South Coast Homeowners Association

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IN THIS ISSUE

SPRING MEETING VIA ZOOM

Attorney James Perero of Myers, Widders, Gibson, Jones & Feingold, LLP in Ventura will lead what promises to be a lively presentation via Zoom. James' firm has been a South Coast member and supporter for many years. James is active with the Community Association Institute's (CAI), California Legislative Action Committee so he also has insights as to the current thinking of the Legislature. His topics include:

1) **When Enough is Too Much: Enforcement Against Repeat Offenders**

    a. Case study about life-long association resident with decades-long violation history (highlights include dog bite caught on ring camera; fake sexual harassment claim against HOA employee to get HOA to back off; resolved with HOA obtaining negotiated lifetime ban on resident)

2) **When Rowdies Seek Control: Moves and Countermoves**

    a. Dealing with disruptions at board meetings
    b. Protecting HOA manager from harassment
    c. Countering false information campaigns

Date – Monday, June 6, 2022

Time – 1130 AM – 1:00 PM (note that this is a daytime meeting)

The zoom link will be emailed to you on May 31 once you have RSVP'd to Mike Gartzke – gartzke@silcom.com.

ARE YOU ALLOCATING YOUR ASSESSMENTS AMONG YOUR UNITS CORRECTLY?

By: Michael J. Gartzke, CPA

Assessment allocation among units is governed under a section of your CC&Rs. For many associations, assessments are imposed equally upon each unit, especially for those associations that the units are similar in size. In some cases, assessments can be unequal based upon the size of the units or the number of bedrooms, for example. One association that I've worked with allocates assessments based upon the initial ratio of selling price to the total selling price of all the units. In all cases, the formulas for allocating the assessments are found in the CC&Rs.

Another approach to varying assessments is to treat certain expenses as equal to all units such as landscaping, pool, administration and refuse pickup while treating other expenses as variable based upon unit size. Some examples of variable expense could include building insurance, reserves for painting and roofing, water usage within units. In these cases, the CC&Rs would also mandate how the assessments would be allocated.

Recently, I was asked to weigh in on an assessment allocation question for a small association. They were using the variable approach described in the previous paragraph but needed to update their budget for the new year. This association is relatively new and had been using the same budget for several years. When an association is first built, the developer submits a budget to the Department of Real Estate (Form 623) for approval prior to selling the units. In the instructions for Form 623, if the variance is less than 10%, then assessments should be equal. If it computed at greater than 20%, then the assessments should be variable. If in between, then it could be done either way. The association obtained the initial DRE 623 which showed the variable assessment of over 20% in detail and was reasonable in my opinion. This ratio is what the association was using going forward. The DRE 623 is not a governing document but the CC&Rs are.

The CC&R language showed that assessments would be based purely upon the size of the unit without consideration of the calculations from the DRE form. In this association, the units vary substantially in size where the larger units are more than double the size of the smaller units. Since the DRE formula was not in the CC&Rs, the assessments had to be changed to the amounts dictated by the CC&Rs. This meant that the larger units are now paying a lot more while the smaller units are paying less. In order to change the assessment calculation back to the DRE Form calculation, a CC&R amendment, approved by the owners, would be required.

RETURNED CHECKS DURING UNION BANK CHANGEOVER TO PACIFIC WESTERN BANK

(MONITOR YOUR ACCOUNTS REGULARLY AND RECONCILE PROMPTLY AT MONTH-END)

In early October 2021, Union Bank completed the sale and transfer of its Homeowner Association Services Division to Pacific Western Bank, a transaction in process for nearly a year. At that time of the transfer, one of my HOA clients issued me a check which I deposited. A couple days later, my client contacted me to say that several of their checks were not honored by Pacific Western Bank – "unable to locate account". Sure enough, a couple more days later, my bank reversed the deposit and charged the usual NSF fee. No worries, a few days later my client reissued the check which I subsequently deposited. All is well, right?

Not so fast. My client called me a few days later and said that both checks had cleared their account and asked that I refund the duplicate payment. But I had only been credited for the second payment since the first payment had been reversed by my bank as NSF. So what is going on? I checked with my bank to see if somehow both checks cleared and they had placed one is a "suspense" account (didn't know what to do with the credit). Years ago, I had a client who had a $40,000 deposit posted to the bank's suspense account rather than the client account for reasons unknown. It took some sleuthing to find it. But my original check could not be redeposited so my next stop was to Pacific Western Bank.

My contact at Pacific Western could see that their customer's account had been charged twice and I provided them with my bank statement and the returned check document showing I had a net deposit of one check. It took some time for Pacific Western to track down that somehow Union Bank had made an error in charging my client's account for the returned check. So Union Bank had to make an adjustment with Pacific Western Bank so that Pacific Western could credit my client's account and make them whole. All of this took about six weeks to solve.

The takeaway? Don't presume your bank statement is always correct and reconcile your bank accounts promptly. Banks have policies limiting the amount of time you have after month-end to call any error to their attention. Let's hope I was the only one who had this problem with the changeover.

CAN WE BORROW FROM OUR RESERVES ACCOUNT?
(Yes, subject to Civil Code Procedures)

By: Michael J. Gartzke, CPA

The Civil Code imposes several restrictions on the use of association reserve funds. The pertinent sections of the code follow:

5510.
"(a) The signatures of at least two persons, who shall be directors, or one officer who is not a director and one who is a director, shall be required for the withdrawal of moneys from the association's reserve accounts.

(b) The board shall not expend funds designated as reserve funds for any purpose other than the repair, restoration, replacement, or maintenance of, or litigation involving the repair, restoration, replacement, or maintenance of, major components that the association is obligated to repair, restore, replace, or maintain and for which the reserve fund was established.

5515.
(a) Notwithstanding Section 5510, the board may authorize the **temporary transfer** of moneys from a reserve fund to the association's general operating fund to meet short-term cashflow requirements or other expenses, if the board has provided **notice of the intent to consider the transfer in a board meeting notice** provided pursuant to Section 4920.

(b) The notice shall include the reasons the transfer is needed, some of the options for repayment, and whether a special assessment may be considered.

(c) If the board authorizes the transfer, the board shall issue a written finding, recorded in the board's minutes, explaining the reasons that the transfer is needed, and describing when and how the moneys will be repaid to the reserve fund.

(d) **The transferred funds shall be restored to the reserve fund within one year of the date of the initial transfer**, except that the board may, after giving the same notice required for considering a transfer, and, upon making a finding supported by documentation that a temporary delay would be in the best interests of the common interest development, temporarily delay the restoration.

(e) **The board shall exercise prudent fiscal management in maintaining the integrity of the reserve account**, and shall, if necessary, levy a special assessment to recover the full amount of the expended funds within the time limits required by this section. This special assessment is subject to the limitation

imposed by Section 5605. The board may, at its discretion, extend the date the payment on the special assessment is due. Any extension shall not prevent the board from pursuing any legal remedy to enforce the collection of an unpaid special assessment." (End of Civil Code Sections)

CC5510(a) requires the board to make the withdrawal of reserve funds. Your manager is not an officer or director and cannot sign on reserve accounts. CC5510(b) specifies what reserve funds can be used for. Reserves are not used as a slush fund to shore up operating deficits. If you need to restore operating funds, CC5515 governs how funds can be borrowed and how they must be paid back.

Under 5515(a), the board must provide notice to members in a board meeting agenda that they plan to borrow. A common borrowing that can occur is the payment of annual insurance premiums where if paid monthly, the association would incur finance charges. The association will repay the reserve fund 1/12th each month to restore the reserves.

Your regular monthly assessment is composed of the operating assessment and reserve assessment. The reserve assessment, based upon the association's reserve study, should be deposited into the reserve account monthly or regularly. Not funding the reserve account because operating expenses exceeded the budget is the same as borrowing from reserves.

The following are examples of use of reserves without a payback plan from two reviews I performed during 2021.

1) **Failure to fund budgeted reserves –** The association had significant operating costs in excess of the budget for maintenance, landscaping and legal costs of $25,000. Because of the excess expenses, not all the reserve assessments were transferred into the reserve account. Civil Code Section 5605(b) allows the board to impose a special assessment of 5% of 'budgeted gross expenses (annual assessment) without a member vote to meet unforeseen circumstances. The board did not do that. If they had done so, it would have called attention to the issue and raised about $12,000 towards the deficit immedately. The balance should be added to next year's budget as a borrowing payback to restore the reserve account.

2) **Payment of annual insurance premium from reserves/borrowing not recorded or paid back from operating –** The association's management company records all expenditures from the reserve account as a reduction in the reserve equity section of the balance sheet. The expenditures do not appear in an income statement anywhere. No monthly reporting is done of the reserve expenses paid. I've yet to find a colleague who can tell me this is generally accepted accounting principles (GAAP). When I did the review, I had to identify all the funds paid out of the reserve account and classify them on the income statement for disclosure.

There were substantial disbursements from the reserve fund during the year. One of the disbursements was for earthquake insurance. The borrowing was not recorded by the accounting department. The insurance expense did not appear in the operating income statement. It was buried as a reduction in equity on the balance sheet. No repayment to the reserve account was made. The amount of earthquake insurance paid was $480 per unit ($40 per member per month) and this expense is not reflected anywhere. The budget vs. actual comparison statement showed a huge positive variance for insurance. The accounting department did not bring it to anyone's attention. The manager did not notice it when 'reviewing' the reports. None of the board members questioned it when receiving the reports. Given losses in the previous two years, the association had an operating deficit of $1,000 per member ($80 per unit per month) that was not addressed in their budgeting process. It was my doing the review a year later that discovered all these issues.

All parties must be engaged in the financial process. The accounting department must look at the reports they generate. Not just "push the button". A large 5-figure variance is easily recognizable in a budget report. It stands out. Managers must review the reports they receive from accounting to look for the same things and ask questions. These findings must be communicated to the board. Civil Code Section 5500 requires the board to review financial reports monthly. There's no way that anyone would not have noticed the issue simply by looking at the report.

A sample monthly review form along with sample financial reports to review can be found starting on page 10 of our 2019 legal review - https://www.southcoasthoa.org/resources/30th%20Law%20and%20Legeslative%20Update.pdf

IS IT TIME TO CONSIDER CERTIFICATES OF DEPOSIT (CDs) FOR YOUR RESERVE FUNDS?

By: Michael J. Gartzke, CPA

With the recent increases in interest rates by the Federal Reserve to banks, some rate increases have started to flow through to depositors in the form of increased rates on CDs. In the past couple years, rates on CDs have been pitifully low. In some cases, they were as low as "money market" accounts. Some money market accounts have been paying 0.01% - $10 per year on $100,000 on deposit.

Recently, an area stockbroker sent me a rate sheet with rates on new FDIC-Insured CDs that can be purchased within their brokerage account. A number of associations already have brokerage accounts through Schwab, Fidelity, Edward Jones and others. In many cases, all that is invested in these accounts are funds in those ultra-low money market accounts. I checked with a couple of our local banks about their CD rates and did not see much movement yet. Here are some of the rates that he sent me in early May:

Term	Rate	Interest per $100,000 per year
3-month	0.65%	$ 650.00
6-month	1.10%	1,100.00
12-month	1.90%	1,900.00
24-month	2.85%	2,850.00

The money market of 0.01% previously mentioned yields only $10.00. You could consider "laddering" CDs in the account where you put 25% each into 3,6,9,12-month CDs. When the 3-month matures, you can make that one a 1-year CD since the 6-month one only has 3 months to maturity. Eventually, all the CDs would be one year accounts maturing every three months.

PENDING LEGISLATION – AB 1410

This bill has passed the California Assembly and has been sent to the State Senate. As of May 13 no action has been taken by any committee of the Senate. There are committee hearings on pending legislation which sometimes creates amendments, etc. before the entire Senate votes. There are several topics in the bill dealing with HOA operations. Here are a couple of them as stated in the Assembly Staff Analysis.

New Required Training on Fiduciary Ethics and Harassment Prevention: Under this bill directors serving on HOA boards and employees of HOAs would be required to take a course on fiduciary ethics and harassment prevention. While state law requires employers with at least five employees to provide sexual harassment prevention training every two years, no HOA-specific training for harassment or other topics is required for someone to serve as a director on the board of a HOA. Given that boards of directors are tasked with a number of budgetary and financial decisions that affect all homeowners in the CID, a fiduciary ethics course could provide valuable training for board members who may be unfamiliar with current state laws on HOA financial practices. It may be worth considering whether fair housing training should be explicitly included in any required training given that California has a number of different fair housing laws and the Department of Fair Employment and Housing currently publishes a harassment prevention guide for housing providers.

Limiting HOA Ability to Restrict Critical Speech: In addition to the above provisions, this bill would make void and unenforceable any policy which restricts critical discussion about the HOA. While it is unknown whether any HOAs maintain rules that prohibit critical discussion of the association, the author's office reports being aware of at least one California homeowner being found in violation of a HOA policy for posting negative views about their HOA on an online neighborhood message platform. Since HOAs operate under democratic self-governance principles, homeowners who are unhappy with the current state of affairs in their community would face a number of challenges mobilizing to elect new directors or seeking other avenues of policy change if their HOA can restrict all critical discussion. This bill clarifies existing protections on homeowner expression to also explicitly include use of social media or other online resources which may be critical of the association or its governance.

Also included in the bill are sections dealing with enhanced documentation requirements for enforcement actions, limits on HOA enforcement actions during declared emergencies and allowing rentals in owner-occupied homes: For complete text, analyses, votes, etc. go to - https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=202120220AB1410

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