

SOUTH COAST HOMEOWNERS ASSOCIATION

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Newsletter Sponsors

Please join us for our fall meeting as South Coast HOA members Chris Andrews, Reserve Specialist of Stone Mountain Corporation and Michael J. Gartzke, CPA will discuss current topics relating to association finances. Among the topics that will be covered:

- 1) Is 100% reserve funding mandatory or even necessary?
- 2) Pending legislation regarding association annual disclosures
- 3) Trends in association expenses
- 4) Updates on Association Financial Statistics
- 5) And More!

Date/Time – Tuesday, September 29, 2009 – 7 PM

Place - Encina Royale Clubhouse

250 Moreton Bay Lane, Goleta

RESERVE FUNDING IN TOUGH ECONOMIC TIMES... How Not to Waste Your Association's Money

Chris Andrews, Reserve Specialist
Stone Mountain Corporation

Has anyone noticed that “*common sense*” doesn't seem to be so common anymore?

If you've ever served on the board of directors for a homeowners' association for any period of time, you have no doubt seen your association's money wasted occasionally as a result of foolish decisions.

Following are some suggestions on how to be smart with your association's money during these tough economic times:

- ◆ Unnecessary projects –Board members have often spent scarce reserve funds on seemingly frivolous aesthetic improvements when their association needed that money in the next few years for key infrastructure projects such as plumbing and sewer failures. In order to ensure that key funds are not spent for the wrong things, build a consensus as to which capital expense items are considered “Mission Critical” (e.g. roofing, plumbing, fire alarm systems) and which items are optional (lobby remodels, pool restroom renovation, landscape additions). Make a list and establish priorities. For items that are contentious like whether or not to do a lobby remodel, consider special-assessing for them and bringing the assessment to the community for vote. Tying an optional expense item to real out-of-pocket dollars for the homeowners is a healthy reality check because it puts that expense into perspective rather than quietly funding it out of the reserve fund.
- ◆ Don't do things the same way because “*that's the way we've always done it.*” Whenever a new project comes up, always solicit input as to what is the best contemporary way to solve the problem. For example, 10 years ago, most pools were being resurfaced with plaster. Now, there are sophisticated fiberglass bonding techniques that allow a chemically inert fiberglass surface to be installed in most pools that lasts much longer and is easier to clean.
- ◆ Use smart construction – Many associations are intelligently choosing new construction methods that reduce costs in the future. For example replacing decking with Trex (long-lasting plastic-wood that doesn't crack or splinter and doesn't need painting). Or replacing siding with cementitious-fibrous Hardieboard or Certainteed siding that substantially extends the paint cycle. A paint-impregnated Certainteed product has a 25-year paint cycle as compared to a 5-7 year cycle for T1-11 (plywood) siding.
- ◆ Establish logical replacement criteria to be used to determine when to replace common area assets.

For example, one unit owner's severely cracked concrete driveway is replaced. Then a neighbor demands that their concrete driveway with minor cracks needs to be replaced in the name of so-called “fairness.” Many weak Boards succumb to this pressure and

blow another \$4,000-\$6,000 on tearing out a completely functional driveway just for a few cracks. For driveway replacement, I usually recommend a three-point set of replacement criteria for the board to evaluate:

- 1) Does the driveway serve its function as a paved surface (e.g. can you drive on it and park there without having to step out of your car into a pothole)?
- 2) Are there any liability hazards that would put the HOA at risk such as trip & fall uplifted sections or potholes?
- 3) Aesthetics – Is the driveway significantly cracked such that it is such an eyesore that it lowers property values and aesthetic appeal of the home?

For most marginally damaged paving, when those three criteria are reviewed, board members often realize that the driveway serves its function as a paved surface and there are no liability issues. So the decision to replace the driveway usually hinges on the subjective issue of aesthetics. Some HOA members insist their driveway needs to be replaced just because of a single 1/8" crack running across the driveway with no uplift. This can be remedied by epoxy-concrete injection and will look satisfactory. Visit the US Post Office - Patterson Avenue office (Santa Barbara/Goleta) concrete entry driveway and look at their concrete crack repair as an example.

Once a Board adopts a stringent set of replacement criteria and has the confidence to hold the line against demanding homeowners, money will be saved for all owners.

- ◆ Construction project management professionals oversee projects and can make the job run smoothly and ensure work is done correctly. A good construction manager can save the association a lot of money by ensuring things are done right the first time. In other cases, they can add considerably to the cost of a project when a knowledgeable homeowner (e.g. a retired contractor) can provide similar oversight for smaller projects where liability isn't a concern. Because their fee is usually based on a percentage of the total cost of the project, there is essentially a monetary reward for running up the cost of the project for the HOA instead of trying to efficiently use your money. Some client HOA's have expressed this concern about their construction management firm. With construction management professionals, proceed with care and be sure to check their references. The benefits of their services can be either compelling or disastrous.
- ◆ Participate with your property manager in the bidding process. Property Managers usually have their own list of contractors they know to be reliable and who presumably have all the proper worker's comp and liability coverage to work on HOA's. Often they get good pricing for you because of the volume of work they provide their contractors. But if you have time to shop around for bids for your own association, you might be able to find lower bids. Sometimes property managers appreciate the fact that you are taking the time to get good cost estimates, provided they are bid to the proper specs and thus don't cause more confusion than necessary. Be sure to get bids from contractors who have worker's compensation and proper condo liability insurance and a good reputation.
- ◆ Relax standards on uniformity where possible. One of the aesthetic virtues of associations is they are usually designed with architectural uniformity in mind. That way you don't see a mish-mash of colors and construction materials that look gaudy. However, because of this, a lot of waste can occur. For example, with garage door replacement, many HOA's have thrown away perfectly good garage doors because only about 40% of them are failing. So 60% of the good garage doors go to the landfill – a

tragic waste of capital assets. If your HOA is low on funds, where it makes sense to do so, consider replacing only the garage doors that are failing and live with the slightly degraded architectural uniformity for a few years while your association saves money to replace the rest. As another example, if your HOA is short on reserve funds and needs to paint the residences, consider phasing the painting over one or more years and only address those buildings that are in dire need of painting.

- ◆ Close analysis of your reserve study. Work with your reserve specialist to determine what is the most optimal way to use your funds over time. 30-Year Cash Flow Optimization techniques are a very effective way to lay out your reserve funding plan. Always be concerned about how to most efficiently use your capital! For example:

1) Can you postpone an optional expense (remodeling the clubhouse) to occur a year or two after a forthcoming mandatory expense such as a major re-roofing project? This usually results in more efficient use of your money and a “smoother” reserve funding curve over time.

2) Are you doing some capital expense projects too frequently (asphalt sealcoating every 1-2 years, painting trim every 4-5 years when it could be 6-7 years)? Some people paint wood trim on fascia & eaves every 5-6 years, but if the color is white, it may not need painting as frequently as a dark brown trim because white trim paint lasts longer than darker colors. Furthermore, do you really need to always paint the underside of your eaves as frequently as you paint all your other exposed wood trim? Eaves can often be simply pressure washed each trim paint cycle and then painted only every two or three fascia trim paint cycles.

3) Stucco painting – most people think stucco should be painted more often than it really needs to be painted. Entire buildings are often painted simply because there are some mildewed sections of the architecture (for example parapet walls and lower 18” mud-stained “splash zones”). Sometimes you can pressure-wash the stucco and it cleans up nicely, thus saving considerable amount of money that was allocated for stucco painting. Color-coat stucco has the paint pigment in the finish coat of mortar, so it can go a long time without painting. On stucco walls with good eave overhang protection, dusty spider webs are often the main reason why appearance gets degraded, but these also respond well to a simple pressure-wash.

4) Roofing – Do preventative roof maintenance. Putting a coat of mastic around roof pipe vents every 5-7 years will pay off in the long run as pipe vent mastic usually develops cracks and can leak. A preventative maintenance roof walk by a contractor will locate problem areas in the roof which can be addressed. The longer roof leaks are allowed to fester, the more costly the dryrot and/or mold remediation will be later.

5) Trees & Hardscapes –Cracked areas in your paving should be evaluated annually to determine the cause of cracks and if they’re getting worse. On the edges of asphalt and sidewalks near landscaping look for cracks that indicate root damage is beginning. Usually the crack points in the direction of the tree whose roots are causing the problem. Become proactive about these crack problems early before they result in costly paving replacement expense by installing root barriers. Survey all your paved surfaces and make a list of locations needing root barriers. It’s a lot cheaper to install root barriers now than have ruined paved surfaces with trip-and-fall hazards that could be a future lawsuit. It is astonishing how many HOA developers and subsequent HOA Boards have unwittingly planted the wrong tree types in the wrong locations (e.g. invasive-rooted tree

species planted right next to streets, tennis courts, pool decks, walkways, and directly over sewer laterals).

6) Regular Inspection of the premises – Every year or so, conduct a site walk-around to look for problem areas and establish a checklist of items to address proactively.

Finally – preventative maintenance is worth its weight in gold. If you are *proactive instead of reactive*, you'll have one of the better-maintained associations with a healthy reserve account. When an association is well-funded and well-maintained, the community spirit is so much better than if people are continually squabbling over finances and complaining about maintenance issues.

FDIC INSURANCE UPDATE AND INSURED ASSOCIATION FUNDS

By: Michael J. Gartzke, CPA

Thanks to South Coast member First Bank & Trust as well as a couple of other members, we've learned that the FDIC insurance limit of \$250,000 per financial institution which was put in place in 2008 has been extended until December 31, 2013. The limit was scheduled to revert back to the original \$100,000 limit at the end of 2009. The higher limit reduces the number of banks and/or bank accounts that some larger associations have to deal with in managing their reserves and operating cash and maintaining complete FDIC insurance on all the association funds.

As I have been completing financial statement reviews for 2008, I have noted the steep decline in interest earnings on association funds. Yields on brokerage money market (Fidelity, Schwab, etc.) accounts have been especially hard hit. While reviewing a 2008 financial statement, I noted one of my clients was invested in the Fidelity Treasury Money Market Fund. This fund invests in US Treasury bonds only. The current yield on this fund is 0.01%. Put another way, if you have \$100,000 invested in this fund, it will pay you \$10 (ten) per year. The association's board has told the manager that they want all their reserve funds placed in Treasuries as these are the safest investment available, more secure than bank certificates of deposit insured by the FDIC. The statement below is taken verbatim from the Fidelity Treasury Money Market Fund web page.

An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although a money market fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the fund.

So it is possible, that if the expenses of managing this fund exceed the income generated from the Treasury bond investments and Fidelity doesn't cover the fund's expenses, the principal is at risk, even in a Treasury money market fund. Principal is only guaranteed by owning the actual Treasury bill or note and then holding it to maturity.

BOOKS FOR SALE AT SOUTH COAST HOA

We have a number of the *2009 Condominium Bluebooks* in stock – Now \$10/each – a \$13 savings – tax and postage included. Consider having copies for your entire board and/or your association's reference library.

REVISITING "GOOD STANDING" - WHY IS IT IMPORTANT?

By: **Beth A. Grimm, Attorney at Law**

Editor's Note: When I review financial statements as an association's CPA, I look to see who owes the association past due assessments. Accounting standards require that amounts due the association from officers, directors and employees be segregated (if material) and disclosed separately from other amounts owed. While relatively rare in my practice, I have seen some cases in recent weeks where association officers owe the association significant amounts of assessments. In one instance, an association officer has not paid her assessment in 2 years, currently owing the association over \$8,000. It was not clear what collection action the association had taken with respect to this officer's delinquent assessments. In another instance, multiple board members from another association directed their bookkeeper not to impose collection costs on delinquent homeowners (including themselves) because the board members "do not consider a homeowner being in default of their dues to be a CC&R violation". Yet these board members expect that all other members pay their assessments to operate and maintain the association. I started to look for an article that addressed the subject of board member responsibility and maintaining "good standing" with the association and found that Beth Grimm (a frequent South Coast contributor) had written on the subject for her website www.californiacondoguru.com a couple years ago. I asked her permission to use the article and she updated it for us.

I did a blog essentially similar to this in October 2007. I was recently asked if a group could republish it. There is quite a bit of confusion and misunderstanding about these terms, and when they can be asserted to prevent someone from serving on the board, and when they can be used to prevent an owner from participating in association elections.

So here goes, I am revisiting the topic.

What does "good standing" mean and why would anyone like or dislike it?

These are my thoughts on the subject - unless the Association documents otherwise describe the terms, "Good standing" means **current with regard to payments** of assessments and outstanding delinquencies, late charges and interest, and collection costs, **and not in violation of any governing document provisions**, including the CC&Rs and Rules.

A "good standing" requirement is great - for board member service. If the Bylaws or CC&Rs provide for it, meaning if they say that a board candidate or director must be in good standing to serve on the board, it assures that the Board sets a good example for the membership and respects the obligations of the governing documents. If (but only if) the documents contain a "good standing" requirement for candidacy or service on the Board, a Director who does not qualify or falls out of "good standing" can be "ousted" from their position, through a process commonly called something akin to "vacating the director position". That is not the same as "removal" or "recall" (because that requires a membership vote in most cases) but if the documents allow for the process, then it means the Board can essentially "unseat" a board

member from their position and, if the documents do not prevent it, appoint another to serve in their place. Hearing requirements are pertinent (see more on this below).

As to voting, it is my belief that requiring **members** to be in "good standing" to be allowed to vote complicates elections and due process procedures within the community. Generally, my experience indicates that members who violate the regulations or fail to pay assessments don't care if their voting privileges are revoked (and generally don't even bother to return ballots - although they may attend meetings just to stir up issues). However, I have seen situations where important measures are before the community and a sizable contingent of the community that is in violation of some requirement wants to vote it down, just because (because the members do not agree with anything the board does in some cases). In that scenario, it might make sense to have the right to deny the recalcitrant members the right to vote. Likewise, if a member is disrupting meetings, then **having the right to suspend them from meetings** based on lack of good standing (not a common provision in documents however) could also be important.

These methods suggest that attorney advice is warranted if you are considering these steps (in other words, don't try this at home without the advice of a knowledgeable and HOA or Condo experienced attorney!).

All of the above leads to the question about what "due process" is required before an association board can impose the good standing requirement to disenfranchise members. Some documents do say that members of the association lose voting rights if they are behind in their assessment payments. That may be appropriate for "automatic" discounting the votes, but I do not like it. Other documents allow boards to suspend voting rights if a member is behind in their assessments or in violation of the rules or CC&Rs. Well and good - it would be my position that a hearing must be offered before the Board could suspend rights to vote on these bases. Why do I believe this? Because I have seen too many cases where owners have been taken by surprise, even blindsided, by these requirements in a contentious election. In some cases, the Board never imposed the sanctions in any previous election. In some cases, they have initiated the procedures after the election commenced, and sometimes, the facts lead to the obvious ... i.e., that the Board used the suspension or rights to throw an election. And that, of course, is devious and questionable, reprehensible, and, I should think, legally actionable.

As for suspending rights to use of the Association facilities for lack of "good standing", it may work well as a deterrent to abhorrent conduct, such as in the case of pool, laundry room, or clubhouse use. In other words, if a member (or by delegation his or her tenant) must be in "good standing" to use the association facilities, bad conduct may be minimized. A violation of the pool or other facility rules is a violation of the governing documents. And this is a remedy that may be enforceable against the tenants, whereby most other remedies are only enforceable against the owner, even for tenant conduct.

As a recap, suspension of membership rights for failure of "good standing" can be useful, but it can also be misused. Some boards apply the "good standing" requirement only sporadically, inconsistently, or to exert control in the face of controversial issues (sometimes just to keep members from voting who they don't like, or to keep people out of the pool that they do not like). In the course of using the "good standing" remedy, Boards may fail to provide owners with adequate notice and a hearing (required for such disciplinary actions). That conduct could be found to be improper on the part of the Board.

AN ASSOCIATION CALENDAR

Many association activities and deadlines occur on an annual or more frequent basis and are spread throughout the year. You can establish a calendar to keep track of all these activities and use it as a reminder to stay on track. It's easy to overlook something. You can look at the following list, add your own items, and then set up each month with its own list of tasks and then review it continually to adequately plan.

Maintenance:

- Fire extinguisher maintenance
- Tree trimming
- New plants
- Irrigation system service
- Turn on/off sprinkler systems
- Weed Abatement
- Pest Control spray
- Pool shutdown for winter
- Elevator and pool Inspections
- Backflow device inspections
- Board walkarounds to assess maintenance needs
- Annual community cleanup dumpster pickup
- Contract review for service providers

Administrative:

- Dates for board meetings (properly post advance notice of meetings)
- Deadline for agenda items for board meetings
- Nominations for board prior to annual meeting
- Annual meeting
- Mailing of annual budget and disclosure packet
- Social events
- Attend Board Training (South Coast Homeowners Association meetings!)
- Renewal of insurance policies
- Filing of Secretary of State Statements of Information and CID form
- Association newsletter
- Minutes distribution
- Member billing and Late Notices
- Web site renewal

Financial:

- Reserve study preparation or update
- Operating budget development
- 1099 filings for contract services – due January 31
- California DE542 Contractor Filings
- Income Tax Filings – 2 ½ months after year-end (can extend)
- Estimated Federal and California Tax Payments
- Annual Financial Report
- Annual Accountant's Review if revenues exceed \$75,000

Payroll tax reports/W2s for employees
Workers compensation wage reports

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