South Coast Homeowners Association

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Volume 33 – Number 1 – January 2022

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33rd ANNIVERSARY MEETING AND ANNUAL LAW AND LEGISLATIVE UPDATE

Date – Wednesday, January 19, 2022

Meeting – 7:00-9:00 PM

Via Zoom – Send email request to gartzke@silcom.com to be added to the meeting list – a link will be emailed to you several days before the meeting

Speakers – James H. Smith, Rogers, Sheffield and Campbell and David Loewenthal, Loewenthal, Hillshafer and Carter

Cost – none – There may be a limit on the number of guests we can accommodate so please have each attendee submit their email address.

The Legislature has been up to their usual modifications to the Davis Stirling Act. Changes for 2022 include some election procedures, insurance of association funds, rental restrictions, emergency health and safety protocols, lot splits and more. Also to be discussed are some California court cases decided in 2021 which may impact association operations. This program is always quite popular and informative. Meeting materials will be distributed to registered attendees when available prior to the meeting and posted to our website afterwards.

Bluebooks were mailed January 6 to all members. No membership dues were assessed for 2022. Hopefully, we can have more meetings and content in the coming year.

A 29-YEAR HISTORY OF RESERVE FUNDING AND EXPENDITURES OF AN ASSOCIATION

By: Michael J. Gartzke, CPA

I have a mid-size association client where the reserve funding data since year 1 (1992) showing reserve assessments and expenditures is available. The association funded its reserves for the first four years from the developer's budget and then had reserve studies done every three years since then in accordance with the California Civil Code. Funding has been done based upon the reserve analyst's recommendation.

During the first four years, no reserve expenses were incurred. Funds and interest accumulated totaling $96,000 after four years. The first major expenditures occurred in year seven where painting was done and rain gutters were installed. For this association, painting is required every 10 years and is due again in three years. Some street maintenance and repair soon followed. Major asphalt replacement is expected in the next 2-3 years. In year 15, wood fence repairs were done and major fence replacements are currently ongoing. Landscape repairs and improvements started in year 10 and have been ongoing. Also, in year 15, the units were fumigated and fumigation is expected again in the next 2-3 years. Over the next four years, major expenditures of $490,000 are anticipated, nearly half of what was spent in the first 29 years as shown below.

The following is the 29-year income and expense report for the association:

Reserve Assessments	$1,173,000	(no special assessments)
Interest Earned	121,000	(only $8,000 in the past 7 years)
Total Income	$1,294,000	
Expenditures:		
Roofing	$ 381,000	
Painting	158,000	
Fences	168,000	
Pool and Recreation Area	80,000	
Landscape/Irrigation	73,000	
Streets	57,000	($118,000 due in 2-3 years)
Fumigation	24,000	(due again in the next 2-3 years)
All Other Major Replacement Categories	113,000	
Total Expenditures	$1,054,000	
Ending Cash	$ 240,000	

Reserve funding started at $22,700 in 1992 and was budgeted for $ 69,000 in 2021 and scheduled to increase 3% annually after that. It is anticipated that the reserve fund will be drawn down to $65,000 in three years to meet immediate major repairs before the fund starts to build again for future repairs and replacements.

As associations age, a greater percentage of the regular monthly assessment goes towards these major repair and replacement costs. In a database of 83 mid-to-larger associations in our area that I maintain, the allocation between operating and reserve assessments in the past eight years has gone from 72% operating/28% reserve to 68% operating/32% reserve. A very significant change (which will be a topic for another article!). Bottom line – more of the monthly assessment is being applied to future major repairs and replacements.

The analysis over each year shows the increase in the reserve fund which hit $516,000 in year 25 which was followed by the $381,000 in roof replacements. No special assessment was required. It may be difficult for some members to understand why the association is accumulating funds and for some it seems to be a high amount. The high-water mark of accumulated reserve funds achieved here probably represented less than 2% of the fair market value per owner of a unit.

LOCAL ASSOCIATION SECURES FUNDING FOR MAJOR REPAIRS FROM GOVERNMENT AND OUTSIDE SOURCE

(Could your association qualify? Some unanswered questions)

A recent article in Noozhawk.com detailed extensive maintenance problems with the El Zoco condominiums in downtown Santa Barbara. According to the article, the association has about $24,000 remaining in reserves (for 17 units) after spending $200,000 on water damage repairs. It was stated that the units are price-restricted, "so the owners can't make a profit when selling them, a fact that hurt their ability to obtain loans from banks."

The project was approved by the city in 1993 and the units sold in 1993-94 with a 30-year price restriction (expires 2023-24). A 2007 article in the Santa Barbara Independent stated that this project is "Santa Barbara's only low-income units designed specifically for artists".

The owners approached the city for help. In early October, the Santa Barbara City Council agreed to loan residents $200,000 with the County putting up another $200,000 and Habitat for Humanity offering $50,000. The individual loans would be $27,000 amortized over 30 years at 3% interest - $114 per month. In exchange, the owners would have to add 63 years to the price-restricted covenant. The City Council approved this quite quickly to preserve low-income housing.

In November, a full page ad appeared in the Santa Barbara Independent offering one of these units for sale by a local real estate brokerage. (Can you imagine the disclosures for the sale?). The price - $850,000! For a 1200 square foot "loft". You can review the website at www.sbcityloft.com.

Are some units not income and price restricted?

Is this owner able to sell this unit for $850,000?

Is this price considered price-restricted under the CC&Rs and deed?

I haven't been able to reconcile this real estate listing for $850,000 with the price restrictions noted in the local media. If I learn anything further, I'll let you know.

ASSOCIATION MONTHLY ASSESSMENT AND EXPENSE TRENDS 2009 – 2021

By: Michael J. Gartzke, CPA

Over the years, I've written about changes and trends in your association assessments and expenses. Previous articles are archived in the newsletter and resources tabs on the www.southcoasthoa.org website. I've received numerous comments and questions over the years and so it's time to update some of the information.

Monthly Assessment:

This is probably the most requested number. What is the average or median monthly assessment for area associations? I maintain a database of mid-to-large size associations which currently has 83 associations in it. In that database, there are numerous financial datapoints collected since 2005. For this analysis, I evaluated from 2009 to 2021. The data is a year behind – 2009 is for calendar year 2008 and fiscal years ending in 2009.

Year	**Average Assess**	**Median Assess**	**Median Operating**	**Median Reserve**	**Operating Percent**	**Reserve Percent**
2009	$440	$377	$281	$101	72.1%	27.9%
2010	454	394	287	101	73.0	27.0
2011	446	391	284	113	70.0	30.0
2012	446	394	290	118	68.8	31.2
2013	453	399	282	121	68.9	31.1
2014	464	403	290	122	69.8	30.2
2015	462	407	286	128	68.0	32.0
2016	466	414	281	130	67.3	32.7
2017	477	410	285	136	66.6	33.4
2018	487	423	291	142	67.4	32.6
2019	504	432	293	146	66.2	33.8
2020	520	445	302	143	67.9	32.1
2021	**536**	**450**	**315**	**154**	**68.3**	**31.7**
$ Change	96	73	34	53	-3.8	3.8
Percent Change	**21.8%**	**19.4%**	**12.1%**	**52.5%**		
2022	**551**	**460**				

The takeaways for me from this chart are as follows:

1) I prefer the median assessment amount as opposed to the average amount since there are some associations with much higher assessments than the median which increases the average. The median is where half of the amounts are above the middle and half of the amounts are below. That treats each amount equally in the calculation. In a sample of 83 associations, the median amount is the 42nd amount. Since 2009, the number of associations in the sample increased by 19.

2) For one year to the next there can be slight increases and decreases. It's the trend over a number of years that takes into account the addition or deletion of association data.

3) The current median assessment is $460 while the average is $551. Since 2009, the amounts have increased 21%, less than 2% per year for both the average and the median. The median operating assessment only increased 12.1% during the period while the reserve funding portion increased 52.5%. The median operating and median reserve assessments are calculated independently from the median total assessments so it is unlikely that the two amounts will equal the median total assessment.

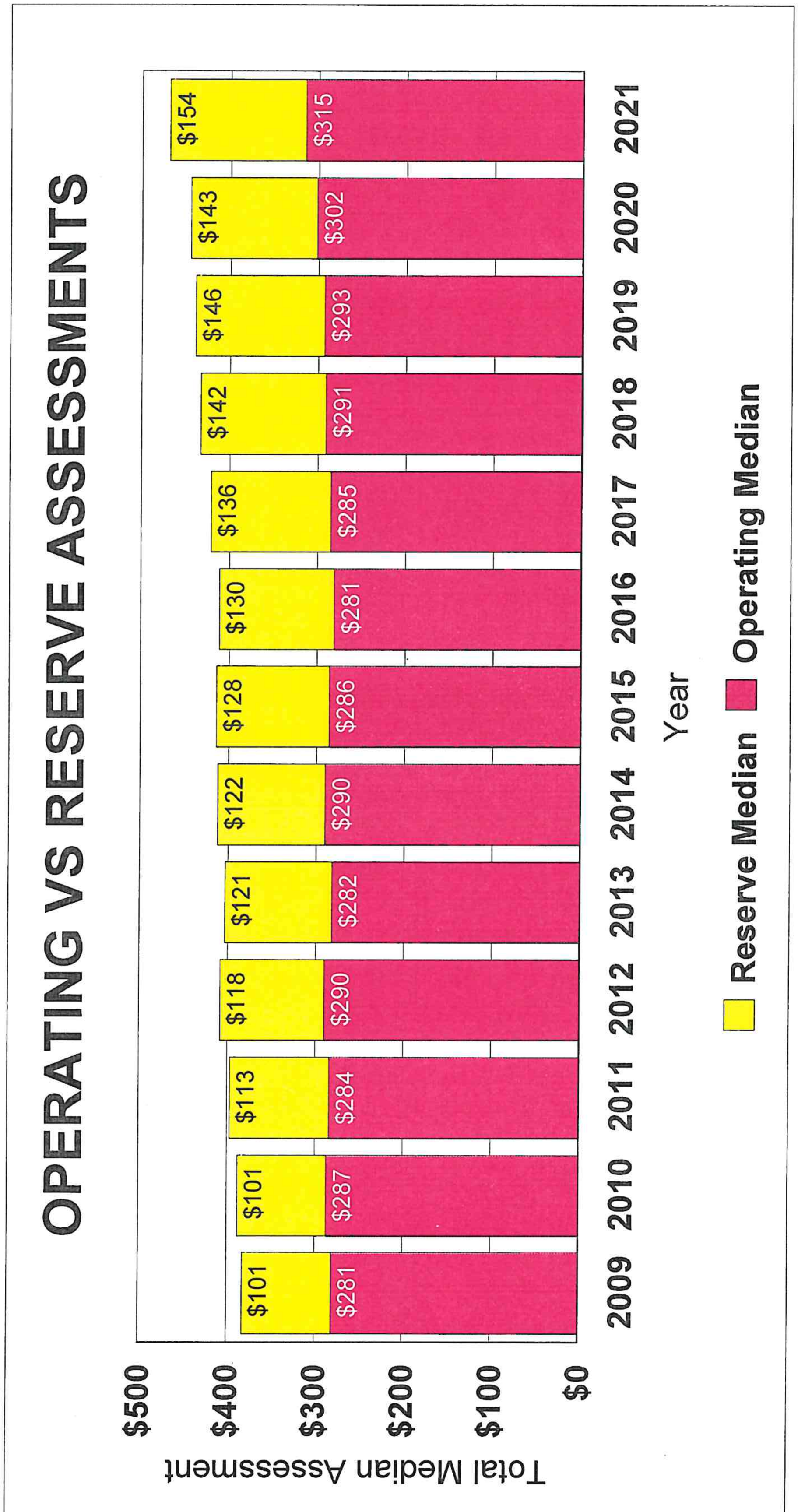
4) The reserve funding portion for many associations is increasing at a much faster rate than the operating portion. In 2009, the allocation between operating and reserves was 72.1/27.9. In 2021, it was 68.3/31.7. That's a 7.6-point swing in allocation (72.1 minus 27.9 = 44.2; 68.3 minus 31.7 = 36.6). It's not unexpected as the associations are now 12 years older than they were in 2009, requiring more major maintenance and upkeep and the cost changes associated with the additional work.

5) I've been asked by several associations in recent years for this type of analysis for their particular association for them to help explain to their members why the assessment needed to be adjusted. In the ones I had evaluated, everyone had a larger increase in the reserve portion of the assessment; some even more dramatic than the overall results shown here.

6) The chart on the following page shows a picture of the relative values between the operating and reserve assessments over the 12-year period. The operating portion increased $34 (12.1%) while the reserve portion increased $53 (52.5%).

7) The chart is based upon historical data so it shows calendar 2020 information and fiscal years through August 2021. I've heard from a number of you that the 2022 assessment changes will be more dramatic. I'm in the process of gathering 2022 budget information from other associations to document the 'chatter'. I'm hopeful to collect enough information to develop a viable analysis and publish those results soon.

8) In our current real estate market, I'll bet that most associations' annual assessments are at 1% or below of the fair market value of the units. For example, a $500 per month assessment would be $6,000 annually. Is the unit worth more than $600,000? For many associations, the answer will be yes.


OPERATING VS RESERVE ASSESSMENTS
Total Median Assessment
$500
$400
$300
$200
$100
$0
Year
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
$101
$281
$101
$287
$113
$284
$118
$290
$121
$282
$122
$290
$128
$286
$130
$281
$136
$285
$142
$291
$146
$293
$143
$302
$154
$315
Reserve Median
Operating Median

TAX AND CORPORATE COMPLIANCE FILING UPDATES

By: Michael J. Gartzke, CPA

Federal 1120H – This continues to be a paper-filed form for 2021. In my practice, the majority of associations file this form since investment income is nonexistent for many associations. Some of us had hoped that the 1120H would be filed electronically this year so that all income tax filings could be handled electronically. In a recent news release, the IRS indicated that they had over 10 million paper filed tax returns of all types that had not yet been processed. Some of these go back months. I'm sure that includes many 1120H forms.

California Secretary of State – Statements of Information and Common Interest Development (SI-100/SI-CID). These forms continue to be due every two years on the anniversary of your incorporation date. For example, if you incorporated in March 1988, your next filing is due March 2022 (even years). If you incorporated October 2005, your next filing is due October 2023 (odd years). Fees are $20 for SI-100 and $15 for SI-CID. Years ago, it took 3-4 months for these to be processed. Currently, processing time is one week.

Forms and Instructions can be found online - https://www.sos.ca.gov/business-programs/business-entities/forms

If you are unclear as to when your filings are due or what your last filings look like, you can access your information from their website - https://businesssearch.sos.ca.gov/. You can see how forms were prepared last time which may help you if you have questions. For newer associations, articles of incorporation are also posted. If you find that an update is needed and it is not yet time for your biannual filing, you can file an update for no fee. If you are needing to update or add bank accounts, the banks will access this information and will require you to update the filings if they are not current.

It is critical to file these forms by the due date and re-file any forms that are returned by the Secretary of State for corrections immediately to maintain active status. If an association becomes suspended by the Secretary of State or Franchise Tax Board, the association loses its corporate powers. In recent years, I've been called on to prepare the FTB form for tax-exempt status because exemption was revoked due to suspension. Non-exempt corporations pay a minimum tax of $800 per year. For a detailed discussion of corporate suspension and revival, see the following webpage - https://www.ftb.ca.gov/help/business/my-business-is-suspended.html.

For my clients, I have a master incorporation list tracking due dates and providing a reminder letter 30 days before the due date. This list includes all corporations, not just HOAs. I update annually at year-end. Recently, I had 3 associations suspended. Two for the SOS filings were delinquent and one FTB delinquency from a year prior to my preparing the returns. All have been alerted to work on revival. Earlier, last year, a nonprofit I work with was suspended for a tax form that FTB wanted from 25-years ago. Again, before my time but hours on the phone by the director with the FTB determined that the form wasn't required after all and they were reactivated at last.

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