SOUTH COAST HOMEOWNERS ASSOCIATION

P. O. BOX 1052, GOLETA, CALIFORNIA 93116
(805) 964-7806
www.southcoasthoa.org
gartzke@silcom.com

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Michael J. Gartzke, CPA, Editor

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2009 MEMBERSHIP INVOICES SENT

In the past few days, your 2009 membership invoice was mailed to the same address that we mail your newsletter. Please forward to your Treasurer, bookkeeper or management company for prompt payment. For payments received by December 20, 2008, you may deduct a 50% discount from the $60 annual dues so your net cost is only $30. Your membership will include one copy of the *2009 Condominium Bluebook*, once it has been received from the publisher, usually in January.

Professional members can also purchase a listing at the back of our newsletter for an additional $80. The listing will appear in all newsletters issued during 2009 plus appear on the sponsor page on our website – www.southcoasthoa.org.

I appreciate your prompt dues payments as it allows for a more efficient use of volunteer labor in making dues deposit and mailing out the books. Hopefully, a 50% discount will assist in that effort.

ANNUAL DISCLOSURES TO BE SENT WITH BUDGET - 2009

Many calendar-year associations are developing their 2009 budgets right now. In addition to the "numbers", the California Civil Code requires that homeowner associations, no matter how large or small, make the following disclosures on an annual basis to their members.

GENERAL DISCLOSURES

1) **Right to receive board and membership meeting minutes** – Disclose how minutes are provided. Some associations send them out automatically; others only on request. Whether they are available by mail, email or association website – Civil Code (CC) 1363.05(e).

2) **Schedule of Monetary Penalties (Fines) –** Required to be distributed whenever changes are made by the association. Many associations will distribute annually. CC 1363(g)

3) **Notice of Requirements for Association Approval of Physical Changes to Property –** The notice shall describe the types of changes that require association approval and shall include a copy of the procedure used to review and approve or disapprove a proposed change. CC 1378(g)

4) **Annual Distribution of Summary of Alternative Dispute Resolution (ADR) Procedures –** Describes what procedures the Association uses to resolve disputes including its internal dispute resolution (IDR) process. Specific language to use is in the law. CC 1369.590 and CC 1363.850.

5) **Insurance Coverage Information –** Disclosures include the name of the insurer, type of insurance, policy limits, and deductibles and a specific disclosure statement from the code. This also needs to be provided if there is a major change during the year. CC 1365(f)

6) **Notice of Right to Receive Annual Financial Report –** Corp Code 8321(a)

ASSESSMENTS AND COLLECTIONS

7) **Notice of Assessment Increase** – CC 1366(d)

8) **Notice of Right to Provide Secondary Address for Collection Notices** – A member has the right to provide a second address (such as a family member, "snowbird" address, property manager, etc.) for any delinquent assessment notices to be sent to. The member must provide this in writing., CC 1367.1(k)

9) **Assessment Collection Policy –** A statement describing the policies and practices in enforcing lien rights for default of payment of assessments (e.g. late fees, pre-lien notification, etc.) CC 1365(e)

10) **Distribution of Written Notice of Assessments, Foreclosure and Payment Plans –** Specific statutory language in the Civil Code which describes the rights and responsibilities of members and the Association – CC 1365.1

BUDGET AND RESERVE DISCLOSURES

11) **Proforma Operating Budget** - CC 1365(a)

a) Estimated Revenues and Expenses on an Accrual Basis

b) Summary of Association Reserves based upon the most recent study (CC1365.5) based only on cash or cash equivalent assets which will include:

i. Estimated useful life of each reserve component
ii. Estimated remaining life of each reserve component
iii. Estimated replacement cost of each reserve component
iv. Current estimate of the amount of cash reserves needed to repair, replace, restore or maintain the reserve components at year-end
v. Current amount of reserve cash at year-end
vi. An accounting of any construction defect settlement funds received and disbursed
vii. Reserves Percent Funded – item v. above divided by item iv.
viii. The current deficiency in reserve funding if less than 100% funded shown on a per unit basis. For example, if the association should have $200,000 in reserves and it has only $60,000 in reserves, then it is 30% funded (60 divided by 200). If there are 40 units in the association, then the per unit deficiency is $3,500. ($200,000 minus $60,000 = $140,000 divided by 40 units)

c) Whether the board has determined that it will defer or not undertake repairs or replacement of any major component with less than a 30-year remaining life and why that decision was made.

d) Whether the board has determined or anticipates that one or more special assessments will be required in the future to meet the reserve funding plan adopted by the board pursuant to CC 1365.5(e)(5)

e) How the association will fund reserves – monthly assessments, special assessments, borrowing, sale of association property, deferring repairs, etc.

f) If the association has any outstanding loans, disclosing the lender, interest rate, principal balance, annual payments and the due date of the note.

g) A description of the procedures used in calculating and establishing the reserve fund requirements including a "straight line" calculation of reserve funds needed (see section b) viii on previous page. If investment income is included in the calculation, the rate of interest cannot exceed 2% of the San Francisco Federal Reserve discount rate. As of September 19, 2008, that rate is 2.25% which means that the highest rate of return that can be used in a current reserve study is 4.25%.

12) **Summary of Reserve Funding Plan –** CC 1365.5(e)(5) – Effective January 1, 2009, a summary of the reserve funding plan is required to be included in the budget with a disclosure that the full reserve study plan is available upon request of a member. Over the next 30 years, the plan shall include a schedule of the date and the amount of any change in regular or special assessments that would be needed to sufficiently fund the reserve plan. The plan must be adopted by the board at an open meeting. Any increase in assessments shall be approved by the board as allowed by CC 1366. (20% per year maximum increase unless an emergency, court order or approved by the members)

13) **Assessment and Reserve Funding Disclosure Summary –** CC 1365.2.5 – The text for this disclosure is found directly in the Civil Code. The Required disclosures include:

a) Current Regular Assessment

b) Any additional or special assessments that have been approved by the board of directors

c) Will currently projected reserve account balances be sufficient at the end of each year to meet the association's obligation for repair/replacement of major components during the next 30 years?

d) If not, what assessments would be necessary to ensure that sufficient reserve funds will be available each year for the next 30 years that have not yet been approved by the board or the members

e) All major components are included in the calculations

f) Estimated amount required in the reserves at year-end

g) Who prepared reserve study and when

h) Project reserve cash balance at year-end

i) Percent reserves funded

j) Alternative calculation method, if not straight-line (e.g. pooling)

k) Estimated amount required in the reserve fund at the end of the next five years based upon current assessments

l) Estimates are subject to change

m) Additional information can be included

14) Right to Inspect and Copy Association Records – Is not a required annual disclosure

2008 CALIFORNIA LEGISLATION – PASS OR VETO

A remarkable amount of HOA legislation was passed by the Legislature at the end of this session. Even more remarkable, the governor vetoed most of it.

AB 567 – Common Interest Development Bureau – This bill would authorize the establishment of a state CID Bureau to provide educational opportunities, a website and toll-free number to field questions. The bureau would be funded from fees levied upon homeowners associations. The initial fee would be $10/unit, every 2 years. A 50-unit association would pay the state $500 once every two years. **VETO**

AB 952 – Assessment Payment Plans – This bill would require the board and an owner to meet and discuss the reasons why a payment plan is needed, if the owner requests a payment plan. The association would have 45 days to provide a payment plan in writing if the evidence warrants it. The payment plan could last no more than 3 years. Lien enforcement procedures would be suspended if payments are made as required. Reasonable fees to administer the plan are allowed. **VETO**

AB 1892 – Solar Energy Installations – Would void any CC&R prohibition or restrictions with respect to solar energy systems – **Chaptered – now law**

AB 1955 – Variable Assessments – Would prohibit associations from levying assessments based upon the taxable value of the property unless it was being done before December 31, 2008 – limited applicability **VETO**

AB 2259 – Rental Restrictions – Would not allow rental restrictions enacted by HOA members after January 1, 2009 to apply to any owner who owned their separate interest prior to the date the rental restriction passed. Would also require owner to provide name and contact information to the HOA about his tenants. **VETO**

AB 2806 – Board Member Education – Would require that all board members and candidates for the board disclose to the HOA members whether they have taken a course in Community Association law and when they took the course. It would be effective in 2010, if passed. **VETO**

AB 2846 – Small Claims Court Disputes – Would expand the options available to an owner in a monetary dispute with the Association to pay under protest and seek relief via Small Claims Court. **Chaptered – now law**

SB 127 – Transfer Disclosures – Requires that necessary disclosures be made within 20 days of the execution of the purchase agreement or the opening of escrow, whichever is later. **VETO**

SB 1511 – Defaults/Foreclosures – Would require lenders and trustees to inform the association of new owners who have taken a separate interest as a result of foreclosure or other transfer of title. – **Chaptered – now law**

Further information on these bills can be found at www.leginfo.ca.gov. We will be discussing those bills that are signed at our annual law and legislative update meeting early next year.

BARBEQUE BAN
Courtesy of the Executive Council of Homeowners (ECHO)

Editor's Note: As I read board minutes as part of the accounting review services that I provide associations, I have noted on numerous occasions problems that some associations have with barbeques, especially those with decks or in close quarters. Some associations have passed rules limiting or banning barbeque use with varying degrees of success. If this is an issue in your association, citing the California Fire Code may put more teeth in any regulation of barbeques. Thanks to our colleagues at ECHO for this information. Their contact information appears at the end of the newsletter.

In 2007, California updated its Fire Code and adopted portions of the 2006 International Fire Code including sections 308.3.1 and 308.3.1.1. These sections effectively ban the use of open-flame cooking devices on combustible decks. The ban became effective January 1, 2008. The sections read as follows:

308.3.1 Open Flame Cooking Devices – Charcoal burners and other open-flame cooking devices shall not be operated on combustible balconies within 10 feet of combustible construction.

Exceptions:

1. One- and two-family dwellings
2. Where buildings, balconies and decks are protected by an automatic sprinkler system.

308.3.1.1 Liquefied Petroleum gas-fueled cooking devices – LP gas burners having an LP-gas container with a water capacity greater than 2.5 pounds (nominal 1 pound LP-gas capacity) shall not be located on combustible balconies or within 10 feet of combustible construction.

Exception: One and two-family dwellings

Associations may want to consider modifying their rules to conform to the updated code. In addition, you may want to contact your insurance agent to find out what impact, if any, this will have on Association insurance coverage.

FDIC UPDATE

To follow up on our earlier article about FDIC insured accounts, the Federal "bailout" legislation temporarily increased FDIC insurance per depositor to $250,000 until December 31, 2009. This allows associations with more than $100,000 at an FDIC insured bank to have insurance up to $250,000. Under the current regulations, however, the insurance limit is scheduled to revert to $100,000 on January 1, 2010. If you purchase a CD with a maturity date after 2009, you will only be insured up to $100,000 per depositor starting in 2010. Some banks have been offering longer-term CDs with maturity dates after 2009. Best course of action – stay with the $100,000 limit.

RAVEN'S COVE TOWNHOMES, INC. VS. KNUPPE DEVELOPMENT CO. (1981) 114 Cal.App.3d 783

Editor's Note: What follows is a summary of a California court case from 1981. This case precedes the enactment of the Davis-Stirling Act by three years and sheds light on the thinking a generation ago about the responsibility and fiduciary duty of an association's board of directors with respect to its finances. I have cited the case frequently in South Coast programs dealing with reserve funding.

BACKGROUND: As noted in the court's ruling, this association is fairly typical –

"The association is a nonprofit corporation whose members are the owners of 65 townhomes in the Raven's Cove development in Alameda, California. In November 1972, defendants James and Barbara Knuppe, the sole owners of the Knuppe Development Company, Inc. conveyed the common areas and facilities in fee simple to the Association. The Developer had been in the residential home building business for over 18 years and had built about 3,000 units, including several townhome developments, before Raven's Cove. The Association was incorporated on November 1, 1972. In August 1973, the Developer recorded its grant deed to the common areas to the Association. By October 1973, construction had been substantially completed and sales commenced. Until May of 1974, when it was turned over to the homeowners, the Association was under the control of the Knuppes, who could not recall any functions that they performed, other than the signing of the Association's bylaws as officers.

"The association holds title to the common areas, including nearly two acres of lawns and shrubbery and landscaped areas. The association also is responsible for maintenance and repairs of the roofs and siding of the individual units, the common areas, and has the responsibility of assessing and collecting dues from the homeowners to establish: 1) an operating fund to pay current costs of upkeep, payment of water bills, and the cost of landscape personnel; 2) **a replacement reserve fund for major costs, such as painting exterior surfaces of the individual units, replacement of roofs and major private street repairs.** (*emphasis added*). Replacement reserves have to be accumulated because the Association: 1) cannot assess its members a sufficient amount in a short period of time to pay for the work and materials required for major repairs and improvements; 2) cannot borrow funds for this purpose as the result of the nature of its assets. **No reserve or operating funds were ever established or turned over to the Association."** (*emphasis added*).

The opinion then describes the various defects in the landscaping, soil and drainage problems, and irrigation systems. The builder did not paint the siding and used ungalvanized nails in the trim resulting in premature deterioration. The lawsuit was brought to correct the construction defects previously noted and to cure the **breach of fiduciary duties by the initial Association directors for failing to establish an adequate reserve fund.**

The ruling continues. "The record indicates that the developer paid the ordinary costs of maintenance until the Association was turned over to the homeowners after the last unit was sold in May 1974….the Developer and its employees totally controlled the Association until May 1974…all directors of the Association were either the owners or employees of the

Developer. As a result of its prior experience, the Developer had learned that it was unwise to turn an association to “inexperienced homebuyers” and “expect them to run a business”. Accordingly, the Developer recommended a professional manager who was employed on the night that the homeowners first were elected to the board of the Association. Six months later, the homeowners’ board independently selected and employed a new manager. The new manager had to sue to obtain the Association’s financial records from the former manager.

“As indicated above, in 1974, no reserve or operating funds had been created; thus, none were turned over to the Association. As a result, the homeowners had to vote a dues increase for operating costs only. Thus, no funds were available to be set aside for reserves, although in one instance $35 had been set aside in escrow for this purpose. Generally, maintenance reserves are set aside for the purpose of roof replacement, painting and long-term maintenance, and the reserve fund is ordinarily commenced with the conveyance of the common area. At Raven's Cove, the conveyance of the common area occurred in 1973 simultaneously with the sale of the first unit.

“The Developer here knew that the bay front exposure of Raven's Cove created particular maintenance problems as to the paint and exterior trim which were the result of severe wind and salt spray exposure of the site. A replacement reserve is a portion of the overall operating budget; in preparing it, the components of the operating budget are used to consider "all those things that will wear out, fall apart, need to be replaced or repaired substantially.

“Each purchaser at Raven's Cove received copies of the Association's articles and the 1972 estimated operating budget, which set forth a contingency fund comprised of $28-$30 per unit per month. The Association's expert testified that $10 per unit would have been a more reasonable initial replacement reserve budget; by the time of trial, the assessment should have been $15 a month per unit.

“The record indicates that pursuant to the declaration of covenants, conditions and restrictions signed by the Developer and each homeowner at the time of purchase, monthly assessments were to start with the conveyance of the common areas to the Association. Necessarily, at the time of purchase, Raven's Cove homeowners bought as yet uncompleted landscaped units.

“The parties have not cited, and our research has not disclosed, any specific authority in this state. Nevertheless, **it is well settled that directors of nonprofit corporations are fiduciaries.** The statutory provisions here applicable are former Corporations Code section 9002, which provided that the provisions of the general corporations law were applicable to nonprofit corporations. The pertinent provision was former general Corporations Code section 820, which **required directors and officers to "exercise their powers in good faith, and with a view to the interests of the corporation."**

THE FINDING

"We conclude that since the Association's original directors (comprised of the owners of the Developer and the Developer's employees) admittedly failed to exercise their supervisory and managerial responsibilities to assess each unit for an adequate reserve fund and acted with a conflict of interest, they abdicated their obligation as initial directors of the Association to establish such a fund for the purposes of maintenance and repair. Thus, the individual initial directors are liable to the Association for breach of basic fiduciary duties of acting in good faith and exercising basic duties of good management." (emphasis added)

COMMENTARY: So while the Davis-Stirling Act does not specifically mandate the funding of reserves or a certain amount of reserves (yet), this California Appellate case from 27 years ago held the developer's board liable for failure to fund reserves because the developer knew that major repair and replacement expenses would occur in the future and that funds should be set aside on a current basis to meet these expenses. Should owner-elected boards be held to the same level of fiduciary duty or a lesser level? I don't see how different boards could be held to different standards. Especially with all that has been published over the past 25 years on the subject.

We know that associations that have substantial common area will incur major expenses at irregular intervals. In South Santa Barbara County, half of the associations are over 30 years old (source: South Coast HOA 2003 Member Survey). Boards that have knowledge of these expenses from their prior history, DRE budgets, subsequent reserve studies, consultation with industry professionals, etc. should make the effort to fund reserves in to meet the Civil Code requirement of Section 1366 – "the association shall levy regular and special assessments sufficient to perform its obligations under the governing documents…".

Many boards are under political pressure from their members to limit assessment increases or keep assessments the same. Some members do not believe that they have any responsibility for funding future major and repairs on a current basis. Some boards will consider reducing reserve funding or using reserves to meet unavoidable increases in operating costs. Some associations will simply transfer into their reserve account whatever money is left over each month, if any. Boards need to use the documentation such as this case to stand up to this pressure and perform their fiduciary duties responsibly.

BOOKS FOR SALE AT SOUTH COAST HOA

We have a limited number of the *2008 Condominium Bluebook* remaining in stock – Regularly $18/each **now only $10/each** until they are gone.

In addition, we have a few copies left of the *Condo Owners Answer Book* by attorney Beth Grimm. A copy was distributed to each association and professional member in July. These are available for $18/each tax and postpaid.

SOUTH COAST NEWSLETTER SPONSORS

ACCOUNTANTS

Vogel & Ayres
Gary Vogel, CPA
4587 Telephone Rd #209
Ventura, CA 93003
805-642-4658

Michael J. Gartzke, CPA
5669 Calle Real #A
Goleta, CA 93117
805-964-7806

James L. Hayes, CPA
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805-937-5637

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805-562-8482
www.mcfarlandfinancial.com

ATTORNEYS

Beth A. Grimm
www.californiacondoguru.com
3478 Buskirk #1000
Pleasant Hill, CA 94523
925-746-7177

James H. Smith
Grokenberger & Smith
1004 Santa Barbara St.
Santa Barbara, CA 93101
805-965-7746

David A. Loewenthal
Loewenthal, Hillshafer & Rosen
15260 Ventura Blvd #1400
Sherman Oaks, CA 91403
866-474-5529

Attorneys (Cont)

Steven McGuire
Price, Postel & Parma
200 East Carrillo, Suite 400
Santa Barbara, CA 93101
805-962-0011

FINANCIAL SERVICES

First Bank Association Services
Judy Remley/Linda White
2797 Agoura Rd
Westlake Village, CA 91361
888-539-9616

ASSOCIATION MANAGEMENT

Sandra G. Foehl, CCAM
P. O. Box 8152
Goleta, CA 93116
805-968-3435

Brenda D. Wilson CCAM
P. O. Box 6882
Santa Barbara, CA 93160
805-692-4901

St. John & Associates
Kristin St. John
P. O. Box 6656
Santa Barbara, CA 93160
805-683-1793

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Goleta, CA 93117
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805-895-2207

ORGANIZATIONS

Community Associations Institute –
Channel Islands Chapter
P. O. Box 3575
Ventura, CA 93006
805-658-1438
www.cai-channelislands.org

Executive Council of Homeowners
ECHO
1602 The Alameda #101
San Jose, CA 95126
408-297-3246
www.echo-ca.org