, a reasonable rate of interest, not to exceed the legal rate, and shall be secured by a recorded lien upon the separate interest assessed. The terms and conditions approved by the board may not include a fee to be charged as a condition of such deferral. Other than deferrals, which are based upon a reasonable finding of financial hardship specific to an individual member of the association, the terms and conditions of any deferral approved pursuant hereto shall be made equally available to all members of the association. Nothing herein shall affect or supersede any law regulating the collection of delinquent assessments."

The Need for A Proper Warranty

Obsolescence happens when there's no money for repairs and rehabilitation, and as illustrated, that situation is almost inevitable. However, a better start in an association's life can at least postpone this crisis. There's been a war raging for over a decade between those who build residential housing and those who buy these new homes. The fight is over who is to bear the liability for poor quality construction. No victor has been declared. California has attempted to resolve this dispute with recent legislation. This legislation fails to address the two fundamental problems with new home construction—poor quality control and the lack of a funded warranty program. Defective construction is the reason homeowners find themselves in disputes with builders, but the lack of a funded warranty program is the reason that those disputes cannot be resolved quickly. Without resolution, these early construction problems will place a community association in an early deficit position as the cost of repairing unplanned for construction problems is added to ordinary and necessary maintenance. It is important to build affordable, attached housing to increase density and avoid further sprawl, so we have to find a way to protect community association budgets from inevitable lapses in construction quality, and give them a fighting chance at fiscal stability.

Real warranty protection afforded to new community associations is one answer, but most warranty programs fail because houses are not like automobiles—the building industry lacks standardization, and, therefore, predictability. Warranties, like any insurance, must be based on some predictable measure of exposure for whoever underwrites them. With houses, there is no track record in a specific development, and almost no way to predict the future cost of warranty claims. The cost of repairing defects can and does vary widely from project to project and even from condo to condo. Some warranty plans have been bankrupted by excessive claims, while others are stillborn due to the underwriter's fear of the unknown.

Exacerbating this uneven record is the adversarial nature of most construction defect claims. Owners see builders as trying to avoid their responsibility to make repairs, and builders see owners as unwilling to take responsibility for the care and feeding of the new project. It is sometimes a fine line between defective construction and ordinary wear and tear, and lawyers and building consultants spend a good deal of time litigating such definitions. Escalating simple complaints to litigation costs money and is inefficient compared to the benefits afforded by a fully funded warranty as the source of repair funds. A partnership between owner and builder, one that is supervised by the government, could provide the necessary warranty coverage.

Homeowners can be skillful in caring for their property if properly motivated and equipped to do so. But, if the budget lacks the funds to repair the buildings, boards are more likely to postpone repairs or choose to litigate against the builder rather than attempt to obtain additional funding from the owners. Litigation would find less favor with board members if the community association was already possessed of the funding necessary to make many of the repairs themselves. Contrary to popular belief, homeowners are not naturally litigious. Boards are pushed to litigate when the builder refuses to make repairs and the association lacks sufficient funds to do it. Those repairs that are necessitated by a contractor's negligence or a product defect could still be the subject of a legal claim, but instead of a home owner's lawsuit, that claim could be better handled by a warranty administrator while the property is being repaired.

There are problems with buildings that are not necessarily the result of negligent construction, and, even if they are, they could be easily resolved by the owner if adequate funding devoted not just to regulating developers who existed. Some water leak issues, for example could be repaired by professional management working through established contractors, quickly and with little drama, if the association had the funds to do it. The occasional roofing problem encountered early in a project's life could be repaired by competent roofers. Random plumbing and electrical problems could receive like treatment. Repairs undertaken by the association, acting through management and experienced contractors, would give an association control over these matters early in the project's life, thus avoiding growing or insurmountable problems later. Even if these problems were clearly the responsibility of the builder, it could be more efficient for the owner to do it—if adequate funding were available.

Funding is only part of the answer, however. A comprehensive, thoughtfully drafted set of maintenance manuals, prepared by professionals, should be supplied to each project. It is exceedingly rare for the builder to leave any kind of"' manual" for the owner to follow. What is taken for granted when you buy a new car—an owner's manual—is almost unheard of for new housing. Equipping owners and particularly boards of directors who must manage often

large and expensive physical plants, with plans, manuals, and copies of applicable warranties gives them the road map that they and their professionals need to begin an adequate maintenance program.

Finally, state government must cooperate by taking a hard look at the regulations, which are currently promulgated to govern the development of new real estate projects. The budget guidelines which are followed by those who must approve new subdivisions have been repeatedly found to be inadequate, at least in California, to properly maintain the development. It's that simple—they just don't require enough cash to be set aside in reserves to do what must be done. A new state department, devoted not just to regulating developers who build condominiums, but also to regulating the association's funding decisions later on, should be considered in those states where government oversight does not now exist.

Overlaying all of this must be a "major medical" type of warranty coverage for those construction problems, which exceed the normal repair capabilities, and funding of the owning association. The most likely source of such protection would be commercial insurance companies, but it could also be provided by a state fund. Getting insurance companies to cover only the most serious defects might seem like a daunting task, but actually carriers spend more money defending litigation and paying for the effects of failing to fix problems early. If warranties had a high deductible, after which the carriers would begin to pick up the bill, it would be easier to attract more insurance to the state to provide warranty coverage.

For there to be real protection for attached housing buyers there would have to be:

(1) A comprehensive, fully-funded budget for routine maintenance and repair that allowed the association to tackle basic problems quickly and without waiting for a "claim" to wind its way through the judicial process. These reserve funds would come, first, from a "seed money" contribution from the builder, and later, through the assessments of the members.

(2) A program of aggressive maintenance and repair guided by a professional set of maintenance manuals that provide standards for maintaining the property.

(3) "Major Medical" warranty coverage from a viable insurance carrier or state fund, which would kick in after the cost of repairs, reached a fixed limit. This "deductible' i.e. repairs paid by the association from its budget, would be high enough to protect carriers from say, the first twenty-five percent of the cost of repairs, leaving carriers responsible for the remaining seventy-five percent. This coverage could be in lieu of the traditional funding method, the builder's comprehensive general liability policies. The premiums for ten years of coverage would be split between the builder and the owners.

Having access to both the knowledge and the means of effecting basic repairs, would put community associations in a position of control of the condition of the project and further enable them to be more responsive to owner complaints. Budgets could provide that repairs go beyond normal wear and tear to include some types of construction defects as well. There is no reason why some construction defects could not be considered a given part of an association's repair budget so long as the funding for those repairs are built into the budget with adequate funding, a substantial part of which would be provided by the builder at time of sale, and the rest by the members through regular assessments over a longer period of time.

This “self-funding” warranty would protect both builder and owner alike and reduce substantially the number of claims which must be litigated. With the addition of a “major medical” construction warranty, backed by established carriers or the state, this plan could equip the buyers of new condominiums with the means to do much more to protect themselves from the effects of poor quality construction, and to rely less on the uncertainties of litigation. A proper funding start, early in the project’s life, can do a lot to postpone eventual loss of value through obsolescence.

Community Maintenance Trusts

There is another concept that should be considered as a way to achieve financial stability in community associations. First, let’s briefly explore the problems faced by developers of new, for sale, affordable housing, as well as those encountered by community associations in existing projects. Most true “affordable” housing available for purchase in urban areas are attached developments—mostly condominium projects. Would-be builders of new affordable housing have often been unable or unwilling to develop new projects for a number of reasons. The high cost of land and the costs of construction, of course, especially in the urban areas of the state, are always a disincentive.

But even if the necessary financing is available to purchase land and construct the project, builders are still reluctant to build attached housing because they perceive that such projects will end up in litigation between the new owners and the builder. Their insurance carriers have echoed that concern. The lack of a workable warranty to cover the project against defects in construction-the overwhelmingly dominant reason for litigation in such projects- is a further impediment, as discussed above.

These circumstances could be greatly improved if it were made possible to combine many community association projects into a single, well-funded, community to which the responsibility for maintenance and repair, including warranty repairs, could be delegated. This is not without precedent. On the government side, we create special districts to administer and maintain all kinds of real estate. Landscape and lighting districts, reclamation districts, water districts, and redevelopment districts are examples of single-purpose government entities formed to maintain or service privately-owned property. These districts are governed by directors elected by the owners of the various properties within the district. A further advantage of a Special District is its ability to raise funds through the sale of public bonds.

In the private sector we have mutual insurance companies, a community of property owners who have joined together to provide financial assurance against certain identified catastrophes. Large community associations, which may include a dozen or more “neighborhoods’ are probably some of the best known examples of combining several smaller projects under the umbrella of a “community” in order to provide more efficient and comprehensive maintenance. Such well-known California communities as Rossmor in Walnut Creek, Sun-City in Roseville, The Villages in San Jose, and Leisure World in Laguna Hills are examples of a group of smaller individual projects which share the benefits inherent in a large mutually owned entity. Of course, large community or property owner associations are usually formed from contiguous parcels, but there is no legal reason why non-contiguous properties could not be aggregated for certain specific purposes without interfering with basic ownership interests.

If the combination of, say, twenty or thirty non-contiguous community associations into a mutually owned and operated "maintenance district" could be achieved, it could bring substantial benefits to each of the member projects. Not only would negotiating power be greatly enhanced when contracting for services, there could be pooling of funds to provide greater liquidity, and form, essentially, a maintenance "insurance" pool to deal the ongoing repair needs of the member associations. A large group of associations could afford more sophisticated engineering and architectural expertise to insure that maintenance and repair projects were designed and executed properly.

There are several types of organizations that would suit this purpose. In the public sector, the obvious choice would be a special district. In the private sector, trusts or non-profit corporations could be used. Whatever it's legal nature; its purpose would be the same—to provide an organization that would accept the delegation of maintenance and repair obligations for a community of non-contiguous community associations. We've coined the term "Community Maintenance Trust (CMT)" to identify these communities.

Builders and existing community associations alike could derive substantial benefits from this arrangement. New construction would have to be inspected by the CMT before the project would be accepted for membership. The reserve requirements for future maintenance would be determined, and the builder would be required to deposit several years' reserve contributions at the beginning of its sales program. Existing projects would have to be appraised and their future maintenance and repair needs estimated before they would be allowed to join the community. They would then have to "buy in" with a sum of money determined by the maintenance and repair appraisal. But once in, future maintenance and repair expenses would be born by the CMT.

CONCLUSION

Sifting Through the Ruins
Needed: A Viable End Strategy

It should be clear that the predicted obsolescence of many community associations is more than mere theory. Many homes in community associations are owned by low and moderate-income owners who can least afford the cost of maintaining these buildings. But the income level of the owners is just one of many factors that lead to obsolescence. Problems include defects in the original construction, lack of proper guidance for maintenance and repair and unrealistic funding plans. It is all about the adequacy of the funding and usually just a question of time. That it starts first in projects owned by the most financially vulnerable should come as no surprise. That it will also come to projects owned by the more affluent owners is a little harder for some people to accept. Unfortunately, this lack of understanding is one of the main reasons it occurs. A failure to face the reality of the true funding needs of a community association will only hasten its demise.

There are a number of creative ideas that might improve this picture: assessment deferral, better warranty programs, or such things as maintenance trusts, to name a few. Certainly, better quality control during initial construction would avoid or postpone some types of deterioration, and more architectural or engineering oversight of large maintenance projects would make existing funds go farther. But in the end it will come down to the availability of

owner-contributed capital, and where that is not forthcoming, and the deterioration cannot be stopped, an end strategy will be needed. When the community association can no longer operate the project as it was intended, there are usually no provisions in the covenants or in state statutes that provide directly for its order dissolution. Avoiding chaos is necessary to preserve any equity that owners might have left.

The Economics of Redevelopment

The problem with most end strategies that might be devised to dissolve community associations is that no single person or entity owns or controls all of the equity in the project. Unified control is required to convert the project into apartments, for example, or to initiate redevelopment. The fact is, in a community association the ownership interests are, by definition, separate. "Packaging" these interests into a single parcel that could be purchased and redeveloped by public or private interests usually means getting all, or a substantial number of the individual owners to agree to sell.

Where the value of the bare land exceeds its value as a community association, that might not be a problem. But where, as will be the usual case, the value of the project is determined simply by the aggregate market value of all of the separate interests, the existing improvements will have to have some value to a potential re-developer. If the cost to rehabilitate the existing structures is too great, and the bare land value too small, the upside profit will be inadequate for commercial developers, leaving only non-profits or public entities as potential participants in a re-development of the property.

Inadequate Legal Precedent

In some states, the right to partition might provide a legal avenue to force a sale of the separate interests, but of course, such a forced sale would not likely be the forum in which the highest return of equity could be achieved. Some covenants may provide for a process of dissolution in the case of major damage or destruction, especially where insurance proceeds are inadequate to rebuild, and these might also offer a legal basis for unwinding an obsolete community association project. Finally, federal bankruptcy law could provide an avenue for a court supervised plan of partition or dissolution, but it is unlikely that any of these methods would be considered an orderly way to preserve or enhance equity.

None of these alternatives offer tried or established precedent because this problem is so new. What may ultimately be necessary is legislative action to create an orderly process for closing the books on an obsolete community association which would protect any remaining owner equity. Without that, it will be every man, woman and lender for themselves. This could mean that equities, to the extent there are any, would be tied up in an obsolete project for years, with the property itself constituting nothing but a nuisance that the local public entity will necessarily have to abate (Note: The Franklin Villas project noted in an earlier part required over $90 million in public funds to achieve redevelopment)

State legislatures should review the condition of community association housing in each state, and enact necessary safeguards and oversight to protect homeowner interests, as well as an orderly process for unwinding those interests when protection is too late.

It is axiomatic that recognizing a problem is the first step towards solving it. Here's to recognition!

2006 LEGISLATIVE UPDATE

AB 770 - This bill would until July 1, 2009, establish in the Department of Consumer Affairs, the Office of the Common Interest Development Ombudsperson. The bill would require the Ombudsperson, to report annually to the Legislature, and to submit recommendations to the Legislature on specified topics by January 1, 2009. The bill would require the Ombudsperson, commencing July 1, 2007, to offer training materials and courses to common interest development directors, officers, and owners, in subjects relevant to the operation of a common interest development and the rights and duties of an association or owner. The bill would require the Ombudsperson to maintain a toll-free telephone number and Internet website for purposes of further providing that information and assistance, and would require an association director or agent to meet certain requirements in that regard. The bill would authorize the Ombudsperson to provide assistance in resolving common interest development disputes. This bill would impose a biennial association fee on common interest development associations of $2 per unit (down from $10), payable upon filing specified information with the Secretary of State. **Vetoed by the Governor**

SB 1560 - This bill would revise provisions governing the conduct of elections in a common interest development. Among other things, the bill would require an association to adopt rules to allow one or more inspectors to appoint or oversee independent 3rd parties to: (1) Verify signatures and count and tabulate votes, (2) Specify that a quorum shall only be required if so stated in the governing documents of the association or other provision of law, (3) Permit a ballot received by the inspector of elections to be treated as a member present for purposes of a quorum, (4) Authorize a secret ballot to be distributed and voted upon by the membership without a meeting, and (5) Impose other requirements relating to proxies and secret ballots, as specified.

This bill would also revise portions of the association records disclosure law effective July 1, 2006 (AB 1098) to permit the association to withhold or redact information from the association records regarding *interior* architectural plans for individual homes, including security features. This bill would additionally prohibit a *3rd* party from being liable for damages for failing to withhold or redact information unless the failure to withhold or redact information was intentional or negligent. This bill would permit the association to deliver documents by electronic transmission or machine-readable storage if those records are transmitted in a redacted format.

The bill would also modify the accounting method requirements of AB 1098 (full accrual accounting on interim financial statements) to permit modified accrual method statements (income-accrual, expenses-cash). This method of accounting is used by many management companies. Cash basis financial statements and reporting would still be prohibited by this statute. **Signed into law, effective date September 18, 2006.**

AB2100 - This bill, sponsored by the California Association of Realtors, would require the pro forma operating budget to include the current deficiency in reserve funding expressed on

a per unit basis, a statement as to whether the board of directors of the association has determined to defer or not undertake repairs or replacement of any major component, and a statement whether the association has any outstanding loans, This bill would require the study to also include a reserve funding plan that indicates how the association plans to fund the annual contribution to meet the association's obligation for the repair and replacement of all major components. This bill would require, if the board of directors determines an assessment increase is required to fund the reserve funding plan, any assessment increase the board adopts to be approved in a separate board action from the action to adopt a reserve funding plan. The bill would require, commencing January 1, 2009, a summary of the reserve funding plan to be distributed to all members.

Chris Andrews, Reserve Specialist of Stone Mountain Corporation, points out that the current bill has inconsistent language regarding the "required" funding of reserves between sections. Chris also notes that a new disclosure in the bill could be confusing for board members to fill out:

> *"…the estimated amount required in the reserve fund at the end of each of the next five budget years is $_____, and the projected reserve cash balance in each of those years, taking into account only assessments already approved and known revenues, is $ _____, leaving the reserve at ____ percent funding. If the reserve funding plan approved by the association is implemented, the projected reserve fund cash balance in each of those years will be $_____, leaving the reserve at _____ percent funding."*

Signed into law effective January 1, 2007 unless otherwise indicated

AB2851 – This bill would authorize a condominium plan to be amended or revoked by a subsequently acknowledged recorded instrument executed by all of the persons whose signatures would be required on the certificate as of the date of the amendment or revocation for the condominium project. The bill would further authorize the amendment of a condominium plan by an association for the purpose of repairing, rebuilding, or reconstructing all or a portion of a condominium project, if (1) the association obtains the written consent of each owner, *the* boundaries of whose separate interest are affected by the revised condominium *plan,* (2) the amendment is reasonable and does not eliminate any special rights, or privileges of an owner or impair any security interest, *(3) 67%* of the owners whose units are subject to that condominium plan vote to approve the amendment, and (4) the association receives the approval of the superior court using a specified petition process. The bill also would set forth notice, election, and recording requirements for amendment of a condominium plan, specify requirements for execution of amendments to plans that affect only industrial or commercial uses, and provide that no amendment of a condominium plan is required for a unit owner to use any common area wall, floor, or ceiling area adjacent to the unit for installing utilities and other fixtures. **Did Not Pass Legislature – Dead for this session**

You can track any of this legislation by going to www.leginfo.ca.gov where you can also find out the current status of the bills, any amendments, hearing dates, votes, etc. The analyses provided by legislative staff provide insights as to why the legislation exists. Often, this is the only information a legislator may see prior to casting a vote.

A LITTLE MORE HELP WITH ELECTIONS

BY: Beth A. Grimm, Attorney At Law

Editor's Note: Beth is a frequent contributor to South Coast through her articles and her annual summer law seminar. This article follows up her July meeting with us on the new elections law and procedures. Beth can be reached through her website www.californiacondoguru.com or at the contact information on the sponsor page at the back of the newsletter.

Many of you have your elections rules done or in the works. Some are waiting until the law is settled. SB 1560 which is the cleanup for the elections bill was amended again **June 20, 2006. It was signed into law as an URGENCY BILL on September 18** and takes effect along with the Elections law on July 1, 2006. It is important that you are aware of these things. This is what the bill does (with commentary on the benefits of the changes):

- requires rules to state qualifications for directors that ***are consistent with the governing documents*** (meaning essentially that you cannot add qualifications that are not already in your documents - the italics are added language, non italicized language is current status);
- allows inspectors of election to **appoint or oversee additional persons to help count ballots** (must be "independent" of board members and/or candidates in a board election) – this is new;
- authorizes a secret ballot to be distributed and voted upon by the membership **without a meeting, unless the governing documents require it;**
- **makes proxies discretionary** (up to the Board) and says they shall not constitute a ballot;
- provides that **a secret ballot is not revocable** after received by Inspector(s) of election (clarifying what was already believed to be true);
- clarifies that a quorum is required for an election under the statute ***if stated in the bylaws or other governing documents or other provision of law***, and ***permits a ballot received by the inspector of elections to be counted toward the quorum requirement.*** (The italicized language is new and is very important to establishing a quorum.)
- **says cumulative voting should be used with the secret ballot process, if cumulative voting is provided for in the governing documents** - my recommendation is that it be noted in the election rules for director elections);
- provides that owners shall in the upper left hand corner of the second envelope, **sign his or her name, indicate his or her name, and indicate the address or separate interest identifier** that entitles him or her to vote (which is intended to clarify owner instructions) - you can put a label on the return envelopes with blanks to help, the statute includes other means than an actual signature;
- **allows the Inspector to verify envelope information and signature prior to the election** (which is important in a large association - but does not allow the envelopes to be opened prior to counting),
- **eliminates the requirements of the secret ballot for delegate voting** (important to associations that use delegate voting); and

- tries to **resolve conflicts with Corp Code by stating 1363.03 controls if there is a conflict** (helpful in arguing what controls, but not a complete fix since the new law uses some Corp Codes and not others).

What it does not do:

1. *Resolve issues related to apathy and a lack of candidates for elections.*
2. *Resolve the question of how an Association is supposed to deal with candidates who have nominated themselves but do not qualify*.
3. *Provide any guidance as to how an association could combine the mail system with the association meeting process*.

You will need to look to your legal counsel to help with these 3 items. The election procedures drafted by me allow various options for Boards that cannot get enough candidates to run for the board or enough votes to get a quorum. Different Associations will approach this in different ways. Some will keep calling meetings or go door to door until they get a quorum for any of the actions or elections and some will simply use other options such as acclamation or appointment if it is too difficult to get enough interest from the members to have a valid election. The unresolved question is how much effort is **required before an Association can use acclamation or appointment instead of continuing to attempt to get the members to volunteer, or vote. Only the test of time will tell what success some owner might have in challenging an election process that is hindered by serious apathy.**

Questions and Answers - Elections Reform for Homeowners Associations
BY Beth A. Grimm, PLC

You probably have heard by now more questions than answers regarding the new "elections reform law" that took effect July 1, 2006. Wouldn't it be nice if you had answers? Well, here goes…….

Question: What's the big deal?

Answer: The "big deal" is that unless your association has been conducting elections by a double envelope secret mail balloting system similar to the absentee balloting system for public elections, things are going to change for almost every, if not every, election that takes place after July 1, 2006.

Question: How are they going to change?

Answer: HOAs are required to adopt rules called the election rules that contain certain requirements and HOAs are required to conduct elections using the double envelope secret mail balloting system similar to the absentee balloting system for public elections for most, if not all, elections.

Question: Do the rules have to be approved by the members?

Answer: No, they do not, unless your governing documents require it – then, check with your attorney. After July 1 they need to be circulated if they deviate from the law and governing documents (contain discretionary provisions). After July 1 they become subject to California

law relating to adoption of rules and that requires providing the draft (before board approval) to members at least 30 days before the open board meeting at which they will be considered for approval, if they have discretionary provisions added.

Question: What must appear in the rules?

Answer: The rules

- Must ensure that any candidate or member of the association advocating a point of view has equal access with other candidates or members to association resources including " media, newsletters, or Internet web sites" during a campaign. The association may not edit or redact (blacken out or remove) any content from communications but may include a statement of non-responsibility for the content.
- Must ensure access to the common area meeting space, if any, during a campaign, at no cost, to all candidates, including those who are not incumbents and to members advocating a point of view including those not endorsed by the Board, for purposes reasonably related to the election.
- Must specify the qualifications for candidates for the Board and procedures for nomination of candidates, and allow for any member to nominate themselves.
- Must specify voting rights.
- Must specify the method of selecting one or three independent parties to act as inspector or inspectors of election.

Question: Does this requirement of ensuring access require the Board to offer "unfettered" access meaning the members of the association can have as much "space" or "time" as they want to advocate their views?

Answer: Not exactly. I read this statute as somewhere between zero and unfettered use. My feeling is that reasonable limits do need to be set for all candidates and association members. For example, candidate statements in the newsletter might be limited to 25 or 50 words or less. Opposing views might have similar limitations. Use of the clubhouse might be limited to a candidates' night and if any candidate or member who wishes to speak cannot be present on that night, perhaps one alternative date. Setting reasonable limits does not mean the board can limit the candidate or any other member from advocating their point of view at an association-arranged meeting or on their own, by using the clubhouse on the same terms as other members, by seeking a mailing to the members via access to the membership lists, etc. Other attorneys most likely have varying opinions on this so it is good to work with an attorney you trust to set the parameters. Neither brother Bob nor your last divorce attorney is equipped unless they have specific training in common interest development law and have followed and studied the issues with his new elections reform law.

Question: If a member can nominate themselves or nominate another member, and there is no restriction on being qualified to be nominated, what do we do about candidates that would not qualify to serve?

Answer: I believe that the association has an obligation to the best of its ability to enforce its governing documents with regard to qualifications for board members. For example, your bylaws might require that board members are in good standing, meaning current with regard to their assessments and not in violation of any of the governing documents. If your bylaws require these things, then I feel the board must determine at some point that the person who

has submitted a name for nomination would not be entitled to be elected. The decision not to allow them to serve might be made at the time the person submits their name as a nominee, or it might be made at the time the ballots are in. In either event, I believe it is critically important for the board (through management or the inspector of election or other resource) to let any owner who has submitted their name or someone else's name, in writing, that if they or the person they nominate are not qualified to serve, then something (depending on the circumstances such as whether the problem can be cured) needs to be done about it.

Question: Can we use members as inspectors of election?

Answer: An HOA can use members, the association manager, the association CPA, a poll worker, or pretty much any other person that has no familial relationship or financial relationship with any of the board members or any of the candidates. The big word in the statute is “independent” third-party. If the HOA wants to use their manager or any other vendor used by the association, the election rules need to state that the Board may appoint the association manager or other vendor as an inspector of election. In my opinion, election rules could give the Board various options with regard to the appointment and I believe it helps the Board to be able to have choices depending on the type of election that is coming up.

Question: What kind of elections are we talking about?

Answer: at the time this is written, elections that are covered by this new law are elections related to election of directors, any elections that would be required with regard to assessments, elections relating to transfer of common area for exclusive use, and elections relating to amendment of any of the governing documents. The reach of this law may be expanded to more elections. Cleanup legislation -- SB 1560 -- in its present form -- would encompass all association elections. There is talk of adding recall elections but not including other association elections, so this point is unsettled at this moment. For certain, the big four listed first in this answer are included.

Question: Can we place other measures on a ballot with “the big four” which are not covered by the new law?

Answer: It is my belief that you can. However, the rules that I am writing and the procedure that I am advocating incorporates a proxy. One of the big questions with regard to this new law is whether or not a quorum is required for a valid election on any of the issues covered. So, when I say I think it is alright to add other measures to a ballot that is required for one of the subjects listed above, it is with an all-encompassing understanding of making sure that the package qualifies in the event a quorum requirement is imposed, ultimately, by a small claims court judge or referee.

Question: So what is this double envelope secret ballot process?

Answer: The association will have to distribute to each and every owner, whether by mail, personal delivery, or otherwise (and I strongly recommend verifying the association records with the method used) a package containing a ballot with measures upon it, but no signature blanks or identifying information, a smaller unmarked envelope into which the ballot is to be placed after the choices are marked, with a larger envelope that has a return address to the

inspector of election. The owners will have to have instructions provided so they know what to do. The envelope that is addressed to the inspector will also have to have, in the upper left-hand corner, some kind of indication that the member must provide their name, address, and lot or unit number if they know it (this would be the description of property that entitles them to vote) and there needs to be some kind of notation which lets the owner know they also have to sign their name. If the association does not give owners explicit instructions, and possibly even if it does, in it is fair to assume that not everyone will follow them. The more of an effort the board makes to make it simple for the owners, the "better" the return will be.

Question: Can the envelope be addressed to the manager?

Answer: if the mailing address is going to be the management office, the envelopes should still be addressed to the inspector of election, in care of the management office. If great care is not taken to assure that the return is intended for the inspector of election, and possibly the envelope looks different than a normal everyday envelope, people's votes are likely to get mixed up with other mail and be opened accidentally. Inspectors of election are not supposed to open ballots prematurely. Neither are managers, board members, or members of any committee. Nothing is supposed to be opened until it is time to count the ballots, and the envelopes have been checked in, and, depending on where the attorney for the association stands on this, whether a quorum is established or not. Again, attorneys have varying opinions on how to carry out this process and when, now, and if, a quorum does need to be established.

Question: What may the inspector or inspectors do if they do not know what to do with regard to any question that might arise during the process?

Answer: It is best to try and head off problems that one can anticipate. For example, my plan is to have the association provide instructions for the inspectors ahead of time to the instructors, allow them to read the instructions, and respond as to whether they feel they can or cannot fulfill the duties of the inspector. The inspectors are invited to ask questions ahead of time. The board and its attorney based on past experiences will have some ammunition available to anticipate problems. By way of example, the inspectors could have instructions provided to them ahead of time as to what to do if they receive two ballot packages from one household. They could have instructions as to what to do if the owner signed in the wrong place on the ballot package or does not sign at all. They could have instructions as to what to do if the owner places the ballot in the outer envelope and throws away the inner envelope. The inspectors could be given the right to consult with the association's counsel if they have question during the process. This probably would give them some comfort level.

Basically, however, the inspectors do have the right to hear and determine all challenges and questions that arise out of or in connection with the right to vote. Therefore, they can make some decisions on their own if they are willing or want to take a position. Any position taken by the inspectors is subject to challenge after the election results are announced, the same as would be any position taken by the association's attorney, the manager, the board, or anyone who has any decision-making authority in the process or the election itself. However, the intent of the law seems to be that by choosing an independent inspector of election, and allowing them to make some decisions, at least arguments between the two parties as to the fairness in the choices made for the inspector and decisions made about the election should

be minimized. Thus, one would not want to choose for an inspector of election anyone who is controversial, independent or not.

Question: What about quorum? Is a quorum required for all elections?

Answer: Ugh! This is it is one of the areas of greatest controversy over this law. Yes, when the cleanup legislation goes through, the necessity of a quorum will be stated, if the documents or law require it. Even if the governing documents do not have quorum requirement, corporate law does for those incorporated associations where the governing documents are silent on the subject.

Question: What about proxies? Can they still be used?

Answer: Ugh! And double Ugh! This probably is the second greatest area of controversy over the new law. It simply is not clear on how an association might integrate proxy use with this double envelope secret mail ballot system. Different attorneys have adopted processes that integrate proxy use and others have all but eliminated it from the process. I think proxies are important. Even though the cleanup law will state that ballots returned count toward the quorum, in some elections the double envelope system is not necessary and the question arises as to whether it then counts toward the quorum. Under my system proxy use would be consistent and be part of the ballot package. If the board sends out a proxy, I believe it needs to provide the form of proxy required by the statute. However, I believe there are various ways to interpret what might constitute a proper "separate" page. For example, I believe a proxy could be used in conjunction with the secret ballot allowing the ballot itself to constitute the "separate" page with instructions.

Question: Do we still need to have a meeting if we use this new voting procedure?

Answer: For this, I have to give a "depends" answer. After the cleanup legislation is approved, it depends on what your governing documents say. For example, some documents say that directors shall be elected at the annual meeting. In that case, I think you need to combine the mail balloting system with the meeting, and if the documents say to allow nominations from the floor, then I think you have to allow for that. I think a board should be advised of the possible ramifications of doing away with the annual meeting. My biggest concern is apathy. A lot of people think it might be easier – but will it? The thing about a public election is it never really matters how few vote, the ballots are still counted. And there is never a problem finding candidates – for some strange reason lots of people want to be President. But that is not true in associations and many look to their meetings to drum up potential candidates. So the good news is …. Meetings may not be required in the future for board elections or otherwise. The bad news is …. If there are no meetings, there might be less (if that is possible) interest in doing service or returning a vote.

Question: What is the worst that can happen?

Answer: Probably one of the worst things that can happen is any individual member might be able to upset the entire election by taking a challenge to Small Claims Court in getting a judge or hearing officer to agree that a single technicality calls for an entire "re-do". This is especially frustrating in a large association that had to go to considerable expense, and thought it did everything right the first time. But, of course, there are worse possibilities. An

owner can seek a fine of up to $500 for each violation of the new law and if a Board of Directors, the association's attorney, and/or inspectors of election really screw up, and are short on “good faith” defenses, the fines could add up. But, of course, there are worse possibilities. An association could be taken to “Big Court” (the Superior one), and end up in the battle of lifetime, lose, and end up with a big attorneys’ fees award to have to pay. In other words, the association may end up paying not only its own attorney, but the attorney hired by an owner or owners who challenge the election. The odds are against an Association recovering its attorney fees even if it wins, because it has to prove the action was frivolous. One technicality issue, and even if the election is not ordered redone, could defeat the quest to prove a challenge is frivolous.

Please consult with an expert on this. You have to have rules. You have to have inspectors of election. You have to have a process. You have to act in good faith. You may have to demonstrate to someone ranging from the “dumbest stick of a” Small Claims Court referee to the smartest retired High Court judge that you acted in good faith and did everything you can to satisfy the mandates a Civil Code sections 1363.03, 1363.04, and 1363.09. Trust me when I say it this, I believe it virtually impossible to anticipate every trip hazard and be guaranteed that you can avoid a challenge under this new law. Why? Because it does not mesh with existing laws in a logical way. It does not mesh with governing documents in a logical way. And there is no roadmap for resolving conflicts at this point in time. It may sound easy, but it is not. If you are interested, I have prepared a list of approximately 20 statutes that existed before the elections reform law in the Corporations Code and Davis Stirling Act that are, in my opinion, adversely affected by this new law and that affect interpretation of this new law. By the words “adversely affected” and “that affect”, I mean that these statutes either specifically conflict with the new elections law, conflict in part with the new elections law, or, though they do not directly conflict, leave open questions as to whether total, or in part, they have any value left. You can read this information if you want to. It is available on my web site http://www.californiacondoguru. All you have to do is go to the site, click on the box on the front page that talks about SB 61 and elections, and then click on be link described as everything that is wrong with the new elections law. Believe me, your head will spin.

If you want to look up the code sections themselves, you may link to: http://www.leginfo.ca.gov/calaw.html .... (check the code you want and plug in the first of the series number of the statute)

If you want to look up the bill has been proposed to clean up the elections reform law, you may link to:
http://www.leginfo.ca.gov/bilinfo.html …… (plug in the bill number SB 1560)

If you want to follow my dialogue on the new bill, visit http://www.californiacondoguru and click on the front page, the box that says “Beth’s Blog”. I am doing my best to keep a consistent running commentary about what is happening with SB 1560 in the elections reform law.

And, of course last but not least …….. Good luck!

A LITTLE MORE HELP WITH ELECTIONS – SAMPLE PACKAGE WITH PROXY

The enclosed is part of my package of election rules that combines a proxy with the ballot package and some envelope instructions. My process simplifies use of proxies. If you do not have a rules package yet, you need to get one. See proposal on the website – above, or email and ask for one.

INSTRUCTIONS FOR THE VOTING PACKAGE ENVELOPES:

SMALLER OF THE TWO IN THE PACKAGE:
The following statement is to be placed on the **smaller blank envelope** that the ballot goes into (no other markings).

"PLEASE PLACE YOUR BALLOT IN THIS ENVELOPE AND SEAL IT. THEN, PLACE THIS ENVELOPE INTO THE LARGER ENVELOPE ADDRESSED TO THE INSPECTOR OF ELECTION AND SEAL THAT ENVELOPE."

If using a ballot box, the statement would include: **"[or] PUT IT IN THE BALLOT BOX THAT IS LOCATED at_____".**
OUTER ENVELOPE FOR INSPECTOR

ON **FRONT SIDE**, PUT THE ADDRESS OF THE INSPECTOR, OR WHERE THE BALLOT PACKAGE SHOULD BE SENT OR DELIVERED.

ON THE **FRONT SIDE,** UPPER LEFT CORNER: either affix a label or have the area printed with the following, in the area where the return address would normally go:

OWNER NAME_____
PRINT PLEASE
OWNER ADDRESS:_____
_____
LOT/UNIT NUMBER:_____

OWNER **SIGNATURE**:_____

ON THE **BACK OF THE ENVELOPE ADDRESSED TO THE INSPECTOR** – have the proxy printed on it with the envelope flap down or below the flap. **AS FOLLOWS:**

_____ HOA PROXY

The undersigned, a Member of the above HOA, hereby appoints _____ as my/our proxy. If no name is filled in, the Inspector(s) of Election shall serve as proxy. My proxy, if other than the Inspector(s), shall vote on my behalf according to my instructions given separately. **If my proxy is the Inspector(s), the instructions are to count/tabulate the secret ballot enclosed as cast by me.** In any event, including if the ballot is blank when it is turned in to be counted, this proxy is to be counted toward the quorum requirements. I understand the ballot once provided to the Inspector(s) is not revocable.

_____Printed Name:_____

Signature

_____Printed Name:_____

2007 MEMBERSHIP BILLING

Your 2007 membership bills will be mailed the week of October 3. No price changes for 2007! Your dues and other optional charges remain the same from 2006. Note that if you pay your dues before November 30, you receive a $20 discount (1/3 off). Collecting all the dues in a short period of time is more efficient for the other South Coast volunteers and myself. Thank you for your prompt attention when your renewal notice is delivered.

CAI CHANNEL ISLANDS – HOMEOWNER ASSOCIATION EXPO

The Channel Islands Chapter of the Community Associations Institute is holding their annual trade show and seminar on Friday, October 27 from 1-4 PM at the Ventura Beach Marriott Hotel on Harbor Blvd. (Seaward exit). Many area tradespeople and professionals have exhibit booths at the Expo where you can meet these specialists, ask questions and obtain information. From 2-3 PM there will be a "Free Legal Advice for HOA Representatives" session featuring 4 Southern California attorneys. There is no charge to attend. For more information, you can call 805-658-1438 or visit their web site www.cai-channelislands.org.

IS SIPC INSURANCE THE SAME AS FDIC INSURANCE?

The Securities Investor Protection Corporation (SIPC) is a nonprofit membership corporation that provides insurance of up to $500,000 per brokerage account in the event that a security dealer-broker goes under and the securities and cash are seized by creditors. The SIPC is not a government agency like the Federal Deposit Insurance Corporation (FDIC). The member brokers pay a premium to insure their funds. Some brokerages maintain private insurance at higher levels.

The SIPC does not insure for the decline in the value of security accounts due to market conditions. This includes the many money market funds that brokerages have. Several years ago, when interest rates declined to record low levels, some money market funds paid less than one-tenth of 1% interest on accounts as investment income was used to pay fund expenses and there was nothing left for the account owners. Unlike a bank money market fund, the principal in a brokerage money market fund is not insured against the loss of principal.

US TAX COURSE CASE FEATURES SUSPENDED CORPORATION

The Federal Tax Court dismissed a corporation's petition to redetermine income tax deficiencies, penalties, etc. because the corporation could not prosecute the case. The corporation's powers, rights and privileges were suspended by the state of California. It lacked the capacity to prosecute or defend the case (NT Inc. 126 TC No 8, Dec 56,487 as reported by CCH Tax Newsletter 4/20/06)

As noted in the past, all corporations including homeowner associations must file income tax returns annually with the Franchise Tax Board and information statements every two years with the Secretary of State. Failure to do either will result in the suspension of the corporation's power with potentially disastrous results.

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