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Volume 33 – Number 2 – February 2022

33rd ANNIVERSARY MEETING AND ANNUAL LAW AND LEGISLATIVE UPDATE

Thanks to all who attended the January 19 Annual Law and Legislative Update Zoom meeting. We had over 80 people on the meeting, board members as well as professionals. Thanks to attorneys James Smith and David Loewenthal for sharing their insights on the changes for 2022.

For those who were unable to attend the meeting, the speakers' materials have been posted to our website - https://www.southcoasthoa.org/resources.html The first three entries contain the 2022 update materials. Also on the resources tab, you will find materials from previous meetings. You are welcome to peruse them as well.

We also welcome our new members that joined us for the first time for the law and legislative update. You will also find a library of prior years' newsletters available to you. Those can be found at - https://www.southcoasthoa.org/newsletter.html

AFFORDABLE HOUSING QUESTION UPDATE

In the last newsletter, I wrote about an association that was receiving loans and/or grant money from governmental sources for major repairs since it was originally established as a low-income ownership project and then I wondered how one of the units could be marketed for $850,000. It turns out that this unit had been foreclosed upon by the lender at some point. It appears that when a price or income restricted unit is foreclosed upon, those restrictions are eliminated and the unit becomes market rate.

TRENDS IN ASSESSMENT CHANGES FROM 2021 TO 2022
Santa Barbara County

By: Michael J. Gartzke, CPA – January 2022

In December 2021, I emailed many of our members to request that you send me your monthly assessment information for 2021 and now that we are in calendar year 2022, what your monthly assessment is this year. Thanks to Team HOA, St. John & Associates, Coast Community Property Management and Good Management for sending information about associations they work with as well as the many board members who sent information about their individual associations. I received usable responses from 124 associations ranging from 2-280 units representing over 4,100 units in our area, a pretty, sizable sample.

This is my attempt to quantify the “chatter” about the magnitude and frequency of assessment changes for 2022. As noted in the January newsletter, in a different database of associations that I provide reviewed financial statements for (assessments greater than $75,000 annually), the average assessment increased $96 per unit per month from 2009-2021 ($440 to $536 – 21.6%) or less than 2% per year. The median assessment increased $73 per unit per month from $377 to $450 – 19.4%, a slightly lower increase. The median amount is where half of the amounts are higher than the median number while the other half are below. In that database, the median operating assessment increased $34 (12.1%) while the median reserve assessment increased $53 (52.5%). In 2009, the reserve portion of the monthly assessment was 27.9%. In 2021, the reserve portion had increased to 31.7% of the monthly assessment.

TABLE 1 – ALL RESPONSES (124)
Regular Monthly Assessment

	2022	2021	$ Change	% Change
Average	**$437.01**	**$413.04**	**$23.97**	**6%**
Median	**$397.50**	**$380.00**	**$17.50**	**5%**
Changed	**74**			
No Change	**50**			

Given that in the previous 12 years, the rate of change was less than 2% per year shows that the 2022 changes are significant. Still, 40% of the associations reported no change in their assessment for 2022. Of those associations that did change their assessments:

TABLE 1A – PERCENT CHANGES

Percent Change	Number of Associations
1-4%	**12**
5-10%	**42**
11-15%	**10**
Greater than 15%	**10**

Insurance costs were cited by many responses contributing to the increased assessment. Not all associations provide dwelling coverages. Many condominium associations in our area provide earthquake insurance and some are required to provide flood insurance. Up until a couple years ago, insurance costs had held steady. In my review database cited earlier, the median insurance cost per unit per month was $60 in 2008 and $60 in 2018. It increased to $68 in 2019 and $72 in 2020. No data is yet available for actual 2021 costs. Given that insurance was cited as a top reason, we can expect that the median cost will rise significantly.

Reserve funding was cited by as many responses as insurance. The median reserve funding portion of the assessment had increased from $101 in 2009 to $154 in 2021. Most reserve studies have an inflationary factor built in the 30-year forecast. The most common one I've seen is 3%. Associations will usually have a 3% increase in their budget for reserve funding in years that a study is not done. Full reserve studies are done every three years so many associations did not have a new study done in 2021.

Chris Andrews of Stone Mountain Corporation, a reserve study provider for over 25 years, provided the following analysis of the profound influence of recent construction cost inflation on Reserve Funding needs – and hence HOA fee increases. Also mentioned is the relationship of dramatically-increasing construction costs to higher insurance rebuild costs.

"For Board members who need help justifying steep HOA fee increases, here is the State of California's "Construction Cost Index" data that shows that California Construction Cost inflation has been 13.4% so far in 2021!

https://www.dgs.ca.gov/RESD/Resources/Page-Content/Real-Estate-Services-Division-Resources-List-Folder/DGS-California-Construction-Cost-Index-CCCI

California Construction Cost Index 2021-2025

Month	Index
January	7090
February	7102
March	7130
April	7150
May	7712
June	7746
July	7846
August	8122
September	7900
October	8080
November	8141
December	8072
Annual % *	13.4%

Costs for HOA reserve study items (roofing, paving, painting, etc.) are strongly-tied to Construction Costs -- <u>not</u> the Consumer Price Index we often hear about in the financial news. The CPI is based on a basket of typical household goods (food, energy, staples) and is very different from construction costs.

If reserve study cost items are likely to be uniformly subject to the above 13.4% California Construction Cost Index inflation, one might conclude that most reserve studies prepared recently should show about a 13.4% increase in recommended reserve funding. In many HOAs, the Reserve Funding line item in the overall budget is often the most costly line item in the total annual budget – next to insurance premiums. So reserve funding is a key driver in determining the magnitude of HOA fee increases.

It's important that HOA Board members consider the foregoing realities of this hyper-inflationary period that we are in -- as they discuss the need for increasing their annual reserve funding amount per their reserve study...

Not only does Construction Cost Inflation drive the need to increase reserve funding substantially, but it has a profound influence on insurance rates. There are generally two inputs to insurance rate increases:

- Catastrophic loss claims in any one year that deplete the catastrophic loss pool of funds held by insurers, and

- Rebuild Cost per Square foot.

Most people tend to focus mostly on whether or not there were fire/earthquake/hurricane disasters in the recent past and they base their personal expectations about insurance rate increases on their perception of this catastrophic loss factor. For example, *"There have been many major fires this past year with millions of insurable losses, so I'm guessing that my HOA's fire/liability insurance policy will increase substantially."*

However, now we're facing substantial increases in Rebuild Cost per Square foot – as underscored by the 13.4% increase in California Construction Costs cited above. If HOA members think they can rebuild a fire/earthquake damaged home for last year's rebuild costs, they may have a rude awakening if disaster strikes. Board members who understand the concept of "fiduciary responsibility" should wisely increase the "rebuild cost per Square foot" in their earthquake and hazard/liability insurance policies to reflect these realities."

Water costs specifically were also cited by some, especially master metered associations where the association pays for members' water. The cities and water districts have not been shy about raising rates and fees each year. For members who do not pay a water bill directly, they have no idea how these costs have increased. The cities and counties have also increased their rates for refuse collection to pay their increased costs and the recycling projects they have undertaken.

We are in for a rude awakening for natural gas prices. Here is an excerpt from Southern California Gas.

“Effective January 1, 2022, the procurement component of the core sales rate will increase 18.440 ¢/therm to 83.569 ¢/therm. This increase resulted from an overall 16.922 ¢/therm increase in commodity price and an increase of 1.518 ¢/therm in account adjustments. Compared to a year ago, the **procurement rate is about 110.2% higher** (39.764 ¢/therm) than what it was effective January 2021.”

So natural gas prices have doubled during 2021. We use much more gas in the winter for heating. Master metered associations use gas for hot water heating as well as pools and spas. Much of the increase occurred after September 2021 so it was not budgeted for by most associations. Time will tell how long these extremely high prices will last.

And then there is the new Central Coast Community Energy organization which procures the electricity (1/3 of cost) and has Edison delivers it (2/3). This allocation took place for most customers on October 1. On the same date Edison raised it delivery rates. A City of Goleta press release in December 2021 stated –

“Residents and businesses may have noticed an increase in their electric bills in the last month. The increase is due to Southern California Edison’s increase in its transmission and distribution rates and is NOT related to the City’s new electricity provider Central Coast Community Energy (CCCE).

On October 1, Southern California Edison (SCE) raised its transmission and distribution rates for all customers. These increased rates, which typically account for approximately 2/3 of an average household’s monthly electricity costs, were reflected in customers’ bills starting in November, **and will amount to a monthly increase of approximately $10 per average household.** The increased rates are tied to SCE’s need for continued grid infrastructure development and hardening to prevent wildfires and accelerate grid modernization. For more information visit www.sce.com/bill_change.

Also in October, all Goleta electricity customers were enrolled in CCCE service. CCCE is now in charge of electric generation (*how* and *where* our electricity is generated), a cost that typically makes up approximately 1/3 of an average household’s monthly electricity costs. SCE will no longer charge customers for electric generation (how your electricity is generated), but SCE will continue charging customers for transmission and distribution (how your electricity is delivered). CCCE electric generation charges now appear on your SCE bill as a separate line item. Those enrolled with CCCE are now shared customers: SCE provides and charges for transmission and distribution, CCCE provides and charges for electric generation.”

A few responses cited landscaping and maintenance in general. A couple said that increased administration costs contributed such as unexpected legal costs and going from self to professional management. Only one stated that a portion of the increase was going to repay a prior year deficit. In my work last year, there are several associations who should have been increasing their assessments for that reason.

As noted earlier, the number of units in each association varies widely, from 2 to 280 units. The next three tables break down the changes based upon the number of units in the association.

TABLE 2 – 2-10 UNITS
Number of Responses - 50

	2022	2021	$ Change	% Change
Average	$385.31	$368.97	$16.34	4%
Median	$331.00	$310.75	$20.25	7%
Changed	19			
No Change	31			

The majority of the associations with no change in assessments (62%) came from this group. The overall assessments were somewhat less than the total group in Table 1. Of the 19 assessments that changed, 8 changed by more than 10%.

TABLE 3 – 11-25 UNITS
Number of Responses - 31

	2022	2021	$ Change	% Change
Average	$418.02	$391.73	$26.29	7%
Median	$395.00	$375.00	$20.00	5%
Changed	20			
No Change	11			

More of these associations changed their assessment in 2022 than the 2-10-unit sample. The median assessment is $64 per month higher than the smaller group. The rate of change was comparable with the smaller group. More of the smaller groups do not have full property management services. Many will pay for outside bookkeeping services while some are purely self-managed.

The final table shows the changes for the associations with 26 or more units.

TABLE 4 – 26-280 UNITS
Number of Responses - 43

	2022	2021	$ Change	% Change
Average	$490.49	$460.44	$30.05	7%
Median	$471.00	$435.00	$36.00	8%
Changed	35			
No Change	8			

Nearly all the larger associations had an assessment increase for 2022 and the increases were sizable. Median and average assessments are higher than the associations with fewer than 26 units. Nearly all the larger associations have professional management (but not all). From my review of the list, all have professional reserve studies done and have them updated every three years. Perhaps more is being funded into the reserve account.

This group's median assessment is $140 per month more than the 2-10-unit group and $76 per month more than the 11-25-unit group.

Associations are quite diverse. In the total sample, the maximum monthly assessment was $1,419 and the lowest was $33.

We are all affected by the increased costs that associations incur. Building costs, insurance and utilities are rising faster than the CPI, even though the CPI rose 7% nationally in 2021 and 6.6% in California, according to the Bureau of Labor Statistics. I think most owners understand why assessments increase. Some don't understand what their assessments pay for. Perhaps, there's some information here that will help you at your annual meetings to explain the need to increase assessments.

Finally, I received data for 12 associations that I couldn't integrate into the sample. These associations have variable assessments (not everyone pays the same amount) and I didn't have the amounts of the range to make the calculations. I did receive information about the percentage increases, though.

Amount of Change	Number of Associations
No Change	**5**
1-4%	**2**
5-10%	**4**
Over 10%	**1**

DO ALL THESE LAWS APPLY TO SAMLL ASSOCIATIONS

One of the questions that came up in the January meeting chat box was whether all these laws pertain to small associations as well as larger ones. The short answer is yes, unless the code section indicates otherwise. Some laws only apply to condominiums and not planned developments. For example, pest control obligations can be different for planned developments as opposed to condominiums. The balcony inspection law applies to buildings with 3 or more attached units (but not 2).

Unless the governing documents require it, an association with less than $75,000 in annual revenue (including assessments) do not have to have a financial statement review done by a certified public accountant. Instead, the corporation code (Section 8321) governs what financial reports members must receive annually and who can prepare them.

Yes, the vast majority of the Civil Codes (Davis-Stirling Act) apply to all associations, regardless of size.

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