



## South Coast Homeowners Association

P.O. Box 1052  
Goleta, CA 93116  
805.964.7806

[www.southcoasthoa.org](http://www.southcoasthoa.org)  
[gartzke@silcom.com](mailto:gartzke@silcom.com)

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### **ANNUAL LAW AND LEGISLATIVE UPDATE MEETING**

It's time for our 34<sup>th</sup> anniversary meeting with our law and legislative update.

**Date – Wednesday, January 11, 2023**

**Time – 6:30 P.M.**

**Place – Via Zoom**

**RSVP – [gartzke@silcom.com](mailto:gartzke@silcom.com) to receive the link in early January**  
**Each attendee should send me their own email to regulate count**

**Cost – none**

**Speakers – David A. Loewenthal – Loewenthal, Hillshafer & Carter**

**James H. Smith – Rogers, Sheffield and Campbell**

2023 dues notices were mailed out to members in mid-November. Please pay to receive the discount by December 16. We hope to mail the annual Condominium Bluebook in early January to all members that have renewed. Please email if you did not receive the invoice.

## LEGISLATION AND LAW TO BE DISCUSSED AT OUR JANUARY PROGRAM

### **AB 1410** – Several new provisions including:

- 1) “Roommate rentals” (renting a portion of an owner-occupied home to a tenant) cannot be prohibited. (Civil Code 4739)
- 2) Restrictions on corrections of some CC&R violations during a declared state or local emergency. Collection of past due assessments is not affected. (CC5875)
- 3) Members may use social media to comment on association operations. Associations cannot ban content. Associations are not required to provide access to its website or social media. (CC4515)
- 4) Associations cannot require payment of an insurance deductible (or pay a fee, deposit or insurance) for damages arising out of use of common area for protected political activities as defined in the code (CC4515)

### **AB 1738** – Electric Charging Stations – In your Future?

This bill would, commencing with the next triennial edition of the California Building Standards Code, require the commission and the Department of Housing and Community Development to research and develop, and authorize the commission and department to propose for adoption, mandatory building standards for the installation of electric vehicle charging stations with low power level 2 or higher electric vehicle chargers in existing multifamily dwellings, hotels, motels, and nonresidential development during certain retrofits, additions, and alterations to existing parking facilities, as specified. (Legislature Bill Analysis)

### **SB 897** – Accessory Dwelling Units (ADUs) – Junior Accessory Dwelling Units (JADU)

Restricts the conditions that planning commissions/departments, city and county government can impose upon an applicant to build an ADU or JADU.

### **Golden West Patio Homes Owners Assn v. Cortez** (G060606) – Calif Court of Appeals

The case deals with an association tenting multifamily buildings for termites, an owner who refused to vacate, the court order requiring the owner to vacate and the award of attorney fees to the association for its legal costs to obtain the “application for summary removal of the occupants”. Search the case number above for the complete opinion.

These as well as other new laws and cases will be discussed in much more detail at our January 11 program.

## IS INTEREST INCOME TAXABLE TO YOUR ASSOCIATION?

The short answer is “yes”. Interest (and investment) income is taxable to the association as it is considered “nonmember” income, even if the association is considered “nonprofit”. Membership income such as assessments is not taxable. Paying income taxes on interest has not been an issue for many associations since interest rates have been so low that even associations with several hundred thousand dollars in reserves have not paid any Federal or California income taxes for over 10 years.

Some associations are taking advantage of the change in interest rates initiated by the Federal Reserve in recent months and have moved funds from “money market” accounts paying 0.01-0.10% interest to certificates of deposits paying upwards of 3.50-4.50%. On \$100,000, this change can result in an increase in annual interest from \$100 (0.10%) to \$4,000 (4.00%). Also note that CDs are insured by the FDIC for \$250,000 per financial institution. Funds on deposit at a bank in excess of \$250,000 will not be insured.

Deductions against interest income are limited to direct costs. In court cases, IRS and FTB have allowed limited deductions for tax preparation, bookkeeping and financial management. Any direct expenses such as bank fees on the investment account can also be deducted. Membership expenses such as utilities and maintenance are not deductible against nonmember income.

The tax rates on net taxable income are fairly high.

Federal – filing form 1120H – 30%

Federal – filing form 1120 with appropriate income election – 21% (until 5 years ago, this rate was 15% on the first \$50,000 of taxable income). The “Tax Cuts and Jobs Act” of 2017 raised the rate on this tier of income by 40%!

California – 8.84%

If your investment income exceeds \$1,000, check with your tax preparer to see how much income tax you should budget for. I suspect not too many associations will be impacted in 2022 but plan accordingly for 2023. While many associations will pay small amounts of tax through the operating fund, since the income is being earned on the reserve fund, the taxes can be charged to the reserve fund.

While California income taxes can be remitted by check to the Franchise Tax Board, Federal taxes cannot. If you become subject to tax and haven’t had to pay any in the past ten years, you will need to set up an e-payment account with IRS at [www.eftps.gov](http://www.eftps.gov).

Businesses, including homeowner associations, are required to use this payment method. If you have changed property managers, bookkeepers or treasurers, you will need to get the login credentials if they had an account or you will have to reregister.

## HOA HOMEFRONT – READER QUESTIONS - RISING HOA INSURANCE RATES AND BROKER ADVICE

By Kelly G. Richardson, Esq.

Editor's Note: Many associations are finding that their insurance premiums are rising substantially. I've been looking for information to pass along to you. Mr. Richardson provided permission to me to reprint his recent article on the subject which follows below. His columns appear in newspapers including the *Santa Barbara News-Press*. We thank Kelly for sharing this information.

Kelly G. Richardson, Esq. is a Fellow of the College of Community Association Lawyers and Partner of Richardson Ober LLP, a California (Pasadena) law firm known for community association advice. Submit questions to [Kelly@roattorneys.com](mailto:Kelly@roattorneys.com). Past columns at [www.HOAHomefront.com](http://www.HOAHomefront.com). All rights reserved®.

Hi Kelly: Thanks for all the great info on HOAs. Our community's liability insurance policies are up for renewal soon. Some neighboring associations are reporting ten-fold increases in fire insurance premiums due to brushfire proximity concerns. Even though our community does not appear to be in a fire-prone area according to real estate sources, are we in for a huge shock? B.C., Rancho Santa Margarita.

Dear B.C.:

Many of my client associations have also had an increasingly difficult time with the rapidly increasing cost of insurance coverage protecting against damage to the property. To bring some insurance expert guidance into the discussion, I contacted Michael Berg, of Berg Insurance in Lake Forest, and Scott Litman of the Scott Litman Insurance Agency in Calabasas, two leading insurance brokers known for serving HOAs.

As to the outlook for insurance premiums, Litman said "unfortunately, this is going to be a long-term problem. According to reports, claims for wildfires are increasing substantially each year." Michael Berg explains that placement of property damage insurance is not hard for every community, but "only those that are experiencing a challenging claim history or located in wildfire hazard zones." For those communities, he states "placement will continue to be a challenge."

I asked our experts, how can HOAs maximize their insurance dollars? Berg said HOAs should make sure their broker specializes in HOAs to make sure that the HOA has the right advice in making the business decision for their community. Litman suggested exploring changing the HOA's approach to "bare walls" insurance, which often requires an amendment to the CC&Rs. He said this could reduce the premium about 5%, depending upon the insurance company.

Bare walls insurance means the HOA only insures for the shell of the residence –the interior is only restored to the drywall, excluding fixtures (cabinets, sinks, etc), finishes (carpet, wallcovering) and interior contents. Many of my condominium client associations have moved in that direction, but first the CC&Rs must be examined. As Mr. Litman stated, it may require a CC&R amendment to align the HOA's insurance responsibility with its damage

responsibility. Also, if the HOA adopts a “bare walls” approach, some reasonable advance notice should be provided to homeowners, so they are not exposed to major uninsured loss after the HOA insurance changes. Before pursuing bare walls as an insurance option, consult experienced HOA legal counsel on this important issue.

Another technique many HOAs use is to reduce the cost of insurance is to increase deductibles, and many HOAs already have pursued that strategy, requiring the HOA to be prepared to absorb a greater out of pocket loss.

I asked the experts about common mistakes they see regarding HOA insurance. To Mr. Berg, “the biggest mistake is ignoring the business relationship with their insurance provider.” Scott Litman said, “we find a substantial amount of policies missing important coverages.” He recommended HOA boards and managers annually review their policies.

There are many excellent insurance experts serving California HOAs. Thanks to Michael Berg and Scott Litman for sharing their expertise and advice.

HOAs are better served if lawyers and insurance brokers communicate regarding their mutual clients. HOAs should review their insurance coverage to confirm that it matches its governing document responsibilities for insurance and damage.

Best regards, Kelly

## **MANAGEMENT – WHAT IS THE RIGHT FIT FOR YOUR ASSOCIATION?**

Several times each year, I have association clients, South Coast HOA members and people in the community ask me about management services, how much it costs, who I would recommend among other questions. It’s not the property management that is the question but it’s the “people management” dealing with volunteer boards, residents, differing opinions and the interactions with management. This is the ongoing challenge associations face.

When I joined my association board 40(!) years ago, many associations were self-managed. Nearly all associations in our area were under 15 years old. Mine was 10 years old at the time. (So, it’s now 50 years old). Board members undertook all of the contracting, supervising, dispute resolution functions directly without the help of professionals. While there were laws pertaining to associations scattered through the Civil Code, the first iteration of the Davis-Stirling Act wasn’t passed until the mid-1980s. Reserve studies were in their infancy. As laws have gotten more complex and the common area components aged, it has become more complicated to effectively operate and manage associations today. It has also become more difficult to attract and retain board members with all the property and people management skills our current environment requires. That said, I am constantly amazed and awed by the volunteer talent I work with in our area associations. Thank you for your service.

In recent weeks, I’ve encountered a couple instances which I have dealt with over the years but accurately describe the dilemma that associations face in obtaining capable management.

I received the following email from an HOA client – “Good morning, Mike! We need a new management company. Do you have a recommendation?”. I have worked with the

association for over 20 years and know who their current manager is as well as predecessors. So my question back to the client: “What is the issue with your current manager?” The response: “Our manager resigned, due to the board’s dysfunction, outdated CC&Rs and not having any new procedures in place for elections, etc. Our manager did an excellent job and really helped us but our board is pretty awful and as soon as our manager resigned, I resigned from the board as well”.

Can you imagine if I referred them directly to a management company? Think of the effect it would have on my relationship with that company. I provided them links to directories of managers within South Coast HOA and also CAI-Channel Islands to make inquiries. I would hope that the board recognizes that there needs to be an internal culture change if they are having difficulty retaining management. Managers do not want to be treated poorly. And I hope that the management prospects do their due diligence in investigating the association prior to offering services. Perhaps the new company can right the ship. Let’s hope so.

The second scenario involves a self-managed association that has also been my client for many years. Over time, much of the work has fallen into the lap of one board member. Recently, two new board members (younger) have come on board to help with the various tasks. They have a facilities manager (owner, paid) to oversee maintenance. In my reading of the board minutes and general ledger during the accounting review process, I’m concerned that there could be much deferred maintenance. (I have not inspected the property). Given the fair market value of units today, it is critically important for the buildings and common areas to be properly maintained. Like most all associations, they are faced with increased assessments, including insurance..

I met with one of the new board members and we discussed her questions as well as some technical aspects of association operations such as timelines for budgets, disclosure documents and elections. To help her understand the role of professional management, I prevailed upon three managers in our local community (I owe them big time!) to talk with her so that she could get a better understanding of what managers do than I could provide her.

This association has never had professional management so if they choose to investigate their options, this will be a culture shock, too. Professional managers should require adherence to California laws. Some management companies do a lot online with portals to make payments, to contact management and retrieve documents. Some managers have many years of experience; others, much less so. Larger management companies have challenges in retaining management staff. A former client had six different managers assigned to them over an 18-month period. How can anyone at the management company understand what issues the association is facing? Does the manager understand the monthly financial statements being generated by the accounting department? I’ve written previously about glaring issues in financial statements where no apparent analysis was undertaken by board members, management, or even the accounting staff. Some due diligence is required by boards to properly vet management candidates.

There aren’t a lot of choices for management in Santa Barbara County. If you have issues with management, try to work through them with your manager or upper management if it’s a larger company. Management changes and transitions can be bumpy and difficult even in the best situations.

## FLORIDA HOA FRAUD CASE EVOLVING

Last month when I sent a save-the-date email for our January 11 program, I also included an article about a multi-million-dollar fraud case unfolding in South Florida. The article detailed the arrest of five board members of the Hammocks Community Association (6,500 homes) accused of stealing \$2 million in association funds and diverting it for personal use. Search “Hammocks Kendall” on the internet for the detailed article from the Miami Herald from November 2022.

Members started a petition drive in February 2022 when they received notice that their assessments were increasing upwards of 400%. Their assessment, which appears to pay for common area elements such as streets, parks and recreational facilities, was to increase from \$84 per month to \$340 per month. The attorney for the association was quoted as saying “They didn’t raise the association fees for seven years so they’re basically catching up to where they should have already been.” This controversy attracted TV coverage and members collected funds to hire their own attorney to compel the association to provide records to support the need to raise the assessments so much. Elections and board meetings were not held regularly. Reviewed or audited financial statements were not done in six of the past seven years. During the investigation leading to the arrests, prosecutors found improper expenditures going back to 2016.

Immediately after the arrest of the board members, the court appointed a receiver to take control of the association. Two weeks later, he provided a report to the judge in open court and recorded.

“There is space between the floor and the lower level and there used to be a small storage. They wanted to make sure nobody could find anything.”

The attorney for the members said “He got rid of the entire office, we got rid of all the abusive security, we got rid of the disrespectful pool attendants.”

“We discovered that the association requested a \$1.5 million loan from Poplar Bank which is stunning. No nonprofit should be asking to borrow money to cover operating expenses.”

The next hearings are scheduled for January 2023.

Could this happen here? The California Civil Code has numerous disclosure requirements to members of the association including budgets, reserve information, policy disclosures and board minutes. Meetings are to be held regularly and minutes are to be made available to members. Sales escrows require all these documents to be provided by sellers to new buyers. Florida’s laws are different than California’s. Stay tuned for updates.

## NEWSLETTER PROFESSIONAL SPONSORS

### ACCOUNTANTS

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

**Gary Vogel, CPA**  
[gvogelcpa@gmail.com](mailto:gvogelcpa@gmail.com)  
818-357-5535

**Mark Jackson – Walpole & Co. CPAs**  
70 Santa Felicia Dr  
Goleta, CA 93117  
805-569-9864

**Jimenez & Company CPAs**  
**Joyce Jimenez**  
PO Box 756  
Camarillo, CA 93011  
805-491-2126

**Bryzek CPA**  
**Ian Bryzek, CPA**  
731 South Lincoln Street  
Santa Maria, CA 93458  
510-538-6014

### BOOKKEEPING SERVICES

**The Bottom Line**  
**Nancy D'Amato**  
PO Box 91809  
Santa Barbara, CA 93190  
805-683-3186

**Laura McFarland, CPA**  
**McFarland Financial**  
7127 Hollister Ave #109  
Goleta, CA 93117  
805-562-8482  
[mcfarlandfinancial.com](http://mcfarlandfinancial.com)

**Debbie Quigley – Accounting Services**  
P. O. Box 62157  
Santa Barbara, CA 93160  
805-967-8117  
[Debbie@debbiequigley.com](mailto:Debbie@debbiequigley.com)

**Oasis Bookkeeping**  
**Patti Karr**  
P. O. Box 132  
Carpinteria, CA 93014  
805-684-7461

**Blue Horizon Management Co.**  
**Kevin Lehman, CCAM, CMCA, AMS, PCAM**  
2020 Alameda Padre Serra 220  
Santa Barbara, CA 93103  
805-586-2583  
[bluehorizonmanagement.com](http://bluehorizonmanagement.com)

**Ferguson Management Group Inc.**  
**Joseph Ferguson | President**  
**CCAM, CAFM, CMCA, AMS, PCAM**  
27 W. Anapamu St, Suite 170  
Santa Barbara, CA 93101  
805-455-8911  
[fmgsb.com](http://fmgsb.com)

### ATTORNEYS

**James H. Smith**  
**Rogers, Sheffield, and Campbell**  
152 East Carrillo  
Santa Barbara, CA 93101  
805-963-9721

**David A. Loewenthal**  
**Loewenthal, Hillshafer & Carter, LLP**  
21 E. Carrillo #230  
Santa Barbara, CA 93101  
866-474-5529

**Myers, Widders, Gibson, Jones & Feingold, LLP**  
**James E. Perero**  
5425 Everglades Street  
Ventura, CA 93003  
805-644-7188

**Price, Postel & Parma**  
**Christopher Haskell/Shareef Moharram**  
200 East Carrillo, Ste. 400  
Santa Barbara, CA 93101  
805-962-0011



## **ASSOCIATION MANAGEMENT**

### **Coast Community Property Management**

**Sandra G. Foehl, CCAM**

P. O. Box 8152  
Goleta, CA 93118  
805-968-3435

### **St. John & Associates**

**Kristin St. John CCAM**

5266 Hollister Ave, #108  
Santa Barbara, CA 93111  
805-683-1793

### **Team HOA**

**Geoff McFarland**

7127 Hollister Ave #109  
Goleta, CA 93117  
805-562-8482  
[teamhoa.com](http://teamhoa.com)

### **The Management Trust Central Coast**

**Gordon Goetz**

5383 Hollister Ave #230  
Santa Barbara, CA 93111  
805-348-4080

### **Kennedy Accounting Systems Alan Fray**

1805 E. Cabrillo #F  
Santa Barbara, CA 93108  
**805-962-1626**

### **Blue Horizon Management Co. Kevin Lehman, CCAM, CMCA,**

**AMS, PCAM**

2020 Alameda Padre Serra 220  
Santa Barbara, CA 93103  
805-586-2583  
[bluehorizonmanagement.com](http://bluehorizonmanagement.com)

### **Old Coast Property Management Arnie Gonzalez**

5266 Hollister Ave #121  
Santa Barbara, CA 93111  
805-563-1234  
[oldcoastmanagement.com](http://oldcoastmanagement.com)

### **Ferguson Management Group Inc. Joseph Ferguson | President**

**CCAM, CAFM, CMCA, AMS, PCAM**  
27 W. Anapamu St, Suite 170  
Santa Barbara, CA 93101  
805-455-8911  
[fmgsb.com](http://fmgsb.com)

### **Bristol Property Management Carolle van Sande**

2920 de la Vina Street  
Santa Barbara, CA 93105  
805-963-5945

## **RESERVE STUDIES**

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**Chris Andrews**

P. O. Box 1369  
Goleta, CA 93116  
805-681-1575  
[SmartReserveStudy.com](http://SmartReserveStudy.com)

### **Reserve Studies, Inc.**

17315 Studebaker Rd #213  
Cerritos, CA 90703  
800-485-8056  
[reservestudiesinc.com](http://reservestudiesinc.com)

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Los Angeles, CA 90025  
805-299-0899

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4213 State St #205  
Santa Barbara, CA 93110  
805-563-0400

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**Dan Baxter**

1033 Santa Barbara St.  
Santa Barbara, CA 93101  
805-963-4048

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280 N. Westlake Blvd #200  
Westlake Village, CA 91362  
805-379-5159

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**Santa Barbara Painting**  
**Gustavo Dabos**  
5874 Hollister Ave  
Goleta, CA 93117  
805-685-3548

**Interstate Restoration LLC**  
1830 Lockwood St. #107  
Oxnard, CA 93036  
805-988-1040

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79 S. Kellogg Ave  
Goleta, CA 93117  
805-962-6101

## **ELECTIONS**

**Official HOA Elections, LLC**  
**Will Morstad**  
133 E De La Guerra Street, Suite E  
Santa Barbara, CA 93101  
805-214-8018

## **JANITORIAL SERVICES**

**Safe Grounds Janitorial and  
Disinfecting Services**  
**Barbara Sanchez**  
P. O. Box 91660  
Santa Barbara, CA 93190  
805-321-SAFE

## **ORGANIZATIONS**

**Community Associations  
Institute (CAI) Channel Islands  
Chapter**  
PO Box 3575  
Ventura, CA 93006  
805-658-1438  
[cai-channelislands.org](http://cai-channelislands.org)

**Educational Community for  
Homeowners - ECHO**  
5669 Snell Ave #249  
San Jose, CA 95123  
408-297-3246  
[echo-ca.org](http://echo-ca.org)