SOUTH COAST HOMEOWNERS ASSOCIATION

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IN THIS ISSUE

South Coast Invoices and Questionnaire Mailings
Insurance Coverage Amounts to Protect Members and Directors
Non-judicial Foreclosure May Result in Title Problems
Independent Contractor Reporting
Upcoming Meetings

SOUTH COAST INVOICES AND QUESTIONNAIRE MAILINGS

Invoices – Please be sure to send in your 2001 dues payment soon if you haven't already. We are in the process of preparing the 2001 Membership Directory and want to include all our members in it. Dues are only $45 annually, a great value. We have ordered the *2001 Condominium Bluebook* and the DRE's *Reserve Study Guidelines* (revised 2000) that will be part of your 2001 subscription. Additionally, we hope to distribute another association book that we know is currently being edited. If you would like to order additional Bluebooks at $15 each, postpaid, just send along your name, mailing address and check and we will ship them out to you as soon as we received them, most likely in January.

Questionnaire – Thanks to all that have returned our membership questionnaire. We haven't received as many responses back as we would like to obtain the best picture of association operations in our area. Part of the problem may have been the many associations that were involved with preparing and mailing their budget information in the fall. Since most of that work has been completed, the deadline to return your questionnaire has been extended until **December 22nd**. If you have misplaced your questionnaire, please call and we will send you another one promptly. We intend to distribute the results as a part of the 2001 Membership Directory.

CORRECTION

In the "Budget Tips for your 2001 Budget" (Oct 2000), there was a math error. I indicated that gas costs increased from 54 cents to 72 cents per therm, an increase of **25%**. My grade school kids would point out that increase is **33.3%** (18 cent increase divided by 54). Oops! To follow up, gas costs are now 80-81 cents per unit, an increase of **50%!** For some associations that use gas for pools, interior fireplaces, etc., this will be a major cost increase.

INSURANCE COVERAGE AMOUNTS TO HELP PROTECT OWNERS AND VOLUNTEER OFFICERS AND DIRECTORS

Over the past several years, amendments were made to the Davis-Stirling Act (Civil Code) to provide members with some levels of liability protection in the event of a claim or a lawsuit against the association or one of its members. These laws are found in Civil Code Sections 1365.7 and 1365.9 and are summarized below:

Officer and Director Liability: A volunteer officer or volunteer director of an association, which manages an exclusively residential common interest development shall not be personally liable to any person who suffers injury (bodily injury, emotional distress, wrongful death or property damage or loss) as a result of the tortious act or omission of the volunteer director or officer, if all of the following criteria are met:

1) The act or omission was performed within the scope of the officer's of director's association duties. (this includes evaluation of issues pertaining to construction defect issues)

2) The act or omission was performed in good faith

3) The act or omission was not willful or grossly negligent and

4) The association maintained insurance at the time the act or omission occurred that includes general liability for the association and individual liability of officers and directors (errors and omissions) of the association in the following minimum amounts

   a) **$500,000 –** if the association has 100 or fewer separate interests (units)

   b) **$1,000,000 –** if the association has more than 100 separate interests

Other criteria that must be met include that the director may not own more than 2 separate interests (but can be a nonowner if the association has nonowner directors), cannot be the developer or a developer representative, and cannot receive compensation for services other than payment for out-of-pocket expenses.

Member Liability: In 1992, the California Court of Appeals in *Ruoff vs., Harbor Creek Community Association* ruled that individual owners as well as the association could be held individually liable for injuries sustained by someone in the common area. If the damages exceeded the association's insurance coverage, a claimant could go after one or several owners for the balance of the judgement (looking for deep pockets). As a result of this case, Civil Code Section 1365.9 was enacted to provide limited civil liability protection to members of the association. If the association maintains general liability insurance as noted below, then any claim for damages can only be brought against the association and not individual members.

$2,000,000 – If the association has 100 units or less

$3,000,000 – If the association has more than 100 units

COLLECTION UPDATE: NON-JUDICIAL FORECLOSURES MAY RESULT IN TITLE PROBLEMS MAKING A UNIT DIFFICULT TO SELL

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Editor's Note: In recent years, most area associations have been successful in collecting their assessments on a timely basis. This is due to the stronger economy and increase in real estate values and equity for many homeowners. Should real estate economics reverse, as they did in the early to mid 90s, more associations may have collection problems and will look to foreclosure as the final option to collect assessments. This article looks at one type of foreclosure process and potential issues for the association to deal with.

The next time an Association is contemplating a non-judicial foreclosure as a means to collect delinquent assessments from a homeowner, the Association should be aware that if it actually ends up owning the unit, its problems are not over but may just be starting.

Non-judicial foreclosure of an assessment lien is a formidable remedy afforded to associations to assist in the collection of delinquent assessments. It is authorized under the CC&Rs of every common interest development and is statutorily recognized in Civil Code Section 1367 of the Davis-Stirling Act. As it name indicates, non-judicial foreclosure does not involve a lawsuit and is generally recognized as an expeditious and cost-effective alternative to a judicial foreclosure in which a lawsuit is filed. The non-judicial foreclosure can be completed in approximately 120 days and the fees for this process are set by statute. At the trustee's sale concluding the foreclosure process, the Association "credit bids" (offers to purchase the unit for the amount of the debt which the owner owes the Association) on the property for the amount of the owner's delinquency, obtains title and then can resell the unit to pay the debt.

However, this remedy is not necessarily a panacea for the Association because title companies may not be willing to provide insurance guaranteeing title to the property, which is an absolute requirement if the purchaser is financing the purchase of the foreclosed unit from the Association. The reason that this insurance may not be readily available is that the title insurance carriers, for the $400 - $600 premium, are unwilling to take the risk that the foreclosed-upon owner will not seek to have the foreclosure set aside because of a technicality or fraud concerning the notice process. The Trustee's Sale Guarantee, provided in due course by the Trustee handling the foreclosure, provides no representations or assurance that the claim is valid or that statutory requirements were carried out. In short, the title company could be left holding the bag (editor's note – some legal term!) for either an invalid claim by the Association or an error by the Trustee during the process. So rather than being subjected to that risk, title insurers will not write such policies.

In effect, this means that the group of potential buyers of foreclosed-upon units is substantially limited to all cash purchasers because lenders financing a sale will mandate that a title policy be provided. This limited market may or may not present a problem for Associations, but it definitely is an important consideration of whether non-judicial or judicial foreclosure is used to collect delinquent assessments. Otherwise, after an Association expends its resources to obtain title, it may find itself holding a property it cannot sell, or

cannot sell quickly, to recover its costs.

This potential problem does not mean that Associations should never use the non-judicial foreclosure remedy. This remedy still remains a viable and effective means to persuade owners to pay current during the process, to remove “deadbeat" owners from living off the Association and force lenders to take title by foreclosing on the unit. However, it does not mean that the decision to employ this remedy should not be a knee-jerk reaction, particularly if there is a reasonable probability that title will be obtained. It depends on whether the primary goal of the Association is to recover money from a subsequent sale of the property. The fact of the matter is that non-judicial foreclosure is a more effective tool to coerce an owner to pay or to coerce a lender to foreclose than it is to obtain an asset to resell. That is because of the title issues referred to previously as well as the fact that most properties will be encumbered by a senior lien (mortgage, taxes, etc.) which the Association takes subject to in the foreclosure scenario. Rarely will a lender abandon its security interest and its lien inherently impacts the Association’s ability to sell.

So the point here is not that non-judicial foreclosure is a remedy to be avoided; rather it is a remedy that should be employed with the knowledge of certain inherent limitations when it comes to actually collecting money for the Association. Collection of delinquent assessments is not always a “cookie cutter” operation that does not require analysis, unless the Association’s collection budget is unlimited. Since that is a rare commodity for a homeowners association, the limitations of this remedy must be part of the decision-making process in determining how to approach a delinquency.

Schimmel, Hillshafer and Loewenthal is a South Coast member. They can be reached at 805-564-2068 (Santa Barbara).

INDEPENDENT CONTRACTOR REPORTING
NEW REPORTING REQUIREMENTS FOR ALL CALIFORNIA BUSINESSES
INCLUDING ALL HOMEOWNERS ASSOCIATIONS

What you need to know by January 1, 2001

Last January, we reported on a new law that was passed in 1999 but was not to be effective until 2001 that requires all businesses, including homeowner associations, to report the hiring of independent contractors to the Employment Development Department. Because of the onerous paperwork burdens and other major problems associated with this law, we had asked our legislators to consider legislation amending these reporting requirements to remove homeowner associations and other volunteer, nonprofit organizations from the reporting requirement. Needless to say, our pleas fell on deaf ears locally. So, effective January 1, 2001, your association has a new reporting requirement to the State of California for all the independent contractors that provide services to your association. These providers include gardeners, painters, handymen, maintenance contractors, accountants, bookkeepers, managers, attorneys, computer consultants, etc. The reason for this reporting requirement is not to collect income taxes but, rather, to gather data on where people work to track down deadbeat parents who are not paying child support obligations.

Background: Homeowner associations, like other California businesses, are required to file forms 1099s with the IRS every January for payments made to noncorporate providers of services to their businesses if the payments during the previous calendar year exceed $600 and the service provider is not an employee (for which you would issue a W2 form). The service provider's name, address, social security or tax identification number is collected by the association and reported on the 1099 form along with the amount paid by the association during the calendar year. Copies are mailed to the service-provider and to the IRS. The IRS tabulates the information and forwards it to the California Franchise Tax Board. This 1099 reporting is done once a year, in January, to increase compliance with income tax laws by self-employed individuals.

Our state government has been concerned in recent years about its collection record for compelling parents to meet their child support obligations. Three years ago, employers were required to report new employees within 20 days of hiring to locate delinquent parents more quickly. This reporting requirement has now been extended to independent contractors, effective January 1, 2001. Letters are going out from the EDD right now to California businesses informing them of the new requirement, providing questions and answers to some basic questions and providing two copies of the reporting form.

Implementation: Planning during December can be most helpful to you, as your first reporting deadline will be January 20, 2001. Refer to the copy of the reporting form DE-542. For identifying your association, you will complete the name and address section at the top of the form. Under Federal ID No, CA Employer Account Number or Social Security Number, most HOAs only have a Federal ID Number and so that is the only number you report. If you have employees, then you also report your CA Employer Account Number. For the independent contractor, you provide the following:

- Name and Address
- Social Security Number (not tax ID number)
- Start Date of Contract – Verbal contracts OK
- Amount of Contract (including cents!!!) – Can be estimated
- Contract Expiration Date – none if ongoing
- Whether Contract is Ongoing

Contractors who are corporations, partnerships and limited liability companies are not required to be reported as service recipients by associations.

If the contract is ongoing or when a service-recipient receives $600, then reporting only has to be done once in a calendar year, within 20 days of contract. Here are some samples of when the report is due:

1) Payments of $100 per month to janitorial service on the 10th of each month. $600 would be paid by June 10th. Reporting would be due by June 30.

2) CPA engaged to review financial statements. Engagement letter signed January 8, 2001. Work commences in February and completed in early March and payment made on March 29. Reporting is required by January 28, 20 days after signing the contract.

3) Gardener is retained on a monthly basis to provide services to the association for a fixed monthly fee of $1,000 per month. Since the contract was in existence as of January 1 and is ongoing, reporting is required by January 20.

4) Contractor is used off and on for various fix-up jobs on an as-needed basis. No formal contract is executed. You can either report in January as ongoing or wait until payments exceed $600, whenever that occurs during the year.

Where to send the forms:

By Mail: Employment Development Department
P. O. Box 997350 – MIC 99
Sacramento, CA 95899-7350

By Fax: 916-255-3211

Paper Flow: Information provided by you is sent to the EDD via mail, fax or magnetic media. The EDD processes the information and forwards it to the California Department of Justice. They will then send information to the County District Attorney for follow-up to match contractor information with deadbeat parents.

The Hammer: The EDD can impose a penalty of $24 for omitted or late reports. If the omission is willful (a conspiracy between the contractor and the association not to report), a penalty of $490 can be assessed. In addition, if a business does not report a contractor that owes delinquent child support, a custodial parent can file a suit in small claims court against the association for damages.

Problems, Problems, Problems: Where to start? Here are a few issues to consider:

1) **Original Form**: I called EDD to see if the original form must be used, which has all of the fields outlined in red boxes. Obviously, photocopies would be black, not red. Guess what? EDD says you must use the red form. I disagree. You can fax the form to EDD, which means that when they receive the form, it will not be red. I say you can make photocopies. (Copy of form on Page 8)

2) **20-Day Trigger:** Will the treasurer, bookkeeper or property management staff know when the 20-day window starts after signing the contract? Most bookkeepers won't know anything about the contract until the bill is presented for payment, which can be several months after the contract is signed.

3) **Garnishment:** The County DA's office can place wage garnishments for delinquent child support obligations for employees. Employers then have to withhold from the contract and forward to the Franchise Tax Board (who collects the garnishments). It appears that the County DA can garnish your contract payments, since collecting delinquent child support is the reason for this reporting. So if a contract is garnished, is the association protected if the contractor's employees go unpaid? Or, can the contractor's employees file a mechanics lien against the association for nonpayment? If any of our readers have any insights on this, I would like to hear from you. EDD had no answers.

4) **Reporting Dates:** While some of the reporting can be done in January for ongoing contracts, reporting obligations can occur anytime during the year, not just once a year or once a quarter. As you can see from the examples, one-time contracts can occur anytime.

5) **Costs:** If you ask your property manager, bookkeeper or CPA to prepare these forms for you, expect to pay for this service. It is at least equivalent to preparing 1099s which cost $10-$20 per form to prepare and process.

6) **Administration:** Will the EDD be able to process the information they receive. If there is even minimal compliance, I believe they will be buried in paper.

On the Web: Information is available at www.edd.ca.gov/txicrfaq.htm

Conclusion: Your paperwork burden has grown tremendously as a result of this new law. Professionally speaking, I will recommend that you do your best to comply. Will this burden be reduced or eliminated? Only time will tell. (Don't count on it)

UPCOMING MEETINGS

January 30, 2001 – Law and Legislative Update Panel – Goleta
Holiday Inn, 5650 Calle Real
7 – 9 PM

Last year, we had four South Coast member attorneys provide a panel discussion on a wide range of new legislation and law topics. This program was very well received by you and we had repeated requests to do this type of program again. Each panelist will speak on a specific topic for 10-15 minutes and then questions will be offered by the audience via a moderator for comment by the panelists. Mark your calendars now for this very special program

Panelists: Karen Mehl: Attorney at Law – Santa Maria
Jennifer Tice: Allen and Kimbell – Santa Barbara
James Smith: Grokenberger, Smith and Courtney – Santa Barbara
David Loewenthal: Schimmel, Hillshafer and Loewenthal – Sherman Oaks

Additional meetings are planned for the spring. We will also look to bring back the ABCs for Association Leaders, developed by Community Associations Institute that we presented in 1998 and 1999. Thank you for all your support during 2000. Best wishes for the New Year.

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