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South Coast Homeowners Association

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FALL MEETING

Selected Financial and Corporate Compliance Topics

What you don't know or do may hurt you

Our fall program will tackle some of the necessary processes and procedures for associations to achieve compliance with regulatory agencies and their governing documents. Among the topics to be discussed include-

- Check writing authority and internal control review of funds
- Filings with the Secretary of State and Franchise Tax Board (FTB)
- Maintaining tax-exempt status with FTB and accelerated revocation proceedings
- Annual policy and budget disclosures to owners including a checklist of all necessary Civil Code disclosures
- Anticipated changes in operating costs for 2018
- Updates on trends of selected association financial data

Date – Wednesday, November 1, 2017
Time – 7:00 PM
Place – Encina Royale clubhouse – 250 Moreton Bay Lane, Goleta
Speaker – Michael J. Gartzke, CPA – co-founder South Coast HOA
There is no charge to attend. Light refreshments will be available starting at 6:45.

Look for our annual legislative and case law update in January-February 2018. Details will follow later.

THE FRIGHTENING EROSION OF LAMDEN PROTECTION FOR BOARDS IN CALIFORNIA

By Beth Grimm, Attorney

I am covering a very important topic that was addressed at the program June 24. It is the "erosion" of the pivotal **Lamden** case of 1999 whereby a board that was challenged by an owner on a decision regarding termite treatment. **The Board secured** a decision that has been cited in hundreds of cases since. The critical issue in the case was whether the owner could force the board by going to court to use her expert's recommendation. It is not a case that is limited to termite decisions by any means. It stands for the idea that if a board is called into court, the court can take a deferential position, meaning defer to the board's decision, if the court determines that the board acted in good faith, did some investigation and had a plan. The concept here is that the court would not delve into exactly what the board's actions were in detail but only far enough to determine that they had good intentions and had consulted an expert that offered them a solution, and were following that path. **The court would not try to analyze which plan was better.**

The Court actually said,

"*Courts should defer to a duly constituted community association board's authority and presumed expertise, regardless of the association's corporate status, where the board, upon reasonable investigation, in good faith and with regard for the best interests of the association and its members, exercises discretion within the scope of its authority under relevant statutes, covenants and restrictions to select among means for discharging an obligation to maintain and repair a development's common areas*. **West's Ann.Cal.Civ.Code § 1354."**

It is important because there are many instances when an owner or owners gets frustrated with a board's decision for one reason or another and wants to impose a different decision. There are a hundred reasons why and I think I have heard them all. But my advice has long been along the lines that it can be an uphill battle if the board can show a modicum of diligence, good faith, and has a plan. This is a very simplistic summary but sufficient I think to explain the basics of that case and that very critical decision, and show how it has been eroded since then. Back in 2011 I did an E-newsletter entitled "WHO FIXES WHAT IN AN ASSOCIATION" with emphasis on "**How Has the *Lamden* Standard of Giving Deference to Board Decisions Been Affected?" In the E-newsletter which is archived on my website at** www.californiacondoguru.com **I discussed two cases where *Lamden* was cited in defense of a Board's actions and the Board lost!**

And now we have a pretty new case (end of 2016) that pokes another hole in *Lamden, a pretty serious one at that*. The name of the case is Palm Springs Villas II HOA Inc. versus Parth. The name of the newsletter if you want to look it up is "HOA DIRECTORS – DON'T ACT ALONE OR YOU MIGHT END UP ON A DESERTED ISLAND."

Since this case is the freshest and maybe the most damaging attack on ***Lamden*** I will cover it first. Parth is an octogenarian (woman) serving on the Board of Directors of the Palm Villas II association (or she was when the lawsuit was filed). As President she entered into some very substantial agreements and contracts that bound the association and those contracts went south. The Association suffered because of it. Costs were excessive, many problems were encountered and work was done by contractors that weren't licensed for that particular work and the HOA was charged by another contractor exorbitant sums and because of a lack

of sufficient resources to pay in the Association reserves, a loan was arranged to pay for the work. There were a number of other questionable actions taken that I won't go into, the point being that it looked like this director went rogue. There was evidence that other directors were not contacted or given the opportunity to join in or approve these actions. This barrage of events came after the board tried twice to get owners to approve what the board termed critical special assessments. It seems possible outright frustration with the membership and/or board turned this director into a steam roller but honestly, it is hard to envision someone in their 80s to have that kind of energy!

Without interjecting any other personal suppositions, the fact is this case scared the HOA and the HOA industry terribly! The individual board member was sued by the board/HOA! Questions like who will serve if a board member can really be sued and pulled to trial to explain their actions and how affected the costs of directors' and officers' liability coverage would be. These questions raged all over the state, and in fact the country, because California is one of the leading states setting precedent with cases.

But there was a fundamental problem here. Some of the actions alleged to be directed by this Director went far past negligence. In fact they were in direct contradiction of requirements in the Association governing documents. The director admitted that she was unfamiliar with the HOA documents but claimed she was acting in good faith and should be protected legally by the Business Judgment Rule – and be afforded the deferential treatment offered by ***Lamden***.

In California, the status of the law with regard to board member actions is strongly in favor of accepting what the directors do if there is no evidence of arbitrary and capricious behavior, and if they are acting in good faith in their capacity as board members and if they do reasonable inquiry and diligence, and have a plan. That is Lamden (vs. La Jolla Club Condominium).

You can go back to that E-newsletter in 2016 and see the very detail that sets the Parth case apart from Lamden. She seemed to be acting on her own, NOT WITH THE BOARD. She seemed oblivious to the idea that governing documents exist and need to be consulted to determine board and director authority. She forged ahead without properly investigating the contractor she hired. The board seemed to some degree to be asleep at the wheel though so there may be some things that come up at the trial – or during settlement discussions, that implicate the other board members, or some of them. For example, for months invoices were paid to a contractor that was not doing the work? One has to ask if they were in a void of some kind that caused them to miss very important and obvious clues. I am sure that at some point the very complicated web was put in the hands of attorneys but boy, one wonders what allowed things to get so badly out of hand.

The real critical turn is that if the board ignores the governing documents AND CALIFORNIA LAW which contain limitations on spending HOA funds and committing members to loans without going to the membership or at least the Board for approval, it or any individual member can become a direct target for a legal torpedo. I can't say it in more graphic words.

Let us explore further. The eroding of **Lamden** started way back when in 2010 and this case may just tear the long standing protections for board members apart at the seams.

Here is a brief recap of those cases which you can see discussed in more detail in the 2011 E-NEWSLETTER located at
http://www.californiacondoguru.com/CCNewsletter/CCNewsletters45.html.

AFFAN v. PORTOFINO COVE HOMEOWNERS ASSOCIATION, October 2010. The simple way to describe this case (and the takeaway) is that Boards that choose simple post-event repairs for persistent plumbing (or other) problems as opposed to seeking real and permanent solutions may end up in trouble. It is important to know that adopting a reactionary mode of treating a chronic problem is not a sufficient "plan". And, managers can't count on ***Lamden*** as a defense - it only applies to the HOA. And, it's a risk to change insurance carriers in the middle of a time period when a "chronic" problem has arisen.

Dover Village vs. Jennison, also a 2010 case. In ***Dover Village*** the HOA was intending to charge an owner for sewer repairs to lines that ran under the condominium. In this case, the Association attempted to use ***Lamden*** as a "sword" claiming it supported the argument that the board's decision on maintenance responsibility should be accepted based on an argument that the sewer pipes were "exclusive use common area". The court called ***Lamden***: "a nice illustration of matters genuinely within a board's discretion," but didn't find it controlling. Why? Because the court found the sewer pipes to be common area and the association's responsibility finding that: "Under a natural reading of the CC & R's, the sewer pipe was a genuine common area to be maintained and repaired by the association, as distinct from 'an exclusive use common area appurtenant' to an individual owner's separate interest." The court also reviewed the CC&Rs and found that although there were some areas designated "exclusive use common area", the sewer pipes were not among those items. The takeaway is this: determining exclusive use common areas and the responsibility for maintenance takes careful legal analysis considering both the governing documents and the law and *Lamden* does not provide discretion to the board to decide contrary to those authorities.

I have written pretty extensively on responsibility for exclusive use common area in light of a new law that took effect this year and you can check my blog at condolawguru.com and the newsletter archives on the website for more information.

Ritter vs. Churchill Condominium Association. This case stands for the proposition that where there is a health or safety issue concerned, the HOA should investigate solutions and in some cases, must take action, even if there is a cost involved the owners might not want to pay. I did glean some things from this case that I will share.

(1) Is a ***Board*** safe when it acts on experts' advice in any given situation, and there is no malice involved? ***(It would appear so, at least as it relates to personal individual liability).***

(2) Is the ***HOA*** safe when the Board relies on experts' advice in any given situation? ***(Not necessarily - if the decision of the Board is found to be harmful to members - or for that matter - residents, vendors, etc. as well as has been the experience in other serious cases**.)*

(3) Should all HOA board decisions be given the benefit of the doubt under the "Business Judgment Rule" in the Corporations Code or deference to Board decisions under ***Lamden*** when being reviewed by a court? (***The clear answer is "no".***)

Wrap up: With all of these cases, it is important to note that hindsight is always clearer than foresight, of course, and boards should not be condemned without sufficient inquiry to determine if they were relying on experts, or winging it. Another thing that can and should be

taken away from these case decisions are that there is likely a distinction between the way courts analyze decisions of corporate boards whenever (1) health and safety issues are at stake, (2) the board has not investigated matters sufficiently to devise a reasonable means of discharging its duties, or (3) the maintenance responsibility is determined by the CC&Rs and/or the law, and boards are acting without regard to the law and the association documents. And another takeaway is that if you are on a board and not participating in decisions you too could be found culpable. In other words, if directors stand by and watch a bully or rogue director in action without doing anything about it, culpability may come from inaction as much as inappropriate action. There is also other information on the blog on website in dealing with rogue directors.

Beth Grimm is a long standing, dedicated California HOA attorney and a member of South coast and coming to Goleta annually to present a program on hot topics for about 20 years. This article is a related to the topics covered at the June 24 meeting this year at Encina Royale. You can learn more about her at her website www.californiacondoguru.com and her many articles and publications and see many topics covered in her blog https://condolawguru.com .

PUBLICATIONS FROM THE CALIFORNIA BUREAU OF REAL ESTATE

For many years, the California Bureau (formerly Department) of Real Estate (BRE) has published several publications for homeowners association. We had provided/reprinted them for members in years past. Two of the publications have been recently updated and are available for review/download at no cost from their website.

Operating Cost Manual for Homeowner Associations – revised January 2016 – this booklet references the many categories of expenses that an association may encounter and provides some estimates as to expected costs. The booklet is used primarily by developers in establishing the initial budget submitted to the Bureau for approval prior to the initial sale of the units. You can access the manual from the BRE website at

http://www.bre.ca.gov/files/pdf/OCM_final_2015.pdf

Reserve Study Guidelines for Homeowner Association Budgets (2010) – This booklet provides a comprehensive overview into the reserve study development process, why it is needed, state law requirements and how to gather the needed information to prepare a comprehensive report. Yu can access this booklet at:

http://www.bre.ca.gov/files/pdf/re25.pdf

Common Interest Development Brochure – revised June 2016 – This publication is useful to all residents in a common interest development. As noted in the booklet's preface -

"This booklet is designed to provide general information in response to some of the more frequently asked questions regarding living in a common interest development (CID). We hope it contributes to your understanding and expectations of home ownership in a CID. Since this brochure does not contain specific legal information or guidance, it should only be used as a general source of information."

You can access this publication at –

http://www.bre.ca.gov/files/pdf/re39.pdf

BUDGET AND FINANCIAL CONSIDERATIONS FOR 2018

By: Michael J. Gartzke, CPA

Disclosure Documents – When updating your disclosure documents that you mail with your budget for 2018, please note that the Davis-Stirling Act of the California Civil Code which governs association operations was completely restated as of January 1, 2014. The Civil Code references from Sections 1350-1378 no longer apply. You will need to update your code references to the new Code sections. The new code is available online and the *2017 Condominium Bluebook. See* the 'Resources' tab on the www.southcoasthoa.org website for sample budget and policy disclosure formats.

Drought Considerations – We have had 6 years of below-average rainfall. Lake Cachuma is at 45% capacity (up from 8%). Watering restrictions have been passed by water districts and substantially higher rates and penalties are being imposed. Most water agencies are still imposing drought surcharges. If you use more water because the drought has 'eased', be prepared to spend more for water.

Water/Sewer Rates - There are many water districts in Santa Barbara County (and I'm sure other counties, too). The City of Santa Barbara has been increasing rates 3-4% per year for the last several years in July. In 2016, Santa Barbara raised its rates 21%. The Goleta Water District imposed a 16% rate increase in mid-2012 and has scheduled 5% increases for the next 4 years.

Insurance – After many years of stable or declining premiums, we may be in for some sticker shock over the next year or two. After Hurricane Katrina in 2005, associations saw premiums skyrocket, especially for earthquake and difference in condition policies. These policies are tied into the same kinds of coverages as hurricane and flood damage policies in the South and East.

Southern California Edison (and PG&E) – Is imposing "time-of-use" rates in 2016-17. If you need electricity during peak periods, your rates will increase. If your primary electric use is higher at night (outside lighting), your rates may decline.

Trash/Refuse – Trash Rates typically increase in South Santa Barbara County 3-4% per year in July. Therefore, your current rates should be good for the first 6 months of 2018. Goleta, however, is looking at a 17.76% increase due to county landfill passthrough charges in late 2017. It is unknown how this affects other jurisdictions.

Reserve Funding – As our associations age, many are finding a need to increase reserve funding well beyond inflation rates when studies are updated.

Most other association expenses appear to be stable. The CPI-U for the Los Angeles region increased 2.8% from August 2016 to August 2017. This is somewhat higher than it's been over the past several years as social security recipients well know. Issues with uncollectible assessments from foreclosures have decreased from their peak 3-4 years ago.

MONTHLY ASSESSMENT TREND UPDATE – OCTOBER 2017

BY: Michael J. Gartzke, CPA

Here is a brief update on trends in monthly assessments. This data is taken from the associations that I review financial statements for. (Currently 80, nearly all in south Santa Barbara County). Note that operating costs have increased about 2% per year. Reserve funding has increased nearly 6% per year, triple the operating cost rate. The allocation between operating and reserve assessments went from 75:25 in 2005 to 68:32 in 2017. In 2005, the median age of the associations was 27 years; in 2017 – 35 years. The number of associations reported increased from 55 to 80 during that period.

OPERATING ASSESSMENTS 2005-2017

Per Unit per Month	2005	2017	Percent Change
Median	$229	$285	24.5%
Average	247	337	36.4%
75 Percentile	275	373	35.6%
25 Percentile	176	228	29.6%
Percent of Total Assessment	75.1%	68.2%	

RESERVE ASSESSMENTS 2005-2017

Per Unit Per Month	2005	2017	Percent Change
Median	$78	$134	71.8%
Average	79	141	78.4%
75 Percentile	104	173	66.3%
25 Percentile	53	98	84.9%
Percent of Total Assessment	24.9%	31.8%	

The median monthly assessment is current $414 where half of the amounts are higher and half are lower. This is a modest $11 increase from the end of 2014. It's $113 more than it was in 2005. The median amounts for both operating and reserve funding each increased $56 per month from 2005.

TOTAL ASSESSMENTS 2005-2017

Per Unit Per Month	2005	2008	2011	2014	2017	Percent Change
Median	$301	$364	$391	$403	$414	37.5%
Average	327	420	446	464	478	46.2%
75 Percentile	390	480	490	510	515	32.1%
25 Percentile	245	290	320	339	338	38.0%
Number of Associations	55	63	68	70	80	

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