

# SOUTH COAST HOMEOWNERS ASSOCIATION

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Newsletter Sponsors

## **GRIMM'S TOP 10 WAYS TO AVOID LEGAL TROUBLE**

### **NEXT SOUTH COAST MEETING – JULY 24**

We get lots of questions at our South Coast meetings regarding the “nuts and bolts” of association operations. Questions about topics such as records retention and inspection, open meetings, proper minutes, elections, CC&R violations, etc. come up all the time. Please join us for our annual summer meeting when Beth Grimm, Bay Area attorney and writer, will discuss these and other topics that tend to get associations into legal “hot water”.

**Date** – Thursday, July 24

**Time** – 7 PM

**Place** – Holiday Inn – Goleta – 5650 Calle Real (between Patterson and Fairview)

**Cost** – None

These sessions feature plenty of useful information along with an opportunity to share questions and answers. Reservations are not necessary

### **SOUTH COAST OFFICE CLOSED FOR VACATION – 7/4-7/17**

**PLEASE FEEL FREE TO MAKE COPIES FOR YOUR BOARD MEMBERS  
SHARE THIS NEWSLETTER WITH YOUR ENTIRE BOARD OF DIRECTORS**

## COMMON QUESTIONS & ANSWERS ABOUT RESERVE STUDIES – Part I

**By: Chris Andrews – Stone Mountain Corporation**

Editor's Note: Chris has been preparing reserve studies for over 10 years and is a frequent contributor to our newsletter and has given numerous programs for us as well. Chris can be reached at 681-1575 or at [smc@west.net](mailto:smc@west.net)

Summer is usually reserve study season for most associations because they're looking ahead to preparing their annual budget in the fall and they need to have their reserve study done ahead of their budget meetings.

Consequently, now is the time when board members start to ask various questions about reserve studies, many of which are similar. So here are some typical answers to some of the typical questions.

### **1. What is a reserve study (have to start with the basics...)?**

A reserve study is a long-range financial planning report used by homeowners associations to budget for long-term capital expenses (such as roofing, paving, etc.). Preparing a reserve study involves several steps:

- 1) Develop an inventory of reserve components (roofing, paving, etc.) the association is obligated to maintain
- 2) Determine current replacement cost, useful life and remaining life for those items
- 3) Perform a financial analysis to determine how to methodically fund those long-term costs over time.

The net result of a reserve study is a dollar amount that your association should set aside each year so funds will be available when reserve expenses occur. That amount is your annual reserve-funding budget.

The reserve budget is not to be confused with your operating expense budget. Think of your association's annual pro-forma budget as two budgets running in parallel. One is your operating budget, typically consisting of expenses incurred for normal day-to-day operations such as insurance, pool maintenance, utilities, etc. The other is your reserve budget, which consists of long-term capital expenses derived from your reserve study. These two budgets, added together, comprise your overall annual budget.

Your operating budget is much easier to forecast than your reserve budget because projecting expenses such as next year's landscaping service, utilities, etc. is usually straightforward, whereas projecting the cost of a roofing project 3 years from now can have wide variances. Reserve expenses can vary widely from year to year and the magnitude of the costs can be staggering in comparison to your operating budget. Indeed, the dollar magnitude of your annual operating expense budget pales in comparison to the total value of

your roofs, streets, and amenities covered by your reserve budget. The potential for huge shortfalls in your reserve budget underscores the need to establish a detailed reserve funding plan.

## **2. Are reserve studies required?**

Reserve studies are required every 3 years for most California homeowners associations per California Civil Code 1365, with annual reviews in interim years. Here is an excerpt from CC 1365.5(e) for your enjoyment:

**“At least once every three years the board of directors shall cause to be conducted a reasonably competent and diligent visual inspection of the accessible areas of the reserve components which the association must repair, replace, restore, or maintain as a part of a study of the reserve account requirements of the common interest development if the current replacement value of the major components is equal or greater than one half of the gross budget of the association which excludes the association’s reserve account for that period. The board shall review this study annually and shall consider and implement necessary adjustments to the board’s analysis of the reserve account requirements as a result of that review.”**

The reason reserve studies are required for most, but not all, associations comes from the phrase: **“...if the current replacement value of the major components is equal or greater than one half of the gross budget of the association which excludes the association’s reserve account for that period.”** This phrase exempts associations that have minimal maintenance obligations from being required to do reserve studies. Typically these might be an associations having only a common area green space to maintain and no exterior structural maintenance or roads. For most all other associations, reserve studies are required.

Does the State of California actually have the resources to enforce Civil Code 1365 if your association doesn’t do a reserve study every 3 years? Probably not, but it is in your best interest as an association to adopt sound fiscal planning practices. And as members of your association’s board of directors, you probably won’t want to be considered negligent for not having a reserve study done.

## **3. Must our association do a reserve study every year?**

Assuming your association is not one of the “minimal maintenance obligation” associations that are not required to do reserve studies, your association must do reserve studies every 3 years with annual reviews in interim years. However, in practice, many mid-to-large sized associations have “reserve study updates” in the interim years in addition to the on-site reserve study done every three years. For mid-to-large sized associations, having a reserve study update is a routine part of the budgeting process. This is because enough factors change each year that their boards prefer to systematically calculate the next year’s reserve funding level during annual budget time.

Another reason to do a reserve study more often than every three years is when your association has just incurred substantial reserve expenses and your board needs to know what is the appropriate level of annual reserve funding now that those expenses have been paid. For example, suppose your association re-roofed in the last few months and roofing costs were higher than you had anticipated so you now have less in reserves than you expected. But the good thing is you now have a 30-year roof instead of a 20-year roof, so the next roof replacement cost can be amortized over 30 years instead of 20 years. What impact does this have on your reserve budget going forward? Running a 30-year reserve cash flow analysis will show how this plays out and will determine how much your association now needs to set aside each year to your reserve account. Surprisingly, sometimes reserve studies recommend that you can actually lower your annual reserve funding.

#### **4. Must our association actually fund the amount to reserves that was recommended by the reserve study?**

California Civil Code 1365 doesn't *explicitly* require your board to fund to reserves exactly as recommended by the reserve study. Try to divine the intent of the legislative lawmakers from this Civil Code 1365.5 excerpt:

**“The board shall review this study annually and shall consider and implement necessary adjustments to the board’s analysis of the reserve account requirements as a result of that review.”**

Suppose the board reviews the reserve study and disagrees with the timing of trim painting, for example? Does the board have to fund the reserve budget as recommended by the reserve study anyway?

One could interpret the above phrase to mean that implicit in the board's "review" of the reserve study is some degree of board discretion.

Perhaps a more pragmatic answer to the question is to acknowledge that it is your fiduciary role as a board member to provide for proper maintenance of the common area assets of the association via proper reserve funding. You also don't want to be potentially labeled as negligent in the future. The foregoing are indeed rational reasons for following the reserve funding recommendation.

There are cases where your board may decide not to adopt an annual reserve budget as recommended by the reserve study. You may, for example, opt to special assess for some large expenses instead of raising monthly association fees.

#### **5. The reserve study suggests that our association is way behind in reserve funding. Can we do a one-time special assessment to catch up while keeping our monthly fees about the same?**

Yes, this is fairly common because homeowners typically prefer to keep monthly fees low, if possible. Higher monthly fees can be a disincentive for new home buyers to buy into an association and can potentially have a tangible adverse affect on resale values.

Keep in mind that Civil Code 1366 allows your board to levy special assessments up to 5% of the budgeted gross expenses for that fiscal year without member approval. Larger special assessments require a simple majority vote of a quorum of your members.

## **6. Our association is 30% funded. Should we be concerned?**

The percent-funded estimate is a measure of how much money you have in reserves compared to how much your reserve components (roofing, paving, pools, etc.) are “used up.” If your association is 100% funded, you would theoretically have the exact amount of cash in reserves to pay for the portion of those items that has been used up. If your association is 30% percent-funded you may or may not need to raise reserve funding levels. It all depends on how healthy your current contributions to reserves are. The percent-funded estimate evaluates how well past board members have saved reserves for the future.

For an in-depth discussion on this subject, see the June 2002 Issue of the SCHA Newsletter titled, *“Myths & Realities of the Percent Funded Estimate.”*

## **7. Why can't our association simply pay for roofing/painting/paving/etc expenses as they come up?**

This question implies that the board would like to levy special assessments for expenses as they occur. Some associations operate this way, but there can be significant drawbacks.

The primary drawback is that your board may have trouble collecting all of the necessary money from all owners when large reserve expenses occur. Suppose some owners may not be able to cough up \$10,000 for a roofing special assessment when your association really needs it. It is better to collect the money gradually every year so your association has those funds when they're needed.

Another drawback of the special assessment funding method is that it unfairly penalizes those homeowners who happen to be living in the association at the time of the special assessment. A reserve study calculates an annual reserve funding amount, which ensures that everyone pays equally for the depreciation that occurs while they live in the association. (Depreciation is the process of “using up” an asset such as roofing, streets, etc. over a period of time).

## **8. As a senior citizen who may have to move to a long-term care home in 5 years, why do I have to help pay for the roof replacement that will happen 20 years from now?**

Senior citizens are not the only ones who pose this question. Young people who consider a condo as a starter home and who often don't plan on living there for more than several years ask the same question. The problem with the “short-timer” logic is that these people are benefiting from the use of the roofs, streets, pool, etc. while they're living in the association. If the roof is a 30-year roof and they live in the association for 5 years, then the value of the benefit they derive from the roof is  $5/30^{\text{th}}$  or  $1/6^{\text{th}}$  of the cost of the roof replacement. It is indeed fair that they pay for their incremental use of the roof, streets, pool, etc. even though they may not be living in the association in the future when the actual replacement occurs.

## BOARD BASICS

### WHAT IS THE “DAVIS-STIRLING” ACT

You have seen many references in this newsletter and other HOA resources about the “Davis-Stirling Act. What exactly is the “Davis-Stirling” Act? Why do association boards need to know about it?

**Background:** As common interest development housing started to be developed in the late 1960s and 1970s, laws were enacted by the California Legislature to define associations and regulate their operation. As these pioneer associations aged, it became apparent that these organizations were unique, a blend of business and government. In the early 1980s, special state legislative committees, chaired by Gray Davis and Larry Stirling, were convened to bring some order to the chaos surrounding association law. Different laws pertaining to associations were scattered around the California Civil Code and other codes. The committee brought the existing law into one place, Title VI of the California Civil Code (CC sections 1350-1376), and created new laws with the purpose of improving association operations. In 1985, the Davis-Stirling Common Interest Development Act was passed. Since then, the Act has been amended or changed nearly 50 times. Every year, there are numerous proposals to change the Act and some of them pass each year.

**What it contains:** The Act starts with definitions of association concepts. Here you will find guidance as to what is exclusive use common area and a separate interest, for example (CC 1351). In recent years, a section was added to help resolve association disputes (CC 1354). Some guidance is provided for unit modification and handicap access (CC 1360). Another important section includes membership discipline and fines (CC 1363) and open meeting laws (CC 1363.05). Repair responsibilities pertaining to termite and other wood destroying pests are outlined in CC 1364. Financial responsibilities such as budget preparation, reserve study requirements and required disclosures are found in CC 1365 and 1365.5. Board and association liability protections are found in CC 1365.7 and 1365.9. Limitations on special assessments and regular assessment increases are found in CC 1366. The ability to lien a member’s unit for past due assessments was extensively changed last year. Those laws are found in CC 1367. Construction defect resolution procedures are found in CC 1375.

The Act takes up 65 pages in the *Condominium Bluebook* that we distribute to each association annually. Yet the Bluebook is over 300 pages long. Other laws in the Corporation Code, Health and Safety Code and elsewhere in the Civil Code also affect association operations. However, the laws in the Davis-Stirling Act are exclusive to common interest developments. They do not apply to any other type of organization or corporation. Unless otherwise provided in the law, the Act applies to all associations no matter how large or small. Many provisions of the Davis-Stirling Act are incorporated verbatim into governing documents such as your CC&Rs and bylaws. Governing documents recorded prior to the passage of the original Davis-Stirling Act do not contain the Act’s provisions. In many cases, California law will supercede these governing documents when there is a conflict, rendering these documents obsolete.

No governmental agency tells boards about the Davis-Stirling Act. The California Department of Real Estate is involved when units are sold for the first time but drops out of the picture when the last unit is sold in a new development. Qualified professional

management should be knowledgeable about the existence of the Act and its contents and how it applies to your association. Many associations, especially small associations, cannot afford professional management so it is up to you as board members to be aware of the Davis-Stirling Act and its provisions. Association professionals such as your attorney or CPA should also be knowledgeable about the Act. Disseminating information such as the Davis-Stirling Act provisions and changes was a prime reason why South Coast HOA was formed nearly 15 years ago. By having more information at your disposal, we believe that you will make a more informed decision and in the long run, make better decisions.

## **IMPORTANT CHANGES BEING MADE IN PEST CONTROL**

***By: Chuck Swankosky, General Manager  
Green's Entomological Service, Inc., Ventura***

Editor's Note: After our March article on changes in fumigation regulations, Mr. Swankosky asked that we elaborate some on the new requirements. Green's is a South Coast HOA member. They can be reached at 642-2177.

In order to provide optimal service and guarantee your safety, we at Green's Entomological Service, Inc. wanted to inform you of some recent changes being made in the Pest Control Industry regarding fumigations.

In the wake of the recent gas explosion at a property being fumigated in Los Angeles, the Department of Transportation has ordered the Gas Company to standardize new procedures for the shut-off and restoration of natural gas service to structures being fumigated. Therefore, all Pest Control Company's are implementing the following procedures:

- 48-hour (minimum) advance notice is required for gas shut-off. As a Pest Control Company, we ask that you as the Homeowner or agent do not call the Gas Company to have your service shut-off. This is a service that your Pest Control Company should perform for you.
- 24-hour (minimum) advance notice is required for gas restoration. The homeowner must call (800) 427-2200 for gas restoration service. The Homeowner or an authorized agent, 18 years or older, must be home at the time of gas restoration service.
- The Gas Company requires the Homeowner or agent provide proof that the structure is safe for re-entry. This is a Certification of Re-Entry that is provided by your fumigation company.
- At the time the gas is being restored, the Gas Company will check your appliances and re-light all pilot lights. (Do not attempt to do this yourself!)
- Shut-offs will not occur on Saturdays, Sundays or Holidays

- Restorations can take place on Saturdays, but not Sundays or Holidays

In addition, we urge all Homeowners to inform the Gas Company that the restoration is for a house that was recently fumigated. This will ensure that they give the order priority and also perform the service free of charge.

Important Note: If anyone other than the Gas Company turns on or off your gas service, there may be fines ranging from \$3,000.00 to \$25,000.00 with additional legal ramifications.

Because of the new gas shut-off procedure, we ask that you please schedule your fumigations well in advance to allow your Pest Control Company time to notify the Gas Company. Please be aware that in the event of a cancellation, your Pest Control Company may not be able to guarantee that a shut-off request will be retracted in time to ensure you are not without gas for your home.

Your Pest Control Company should work with you to ensure the process runs as smoothly as possible with minimal inconvenience.

## **OTHER EDUCATIONAL OPPORTUNITIES**

**CAI (Community Associations Institute)** – CAI Channel Islands Chapter holds monthly luncheons in Camarillo on topics of interest to board members and managers. These meetings are held at the Orchid Room, 816 Camarillo Springs Rd., Camarillo. Cost information is available from Diana Sellers at CAI –658-1438.

**May 27** – “Lifetime Components” – Even Lifetime Components Fail – Are You Properly Reserved? Speakers include South Coast member – Bart Mendel of Stonemark Construction Management along with Les Weinberg of Reserve Studies, Inc.

**June 24** – “Realistic Budgets – A Hard Sell?” – A continuation of the May program where the implementation of the reserve study and operating budgets will be discussed by Danita Vaughn of Management Solutions and South Coast member Michael J. Gartzke, CPA

**ECHO (Executive Council of Homeowner Associations)** – Annual Seminar – Saturday, **June 14** at the Santa Clara Convention Center in Santa Clara. Each year ECHO presents a full day of seminars on a wide variety of subjects in addition to the Trade Show where vendors from industries that serve associations are available to answer questions. Each attendee receives a book containing all of the seminar outlines for reference. If you are interested in attending, please call Mike Gartzke at 964-7806 for more information.



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We still have a limited number of publications available for purchase:

***Questions and Answers About Community Associations*** – by Jan Hickenbottom, PCAM. This is a compilation of over 300 columns written by Jan that appeared in the Los Angeles Times from 1989-2001 - \$26.00/each – postpaid.

**HOMEOWNER ASSOCIATION ORGANIZATIONS**

Community Associations Institute –  
Channel Islands Chapter  
P. O. Box 3575  
Ventura, CA 93006  
805-658-1438  
[www.cai-channelislands.org](http://www.cai-channelislands.org)

Executive Council of Homeowners  
ECHO  
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## MEETING REGISTRATION

### MEET THE AUTHOR!

## QUESTIONS AND ANSWERS ABOUT COMMUNITY ASSOCIATIONS

**Jan Hickenbottom**, author of the newly published *Questions and Answers about Community Associations* will speak to South Coast on **Saturday, May 17**

Moby Dicks Restaurant  
Stearns Wharf, Santa Barbara  
Registration – 9:00-9:30 AM  
Breakfast 9:30  
Program to follow  
Cost - \$15 per person

Jan has been a professional in the community association industry since 1979 and has worked with associations of all sizes involved in crisis management, manager recruitment, board training and other consulting services. She has also served as an expert witness in court proceedings and provided mediation of association disputes.

Jan was instrumental in forming the California Association of Community Managers, a self-regulatory trade organization that was formed to educate and elevate the professional standards of care and ethics of community association managers. She has earned their CCAM designation along with the PCAM designation from the Community Association Institute. Jan's Condo Q & A column appeared in the *Los Angeles Times* from 1989-2001.

Space is limited to the first 60 paid reservations.

(Detach here)

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Please find enclosed our check for \$ \_\_\_\_\_ to reserve for Jan's Hickenbottom's presentation on May 17.

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