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IN THIS ISSUE

South Coast Summer Workshop: Determination of Maintenance & Repair Responsibilities Made Easy

By James H. Smith of Grokenberger & Smith, Attorneys at Law

Who among us has not been confronted with the question: Is the Association or the Owner responsible to **maintain** that item?

Who among us has not been confronted with the question: Is the Association or the Owner responsible to **replace** that item?

At this upcoming South Coast Summer Workshop we will have a true to life model Unit with all the disputed areas including, but not limited to, plumbing lines, gas lines, windows, exterior doors, fixtures, built-in appliances, decks etc. We will go step-by-step through the Unit addressing maintenance and replacement responsibilities as between the Association and Owner. Your questions regarding maintenance and repair responsibilities are welcome and will be addressed.

This workshop will have application to both Condominiums and Planned Developments; the emphasis of the program will be on maintenance, repair and replacement obligations concerning Condominium Developments. The workshop will also feature a moderated Question and Answer Session on the program topics at the conclusion of the program.

Date - Tuesday, June 2, 2015
Time - 7:00 PM - 8:30 PM
Place - Encina Royale - 250 Moreton Bay Lane, Goleta
Cost - None - No Reservation Necessary

HOA FINANCIAL DATA COMPARISONS AND TRENDS RESEARCH PROJECT (Part 1)

January 2015

By: Michael J. Gartzke, CPA

Author's Note: This is an update to an article I wrote which appeared in the January 2012 newsletter. You can access that article on our website www.southcoasthoa.org and click the newsletters tab and then 2012.

I have been providing accounting services to homeowners associations since 1986. Since that time I have performed many review engagements for associations in southern Santa Barbara County (primarily from Goleta, Santa Barbara, Montecito and Carpinteria). Over the years, I had received numerous inquiries from board members, managers, etc. as to how their association(s) compared to other associations in the area. At the time, I could share my perceptions of the trends and how their associations compared with others, but I did not have data to support my opinion.

To address this issue, in 2005, I developed a spreadsheet that captured annual data from each association's reviewed financial statements. From that database, I prepared a one-page analysis showing minimum, maximum and median amounts for a number of association financial categories such as cash per unit, fund balances, expenses by major category, regular monthly assessment, reserve fund assessment and more. During the review engagement, I would update the spreadsheet and print the analysis showing that association's data against the totals at that time.

Several years later, I added a pie chart showing how the association's assessment was allocated among five major categories – utilities, insurance, common area maintenance, general and administrative expenses and reserve funding. I also added a bar chart showing their data, measured on a per unit per month basis, compared to the median (half above and half below) so that I could easily show an association if they were above or below the median amounts of their peers.

Comparing one association to another can be difficult. I use these comparisons to highlight similarities as well as the differences between them. For example, an association might have master-metered interior water included in their monthly assessment, increasing utility costs. A planned development may not carry insurance on the dwelling units. Another may have security services at its entrance gate. Common area (and reserve components) can be vastly different as well. Not all associations have pools. Some are built on public streets while others have extensive private roads and parking areas. Some associations are responsible for building maintenance. Others do not.

It has now been nine years since I started the database of my client associations. There were 55 review engagements at that time. There are now 70. 49 of the original 55 are still in the database so 21 have been added since then. The median sized association has changed very little, ranging between 45 and 50 units during the 9-year period. The average year built

is still 1979-1980, now 35 years old. 41 are condominiums, 28 are planned developments and one is a combination.

A common complaint among association members is that their assessment is increasing at a rate greater than the Consumer Price Index. Does the mix of utility costs, insurance, common area services and aging buildings correlate to the CPI to some degree?

To start with, here is the data description and CPI rates for tax years 2005- 2014.

	2005	2008	2011	2014	Percent Change from 2005
Number of Associations	55	63	68	70	
Median Size (units)	50	48	50	50	
Average/Median Year Built	1979	1980	1980	1980	
CPI - LA Urban/Clerical	194.9	217.8	225.1	233.9	**20.0%**

Each annual column will contain the prior year's historical data from the review engagements. For example, the 2014 column contains year ended December 31, 2013 data and fiscal years ending in 2014.

The tables that follow track the data and trends associated with common measurements from association financial statements.

- Cash
- Assessments Receivable
- Fund Balances
- Assessment Income
- Investments Rate of Return
- Operating Expenses
    - Utilities
    - Common Area Maintenance
    - Insurance
    - General and Administrative

CASH

Cash per Unit:	2005	2008	2011	2014	Percent Change from 2005
Median	$2,966	$3,912	$4,664	$5,698	92.1%
Average	3,580	4,536	6,238	6,677	86.5%
75 Percentile	4,175	5,855	7,066	8,680	107.9%
25 Percentile	2,125	1,954	3,678	3,666	72.5%

Combined cash (operating + reserve) balances improved substantially. The median association cash balance increased by over $2,700 per unit, nearly double the median cash balance in 2005. The "75 Percentile" line represents the amount where 75 percent of the associations are at or below. The "25 Percentile" line represents the amount where only 25 percent of the associations are below.

ASSESSMENTS RECEIVABLE

Assessments Receivable	2005	2008	2011	2014	Percent Change
Number of Associations	55	63	68	70	
Number of Units	4,224	4,636	5,203	5,555	
Receivables	$100,388	$351,914	$668,603	$343,603	
$/unit	$23.77	$75.91	$128.50	$61.85	160%

It's no secret that unpaid assessments increased over the past nine years as a result of the collapse of real estate prices in 2008-2011. From loss of employment to mortgages exceeding property values, many associations were negatively impacted by the inability to collect all budgeted assessments. As foreclosures were completed and new owners in place along with a rebounding economy, lost assessments are not as large an issue as it was a few years ago. There's still a ways to go to get to pre-recession levels.

OPERATING FUND

Operating Fund per Unit	2005	2008	2011	2014	Percent Change
Median	$200	$215	$502	$564	182%
Average	248	197	622	816	229%
75 Percentile	361	474	803	1,285	256%
25 Percentile	44	8	227	237	438%
Negative – Associations	12	16	9	9	

Operating Funds are operating assets (cash, net receivables, prepaid expenses) less operating liabilities (accounts payable, prepaid assessments, funds borrowed from reserves, etc.). Substantial improvement was noted here as well. The number of associations with negative operating fund balances (liabilities greater than assets) decreased from 16 at the end of 2008 to 9 currently.

RESERVE FUNDS

Reserve Funds per Unit	2005	2008	2011	2014	Percent Change
Median	$2,658	$3,362	$4,164	$4,904	84%
Average	3,199	4,222	5,883	5,546	73%
75 Percentile	3,664	5,160	6,555	7,457	103%
25 Percentile	1,832	1,937	3,067	3,334	82%
Negative balances	1	2	0	1	

Nearly all of the associations have a professional reserve study prepared in accordance with the Civil Code. Most are prepared by a reserve specialist. Most are funding in accordance with the reserve specialist's recommendation. Associations have substantially increased their reserve funds in the past nine years as more associations have become aware of the importance of reserves.

Part 2 which includes income and expense comparisons and trends will appear in the next newsletter.

REVIEW OF NEW LEGISLATION AN APPELLATE DECISIONS AFFECTING HOMEOWNERS ASSOCIATIONS IN 2014

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Important Appellate Court Decisions

1. **Huntington Continental Townhouse Association, Inc. v. Joseph A. Minor** (2014) 2014 S.O.S. 4543.

Why significant: It represents a continuing trend that is limiting the use of the foreclosure remedy specifically, holding Association's to a high standard of compliance while ignoring the prejudice to Association's when owners do not pay assessments.

This appellate court decision may prove to have a dramatic impact on how Association's operate in the context of collections and may have a significant impact on Association vendors who are hired to effectuate collection of delinquent assessments. Following in the footsteps of the Diamond case from 2013, the Appellate Courts seem to be leaning heavily in favor of protecting individual owner rights while making the Association's ability to collect assessments and the costs are necessarily incurred in exercising the Association's remedies for collection.

Civil Code Section 5655(a) provides that "any payments made by an owner of a separate interest toward a debt described in subdivision (a) of Section 5650 shall first be applied to assessments owed and, only after the assessments owed are paid in full shall the payments be applied to the fees and costs of collection…."

This case stands for the proposition that under Civil Code Section 5655(a), Associations **MUST** accept partial payments tendered by homeowners, regardless of when tendered or how much was tendered, and apply them first to the amount of assessments owed and then to collection costs, without regard to pending collection actions or remedies. The basic language of this statute has been present for years and most legal counsel and collection companies interpreted the statute to mean that "payments accepted by the Association" must be applied to pay down assessment liability first, which "could" impact collection remedies based on the $1800 requirement for foreclosures on assessment liens. However, this language had never been construed to mandate that the Association was obligated to accept partial payments whenever tendered. In fact, good collection practice has been not to accept partial payments at a certain point in the collection process because doing so would undermine the Association's ability to collect already incurred fees and costs and would allow the owner to "game" the system. Practically, this decision gives an owner the ability to unilaterally derail a non-judicial foreclosure action merely by submitting a partial (or even nominal) payment to bring the delinquent assessments under $1,800 (foreclosure threshold) even on the day of a notice Trustee's Sale. The impact of that is to leave the Association responsible for collection fees and costs with no immediate way to collect without starting a lawsuit.

The court rejected arguments that other statutory provisions regarding payment proposals did not mandate that Association's had to agree to terms proposed by members and if that was the case, why should an Association have to accept a partial payment which impairs its remedies. The court did not consider the lack of legislative intent or lack of clear language discussing acceptance of partial payments outside of a payment agreement to be significant. It seems the court was focused on preventing the Associations from effectively using the foreclosure remedy provided in statute. The court was entirely unsympathetic to the Association's difficulty in recovering collection costs caused entirely by the delinquent owner.

I see this case as potentially forcing the Association to use a combination of judicial foreclosure/money judgment action as opposed to the faster and less expensive non-judicial foreclosure process to collect delinquent assessments. Either that or simply a straight breach of CCRs action to obtain a money judgment. By taking that path, even if a partial payment is made, the Association can proceed to obtain a judgment for the remainder of the assessments and all collection costs, even if the assessment balance falls below $1,800.

The case does not attempt to limit the waiver of the right to make partial payments pursuant to a written payment plan or foreclosure forbearance agreement which is defaulted upon. Therefore, it should become standard practice in payment plans to require an express waiver of the right to submit partial payments after a default on the payment plan, at least until another decision rules otherwise.

2. **Beacon Residential Community Association v. Skidmore Owings and Merrill** (2014)

Why significant: Provides Association's with a clear right to pursue claims against designers of residential housing in construction defect cases and should eliminate the standard practice of such defendants attempting to escape responsibility based on lack of contractual privity with the architect.

This case involved an Association that sued for construction defects in a condominium project and included negligence claims against the architects/designers of the project that were hired by the developers.

The California Supreme Court clarified several prior decisions which seemed to indicate that architects and engineers could not be held responsible by end users of real property based on negligence because they owed no duty of care to the Association or its members. The Supreme Court held that architects do owe a duty of care to future homeowners based on common law interpretation of duty. This decision was based on the fact that the architect's work was intended to affect the ultimate homeowner and defective design would foreseeably impact the homeowner, among other factors.

3. **Bel Air Glen Homeowners Association v. Dwlatshahi** (2014) not certified for publication.

Why significant: This case is significant because it illustrates just how expensive enforcement actions can be, even when the issue appears to be simple. It also illustrates that courts can make strange and inexplicable decisions.

This case involved an Association's attempt to enforce a provision in its CCRs which entitled the Association to have a copy of a lease between an Owner and Tenant for the purpose of determining who the tenant was and that the lease contained terms consistent with the requirements of the CCRs relative to leases and tenants. The Association made a demand for a copy of lease from the owner because the property was being resided in by a third person, who ultimately was the Owner's attorney. The Owner and the attorney indicated that the property was not leased and there was no lease in place. They did not advise the Association that the property had been transferred to the attorney via an unrecorded Quitclaim Deed. At one point in time, the attorney represented in writing to the Board that the Owner was still the owner of the property, even though it had been deeded previously. When told there was no lease, the Association did not request information about any other possible reason why the attorney was residing at the property. The Association levied a total of $13,000 in fines against the Owner based on the failure to provide the lease.

The Owner sued the Association alleging harassment and the Association cross-complained to recover the fines and damages for the Owner's failure to produce the lease. Prior to trial, the Owner dismissed its harassment claims and the Association dismissed all of its claims except for $2,000 in fines.

The trial court found that the Owner had a defense to the fines because there was no lease, but the court further found that the Owner had conspired with the attorney or aided the attorney in deceiving the Association. The trial court also found that the attorney had defrauded the Association by stating that the Owners remained the owners when he was the recipient of a quitclaim deed to the property. The court found that Association was entitled to know and had the need to know that the property had been transferred. The court awarded the Association $2,000, declared the Association the prevailing party and awarded $63,910 in attorney fees and costs.

The appellate court reversed the trial court decision, finding that the Association had only sought the lease and had not asked for any other alternative explanation or documentation. The Association offered no authority for the Owner having a duty to disclose the transfer by unrecorded quitclaim deed in the absence of an express request for such disclosure. The parties were ordered to bear their own costs.

4. **Talega Maintenance Corporation v. Standard Pacific Corporation** (2014) 225 Cal. App. 4th 722.

Why significant: Provides guidelines as to when "speech" that occurs at an Association board meeting is not "protected" such that not "all" speech at meetings is protected and inadmissible.

In a growing trend in HOA cases, the anti-SLAPP (strategic lawsuit against public participation) is again a central theme in this construction defect and breach of fiduciary duty case. This statute forms the basis for attacking claims which arise out of certain communications in certain settings that are deemed privileged based on public interest so as to avoid the chilling effect of being sued from exercising free speech rights.

The Associations sued the developer and three former employees of the developer (who had been appointed to the Board by the developer) relative to construction defects in certain trails constructed by the developer in the community. Association alleged that the former directors/employees committed fraud, negligence and breach of fiduciary duty as directors of the Association concerning the developer's obligations to pay for repairs to the trails. The employees filed the anti-SLAPP motion to dismiss claiming that the claims against them arose from protected statements made at HOA board meetings. The trial court denied the motion and the employees appealed the decision. The court of appeal affirmed the trial court's decision.

The alleged protected statements made during an HOA Board meeting concerned what entity was responsible for paying for the maintenance and repair of these trails. The employee directors represented to the rest of the Board and the membership that the Association was responsible for these costs. The Association contended that these statements were false and a breach of fiduciary duty.

The importance of this case is the appellate court's decision to narrowly apply and construe the anti-SLAPP laws and not adopt a general approach that all statements made in an HOA Board meeting necessarily constitute a "public issue" but instead require that the alleged protected speech and statements relate to or involve a public issue, controversy or dispute. In this context, the statements which were the basis for the claims against the developer directors were not properly viewed as a public issue, controversy or dispute that would render them protected.

5. **KB Home Greater Los Angeles, Inc. v. Allstate Insurance** (2014) 168 Cal. Rptr. 3d 142. W

hy significant: This case is significant because it means under the Right to Repair Act, mitigation and repair efforts by owners and associations may necessarily be delayed until notices are given to developers and builders. As a practical matter, it also means that owners and associations are going to be held to a strict standard for compliance with notice

under the Act, even if they weren't aware the loss was caused by a construction defect at the time repairs were started.

This case involved the property insurer of the purchaser of a new home from KB filing a subrogation claim against KB for property damage caused by a water leak in the home. When the leak occurred the owner contacted Allstate, who in turn hired a mitigation/remediation contractor to perform emergency services and repair the damage to the home. After paying for the repairs, Allstate sent KB a notice of its intent to seek recovery of the amounts paid to correct the damage from the defective plumbing pipe which burst. KB did not respond so Allstate filed suit alleging a violation of the Right to Repair Act.

KB argued to the trial court that neither Allstate nor its insured had complied with the notice provisions of the Right to Repair statute which entitled KB to inspect the damage and have an opportunity to propose a repair that it would perform. The trial court rejected that argument based on a decision in the Liberty Mutual case by the California Supreme Court decided in 2013, and the trial court decisions were appealed. That case allowed an insurer to recover from the builder for actual property damages the carrier paid as a result of a construction defect.

The court of appeals ruled that the issue in this case was whether the Act requires notice of a claim under the Act prior to making repairs and indicated that the Liberty Mutual case did not involve that scenario because the builder was given the opportunity to repair. The court of appeals ultimately found that the subrogation claim was barred because Allstate and the insured did not give notice of the claim under the Act until after repairs were completed, thereby denying KB the opportunity to repair.

6. **Seahaus La Jolla Owners Association v. Superior Court** (2014) 224 Cal. App. 4th 754.

Why significant: Clarifies that the attorney-client privilege applies to members of the Association whose "common interests" are protected in a lawsuit for common area defects.

The Association filed a construction defect lawsuit against the developer relative to common area water intrusion problems. The Association's litigation counsel conducted meetings with homeowners to inform them of the status and developments in the case. The developer sought discovery of the information disclosed by counsel to the members of the Association at these meetings and the Association objected that the attorney client privilege applied. The trial court ruled against the Association and the Association appealed.

On appeal, the appellate court looked at the disclosures made in the context of the Davis-Stirling Act obligations owed by an Association to its members and other factors which mandate the involvement of owners in Association members in decisions regarding construction defect actions. The appellate court ultimately concluded that the Association's duties and powers included communications with members, as parties with closely aligned interests. The court further concluded that the litigation meetings were held to accomplish the purpose for which the association lawyers were consulted, including disclosures which the Association was obligated to make. Consequently, the communications at these meetings were deemed privileged and protected under the common interest doctrine.

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