CALIFORNIA COMPLIANCE GUIDE

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Community Financials

www.communityfinancials.com

Board Members

Board Members

The governance documents of each association define the number of Board Members required. The Stirling-Davis Act requires that an association have a Board of Directors but does not have a requirement for quantity of Board Members,

Board Training

The Davis-Stirling Act called for "Department of Consumer Affairs and the Department of Real Estate shall develop an online education course for the board regarding the role, duties, laws, and responsibilities of directors and prospective directors, and the nonjudicial foreclosure process."

Candidate Qualifications

Normally, homeowners would be allowed to establish candidate qualifications for those who represent them. (Corp. Code §7151(c)(3).) Beginning January 1, 2020, a bill sponsored by Marjorie Murray's Center for California Homeowner Association Law (CCHAL) voided all community association candidate qualifications except for those allowed by CCHAL's bill (SB 323). CCHAL imposed one mandatory qualification and gave associations permission to adopt only four other qualifications as set forth below.

Mandatory Qualification. Associations are required to disqualify nominees as candidates for election as delegates and board members who are not members of the association at the time of the nomination. (Civ. Code §5105(b).)

Permissive Qualifications. Beginning January 1, 2020, there are only four candidate qualifications associations are allowed to adopt. They are as follows:

- **Delinquent.** The person is delinquent in the payment of regular and special assessments unless (i) paid under protest , (ii) entered into a payment plan, or (iii) not provided Internal Dispute Resolution (IDR). (Civ. Code §5105(c)(1)&(d).)
- **Joint Ownership.** If the person, if elected, would be serving on the board at the same time as another person who holds a joint ownership interest in the same separate interest parcel as the person and the other person is either properly nominated for the current election or an incumbent director. (Civ. Code §5105(c)(2).)
- **Owner Less Than 1 Year.** If that person has been a member of the association for less than one year. (Civ. Code §5105(c)(3).)
- **Criminal Conviction.** A past criminal conviction that would either prevent the association from purchasing the fidelity bond coverage required by Section 5806 should the person be elected or terminate the association's existing fidelity bond coverage as to that person should the person be elected. (Civ. Code §5105(c)(4).)

Qualifications No Longer Allowed. Marjorie Murray's Center for California Homeowner Association Law voided all other candidate qualifications. Following are some of the qualifications which are no longer allowed:

- The person must be in good standing. Now, a person can have significant architectural and rules violations and unpaid fines and still serve on the board.
- The person must not be in litigation with the association. Even though this creates conflicts of interest and confidentiality problems, persons suing the association can simultaneously serve on the board.
- The person has been convicted of a felony in the past ten years. As long as the association's fidelity bond is not affected, felons can now serve on the board.
- The person is a second or third tier registered sex offender.
- The person meets minimum age and residency criteria. This affects 55+ communities. It means an 18-year old who owns a unit through inheritance can serve on 55+ boards.

IDR Before Disqualification. An association cannot disqualify a person from nomination if the person has not been provided the opportunity to engage in internal dispute resolution. (Civ. Code §5105(e).)

Director Removal. In addition to qualifications for election to the board, many associations include conditions under which directors can removed from the board. For example, bylaws often state that a director's seat can be vacated by the board if the director misses three regularly scheduled meetings in a row or four in a twelve-month period. Associations can continue to use removal provisions provided they are reasonable and provided they do not conflict with the mandatory and permissive qualifications described above.

Qualifications Via Rule Change. Even though the bylaws may be silent on director qualifications, the court of appeal in Friars Village v. Hansing ruled that boards can adopt director qualifications in their election rules provided the qualifications are "reasonably related to the performance of the Board and will serve to protect its overall mission--protecting the best interests of the Association." The court's decision was based on a particular set of circumstances and the language in the association's governing documents so it is unclear if the decision allows associations to freely adopt director qualifications via rule changes. Accordingly, whenever possible, candidate-director qualifications should be implemented via an amendment to the bylaws.

Compensation for Services

The Davis-Stirling Act does not specifically address this topic but unless otherwise provided in the bylaws, Association officers and directors shall serve without compensation. Normally, the documents do not allow compensation. However, Directors/Officers can be reimbursed for any duties that they perform that are not a part of their duties as an officer and for out of pocket expenses.

Board Member Removal

REMOVAL BY BOARD. Where an association's bylaws provide for it or conditions are met as described in the Corporations Code, a director's seat can be declared vacant by the board. Only under limited circumstances can directors, whether appointed or elected, be removed by fellow directors.

Unqualified Director. Boards may declare vacant the office of any director who ceases to meet qualifications that were in effect at the beginning of that director's term of office. (Corp. Code §7221(b).)

Missed Meetings. The Corporations Code allows for removal of a director for missing meetings if provided for in the bylaws. (Corp. Code §7221(a).) If an association's bylaws are silent, a director could miss every meeting for an entire year and the board would be powerless to remove the person. At best, the board could censure the director for missing meetings. A common bylaw provision is to allow the board to remove a director who misses three consecutive regular meetings or a total of four regular meetings in a 12-month period.

Unsound Mind. The board may declare vacant the seat of a director who has been declared of unsound mind by a final order of court. (Corp. Code §7221(a).)

Felony Conviction. Although the Corporations Code provides that a director can also be removed if convicted of a felony while serving on the board (Corp. Code §7221(a)), the Davis-Stirling Act altered director candidate qualifications beginning January 1, 2020. A criminal conviction is relevant only if it would (i) prevent the association from purchasing the fidelity bond coverage or (ii) terminate the association's existing fidelity bond coverage.

Due Process. The vote to vacate a seat is not a disciplinary action--the board is not fining a director for violating a rule. Rather, it is declaring the seat vacant because the person is no longer qualified to be a director. Even so, the board should give notice to the director and hold a hearing in executive session to give the director an opportunity to cure the disqualification. If the director cannot or refuses to cure the disqualifying issue, the board can vote to vacate the seat.

Replacement Director. Once a seat has been vacated, the board can appoint a replacement to fill the seat unless the bylaws state otherwise.

REMOVAL BY MEMBERSHIP. The membership always has the right to remove directors from the board. If an association's governing documents provide for cumulative voting, removing less than the entire board is more complicated because a minority of voters can block the recall even if a majority of voters approve it. The process is confusing, the statute is badly written and authorities disagree on how it works.

Step #1. Approving The Removal. The first step is for the membership to vote by secret ballot to remove a director. If an association has fewer than 50 members, the removal is approved by the affirmative vote of a majority of all members entitled to vote. (Corp. Code §7222(a).) If the association has 50 or more members, removal is approved by the affirmative vote of a majority of the votes represented and voting at a duly held meeting at which a quorum is present, with the affirmative votes also constituting a majority of the required quorum. (Corp. Code §7222(a).)

Step #2. Blocking Removal. Once members approve the recall of a director, the removal can be blocked. No director may be removed when the votes cast against removal would be sufficient to elect the director if voted cumulatively at an election where all memberships entitled to vote were voted. (Corp. Code §7222(b).) Various formulas for calculating the number of votes needed to block removal have been developed by different authors. Following is an example:

$$V = trunc\ \left(\{\ \frac{1}{D+1}\ x\ M\}\ +1\right)$$ [*trunc* = truncate if the result is fractional]

Recommended. We recommend the following formula because it is easier to understand:

$$V > \frac{1}{D+1} \times M$$

V = number of votes needed to block removal
D = total number of directors authorized in the bylaws
M = total number of members entitled to vote

Example. Assume the following: (i) the association has 100 members eligible to vote, (ii) quorum requirements were met, and (iii) there is a five-member board. The formula produces the following result:

$V > \frac{1}{5+1} \times 100 = 16.6$ Therefore, the number of votes needed to block the recall is greater than 16.6, i.e., 17.

One Seat Only. If only one seat had been open when the director in question was elected, cumulative voting was not used in that election. That means that once quorum was achieved, a simple majority of votes was needed to elect the director. The same would apply to his recall, i.e., cumulative voting would not apply. That means a majority of those members casting ballots would be needed to block his removal. For example, if there are 100 units in the association and if the quorum is 50% and if 50 members cast ballots, the director subject to recall would need 26 votes to defeat the recall. If, however, 26 voted in favor of his removal and only 24 voted against, the director is recalled.
Staggered Terms. There is disagreement in the legal community on the impact of staggered terms on the formula. Some argue that it has no effect and the total number of directors authorized in the bylaws are used even if only two directors were elected in the most recent election. We disagree.

The Corporations Code provides that the number of votes that elected a director is the number that can block his recall. It states that "no director may be removed… when the votes cast against removal…would be sufficient to elect the director if voted cumulatively…" (Corp. Code §7222(b).)

Clearly, the number of open seats in an election affects the cumulative votes needed to elect a director. Per the statute, those votes are the same number needed to block removal. Assuming two seats were open in the most recent election, the formula produces the following result:

Example #1 Votes > $\frac{1}{2+1} \times 100 = 33.33$

Example #2 Votes > $\frac{1}{3+1} \times 100 = 25$

V = number of votes needed to block removal
D = *total number of directors authorized at the time of the director's most recent election were then being elected*
M = total number of members entitled to vote

In Example #1 with two open seats out of five, the number of votes needed to block the recall of an individual director would be greater than 33.33, i.e., 34 votes. In Example #2with three open seats, the number of votes to block the recall is greater than 25, i.e., 26 votes. Both examples give results in keeping with the language of the statute since they match the number of cumulative votes needed to elect the directors.

Those Not Voting. Some in the legal community argue that members who do not vote count as "no" votes. With this interpretation, recalling an individual director is virtually impossible due to voter apathy in most associations. The argument for counting non-votes as no votes relies on their interpretation of language in the Corporations Code that "no director may be removed…when the votes cast against removal, or not consenting in writing to the removal, would be sufficient to elect the director if voted cumulatively…" (Corp. Code §7222(b).) We disagree with this interpretation. There are two arguments against the practice.

1. **Written Consent.** First, there are two methods for approval. One is voting by ballot and the other is approval by written consent. In "written consent" one or more documents are circulated to the membership which allows members to sign consenting to the removal of a director or to not sign (consent) if they oppose removal. If a sufficient number of members do not consent to removal (i.e., oppose removal), the removal fails.

2. **Ballots Only.** Approval by written consent of the membership was eliminated when California changed voting procedures for homeowners associations to secret ballots for the removal of directors. Accordingly, written consent no longer applies to the removal of HOA directors. Reading the relevant portion of the Corporations Code, only actual ballots against removal may be counted: "no director may be removed… when the votes cast against removal…would be sufficient to elect the director if voted cumulatively…" (Corp. Code §7222(b).)

Replacement Director. Once members remove a director, his/her replacement must be elected by the membership not appointed by the board. (Corp. Code §7224(a).)

Recommendation: Because there is disagreement in the legal community on how cumulative voting affects recall elections, boards should adopt recall procedures. In addition, they should amend their governing documents to (i) eliminate cumulative voting, (ii) limit abusive recall petitions, (iii) eliminate proxies, and (iv) drop quorum requirements for the election of directors.

BOARD MEETINGS AND MEMBERSHIP MEETINGS

Board Meetings

"Board meeting" means either of the following:

A congregation, at the same time and place, of a sufficient number of directors to establish a quorum of the board, to hear, discuss, or deliberate upon any item of business that is within the authority of the board.

OR

A teleconference, where a sufficient number of directors to establish a quorum of the board, in different locations, are connected by electronic means, through audio or video, or both. A teleconference meeting shall be conducted in a manner that protects the rights of members of the association and otherwise complies with the requirements of this act. Except for a meeting that will be held solely in executive session, the notice of the teleconference meeting shall identify at least one physical location so that members of the association may attend, and at least one director or a person designated by the board shall be present at that location. Participation by directors in a teleconference meeting constitutes presence at that meeting as long as all directors participating are able to hear one another, as well as members of the association speaking on matters before the board.

Open Board Meetings

Open Meetings Required. "The board shall not take action on any item of business outside of a board meeting." (Civ. Code §4910(a).)

Meeting Defined. Board meetings are defined by the Davis-Stirling Act as a gathering of a quorum of directors at the same time and place to "hear, discuss, or deliberate upon any item of business that is within the authority of the board." (Civ. Code §4090.)

Business Defined. "Item of business" means any action within the authority of the board, except those actions the board has validly delegated to any other person or persons, managing agent, officer of the association, or committee of the board comprising less than a majority of the directors. (Civ. Code §4155.)

Exceptions. Not all gatherings of directors are "board meetings" and not all board meetings are required to be open--Executive Sessions are excepted.

Allowable Meetings. With proper notice, the following meeting forms are allowed:

- In Person. Directors can meet in person at a physical location.

- Tele-Video Conference. Directors meet via teleconference, whether by telephone or video conference. (Civ. Code §4090(b))

Disallowed Meetings.

- Unanimous Written Consent. Unanimous written consents can no longer be used for actions without a meeting.

- Email. Email meetings are prohibited except for conducting emergency meetings.

- Chain & Wheel-Hub. Attempts to avoid open meetings by using chain or wheel hub meetings are disallowed.

Notice of Board Meetings

Notice to Members. Unless the governing documents require longer period of notice, members must be given notice of the time and place of board meetings at least four (4) days prior to the meeting. (Civ. Code §4920(a).) Notice can be given by general delivery (Civ. Code §4920(c).) Notice, which must include an agenda, may be given by any of the following methods:

- Billing Statement. Inclusion in a billing statement. (Civ. Code §4045(a).)
- Electronic. E-mail, facsimile, or other electronic means, if the recipient has consented, in writing, to that method of delivery. (Civ. Code §4040.)
- Mail. First-class mail, postage prepaid, registered or certified mail, express mail, or overnight delivery by an express service carrier. The document shall be addressed to the recipient at the address last shown on the books of the association. (Civ. Code §4040.)
- Newsletter. A notice or report mailed or delivered as part of a newsletter, magazine or other organ regularly sent to members shall constitute written notice or report pursuant to this division when addressed and mailed or delivered to the member,

or in the case of members who are residents of the same household and who have the same address on the books of the corporation, when addressed and mailed or delivered to one of such members, at the address appearing on the books of the corporation. (Corp. Code §5016; Civ. Code §4040.)

- Posted in Common Areas. Posting the notice in a prominent location that is accessible to all members, if the location has been designated for the posting of general notices by the association in the annual policy statement, prepared pursuant to Section 5310. (Civ. Code §4045(a)(3)).

There are different notice requirements for emergency meetings, executive sessions, and membership meetings.
Request for Mailing. Members can request that individual notice of board meetings.

Open Meetings; Open Forum

Any member may attend board meetings, except when the board adjourns to, or meets solely in, executive session. As specified in subdivision (b) of Section 4090, a member of the association shall be entitled to attend a teleconference meeting or the portion of a teleconference meeting that is open to members, and that meeting or portion of the meeting shall be audible to the members in a location specified in the notice of the meeting.

The board shall permit any member to speak at any meeting of the association or the board, except for meetings of the board held in executive session. A reasonable time limit for all members of the association to speak to the board or before a meeting of the association shall be established by the board.

Limitations on Meeting Content.

(a)Except as described in subdivisions (b) to (e), inclusive, the board may not discuss or take action on any item at a nonemergency meeting unless the item was placed on the agenda included in the notice that was distributed pursuant to subdivision (a) of Section 4920. This subdivision does not prohibit a member or resident who is not a director from speaking on issues not on the agenda.

(b) Notwithstanding subdivision (a), a director, a managing agent or other agent of the board, or a member of the staff of the board, may do any of the following:

(1) Briefly respond to statements made or questions posed by a person speaking at a meeting as described in subdivision (b) of Section 4925.

(2) Ask a question for clarification, make a brief announcement, or make a brief report on the person's own activities, whether in response to questions posed by a member or based upon the person's own initiative.

(c) Notwithstanding subdivision (a), the board or a director, subject to rules or procedures of the board, may do any of the following:

(1) Provide a reference to, or provide other resources for factual information to, its managing agent or other agents or staff.

(2) Request its managing agent or other agents or staff to report back to the board at a subsequent meeting concerning any matter, or take action to direct its managing agent or other agents or staff to place a matter of business on a future agenda.

(3) Direct its managing agent or other agents or staff to perform administrative tasks that are necessary to carry out this section.

(d) Notwithstanding subdivision (a), the board may take action on any item of business not appearing on the agenda distributed pursuant to subdivision (a) of Section 4920 under any of the following conditions:

(1) Upon a determination made by a majority of the board present at the meeting that an emergency situation exists. An emergency situation exists if there are circumstances that could not have been reasonably foreseen by the board, that require immediate attention and possible action by the board, and that, of necessity, make it impracticable to provide notice.

(2) Upon a determination made by the board by a vote of two-thirds of the directors present at the meeting, or, if less than two-thirds of total membership of the board is present at the meeting, by a unanimous vote of the directors present, that there is a need to take immediate action and that the need for action came to the attention of the board after the agenda was distributed pursuant to subdivision (a) of Section 4920.

(3) The item appeared on an agenda that was distributed pursuant to subdivision (a) of Section 4920 for a prior meeting of the board that occurred not more than 30 calendar days before the date that action is taken on the item and, at the prior meeting, action on the item was continued to the meeting at which the action is taken.

(e) Before discussing any item pursuant to subdivision (d), the board shall openly identify the item to the members in attendance at the meeting.

Board Action Outside of Meetings; Emergency Meetings.

The board shall not take action on any item of business outside of a board meeting.

Notwithstanding Section 7211 of the Corporations Code, the board shall not conduct a meeting via a series of electronic transmissions, including, but not limited to, electronic mail, except as specified in paragraph (2).

(2) Electronic transmissions may be used as a method of conducting an emergency board meeting if all directors, individually or collectively, consent in writing to that action, and if the written consent or consents are filed with the minutes of the board meeting. These written consents may be transmitted electronically.

Emergency Board Meetings.

An emergency board meeting may be called by the president of the association, or by any two directors other than the president, if there are circumstances that could not have been reasonably foreseen which require immediate attention and possible action by the board, and which of necessity make it impracticable to provide notice as required by Section 4920.

Executive Session Meetings.

(a) The board may adjourn to, or meet solely in, executive session to consider litigation, matters relating to the formation of contracts with third parties, member discipline, personnel matters, or to meet with a member, upon the member's request, regarding the member's payment of assessments, as specified in Section 5665.

(b) The board shall adjourn to, or meet solely in, executive session to discuss member discipline, if requested by the member who is the subject of the discussion. That member shall be entitled to attend the executive session.

(c) The board shall adjourn to, or meet solely in, executive session to discuss a payment plan pursuant to Section 5665.

(d) The board shall adjourn to, or meet solely in, executive session to decide whether to foreclose on a lien pursuant to subdivision (b) of Section 5705.

(e) Any matter discussed in executive session shall be generally noted in the minutes of the immediately following meeting that is open to the entire membership.

Meeting Minutes

Required. Boards are obligated to keep minutes of their board and membership meetings. Minutes are the official record of the proceedings of an organization. (Corp. Code §8320.)

Who Takes Minutes. Taking minutes of board and membership meetings is one of the key duties of the secretary. The secretary can prepare minutes directly or oversee their preparation by others and then sign them once they have been approved by the board. Boards can authorize the manager, assistant manager, a management company employee, a recording secretary or a volunteer homeowner to assist in the taking and preparation of minutes. The appointment of an "assistant secretary" should be recorded in the minutes so as to facilitate insurance coverage. In small committees, the chair usually acts as secretary but in large committees and standing committees a secretary may be chosen to keep minutes. (Robert's Rules, 11th ed., p. 500.)

Recording Open Meetings. With the board's permission, the secretary may record open board meetings to assist in the preparation of minutes. Once the minutes have been

approved by the board, the recording should be erased. The recording secretary can, but is not required, to announce that he/she is recording the meeting. Even though the secretary may record meetings for the purpose of preparing minutes, the board can disallow recordings by others, whether it be members or other directors.

Recording Executive Session. Because of the sensitive nature of subjects dealt with in executive session (litigation matters, attorney-client communications, members discipline, personnel matters, etc.) executive session meetings should not be recorded.

What Should Not Be in the Minutes. Minutes should not contain owner comments and never be a transcript of every statement made by directors and attendees. Recording every comment creates potential defamation claims or becomes evidence for other claims against the board and the association. Minutes should reflect decisions and reasons for those decisions, not conversations. "The minutes should never reflect the secretary's opinion, favorable or otherwise, on anything said or done." (Robert's Rules, 11th ed., p. 468.)

What to Include. As a rule, minutes should record what was done at a meeting, not what was said. (Robert's Rules, 11th ed., p. 468.) Even so, the motion should include the rationale for the board's action. Following is a list of essential information that should be found in every set of minutes:

1. *Name of the Association*.
2. *Type of Meeting*. Regular, special, emergency, executive session.
3. *Date/Time/Location*. Date, time and location of meeting.
4. *Attendees*. Directors who were present and who was absent, along with their titles (President, Treasurer, etc.). The minutes should also list guests who were invited to speak to the board, such as the association's CPA, contractors bidding on projects, the association's attorney, etc. Persons who attend the meeting need not be listed in the minutes. (If their names are included in the minutes, they could be subpoenaed for a deposition in the event there is litigation surrounding the meeting.) Instead of attendee names, some associations list the total number of attendees at the meeting. This is not required but is optional.
5. *Approval of Minutes*. Prior meeting minutes should be read and approved. (Robert's Rules, 11th ed., p. 473-474.)
6. *Treasurer's Report*. A verbal report is sufficient.
7. *Committee Reports*. The fact that an officer and committee report, if any, was given. When a committee report is of great importance it can be entered in full in the minutes. (Robert's Rules, 11th ed., p. 471.)
8. *Guest Speakers*. "The name and subject of a guest speaker can be given, but no effort should be made to summarize his remarks. (Robert's Rules, 11th ed., p. 471.)
9. *Motions*. Motions and how directors voted.
10 *Executive Session*. General description of matters discussed in executive session.
11. *Next Meeting*. Date of the next meeting.
12. *Adjournment*. Time the meeting was adjourned.

NOTE: Because the Business Judgment Rule requires that boards satisfy their fiduciary

duties when making decisions, boards should include in their minutes reasons why they took the actions they did.

Attachments to Minutes. Contract proposals reviewed by the board are generally not attached to the minutes. The underlying documents that support the board's decision are kept in the board packet which is kept on file in the management office. Documents may be attached to and made part of the minutes but only with board approval. Individual directors do not have the right to attach documents to the minutes without board approval.

Correspondence. Neither members nor directors have a right to include their correspondence in the minutes. The purpose of minutes is to record the official business of the board not act as an outlet for grievances. If letters are included in the minutes, some correspondence may be inflammatory, inaccurate and defamatory, which could lead to litigation.

Draft Minutes. Draft minutes of open board meetings must be made available to the membership within 30 days. Failure to do so can result in penalties against the association. Notice of the membership's right to minutes must be made annually. Minutes should be readily accessible for membership review.

Meeting Minutes Overview

(a) The minutes, minutes proposed for adoption that are marked to indicate draft status, or a summary of the minutes, of any board meeting, other than an executive session, shall be available to members within 30 days of the meeting. The minutes, proposed minutes, or summary minutes shall be distributed to any member upon request and upon reimbursement of the association's costs for making that distribution.

(b) The annual policy statement, prepared pursuant to Section 5310, shall inform the members of their right to obtain copies of board meeting minutes and of how and where to do so.

Membership Meetings.

(a) Meetings of the membership of the association shall be conducted in accordance with a recognized system of parliamentary procedure or any parliamentary procedures the association may adopt.

(b) The board shall permit any member to speak at any meeting of the membership of the association. A reasonable time limit for all members to speak at a meeting of the association shall be established by the board.

Annual Meeting.

Associations are required to hold membership meetings as often as the bylaws specify, but no less often than director elections are required. If director elections are required annually

(one-year terms or staggered multi-year terms) then the association must have annual meetings. But if the bylaws only require director elections every two years (two-year terms with no staggered elections), they may also permit the association to have membership meetings biennially. If the bylaws require annual meetings but the election of directors is every other year (or some other schedule), there will be annual meetings where no business takes place except to review the accomplishments of that year, review the finances, and answer questions.

RECORD KEEPING

Although members have the right to inspect and copy minutes, they don't own the minutes nor do they have the right to remove them from the association's office.

Sometimes owners mix requests for information with requests for records. The Davis-Stirling Act provides for an owner's limited right to inspect books and records but does not create an obligation that associations compile information.

Records Retention Policy

The following is a general guideline for how long records should be kept. The guideline does not cover all records or situations. Boards should work with legal counsel and a CPA to establish their own records retention policy.

A. Permanent

1. Governing Documents
   - CC&Rs
   - Bylaws
   - Articles of Incorporation
   - Condominium Plan
   - Parcel Map
2. Minutes
   - board and membership meetings. (Civ. Code §5210(a).)
   - committees with decision-making authority.
3. Deeds to Property Owned by the Association
4. Architectural Plans for the common areas.

B. Seven Years To ensure that all statutes of limitations have passed, the following records should be kept for seven years before disposing of them.

1. Financial Records
   - budgets
   - general ledgers, journals and charts of account
   - year-end financial statements
   - accounts payable
   - accounts receivable ledgers, trial balances and billing records

- canceled checks and bank statements
- expense analysis and expense distribution schedules
- invoices from vendors
- deposit slips
- reconciliations
- petty cash vouchers
- purchase orders

2. Expired Contracts

3. Personnel Records (Per Labor Code 1198.5(c)(1) employers are obligated to keep employee records at least 3 years following the date of termination/separation. Employers can keep them for a longer period, but 3 years is the minimum. Personnel records must be kept indefinitely as long as someone remains an employee.)

4. Insurance Records
   - accident reports
   - settled claims
   - expired policies
   - fidelity bonds
   - certificates of insurance
5. General Correspondence

6. Closed Litigation Files
7. Newsletters
8. Expired Warranties
9. Tax Returns
10. Owner architectural submittals.

C. <u>One to Three Years</u> Election materials must be retained by the inspector of elections for one year after the date of the election, at which point the statute of limitations for challenging an election expires and the materials are transferred to the association. (Civ. Code §5125.) When the records can be disposed of is unclear. Since the election materials no longer have any value, there is no reason to retain them. However, some associations prefer to keep them for three years so members can inspect election records for the current year and prior two years. (Civ. Code §5210.)

D. <u>Secure Destruction</u> Whenever an association disposes of records, it must ensure that the records are completely destroyed, preferably by shredding or incineration. Simply throwing them into the trash can result in potential liability if confidential records end up in the wrong hands.

E. <u>Litigation Hold</u> Records should not be destroyed if the association has notice of or reasonably believes it will be involved in a lawsuit. Based on various California cases, the destruction of records could result in sanctions as summarized below:

> Unless justified by the responsible party, the intentional or negligent destruction, concealment, alteration or failure to preserve documents, data, information, or other evidence, reasonably known, at the time when it is eliminated, to be relevant to the issues or subject matter of reasonably knowable, pending or probable litigation, shall be subject to appropriate sanctions imposed in the pending action against a party if and to the extent such elimination of potential evidence is a reasonably certain cause of the substantial impairment of or significant prejudice to the ability to prove or disprove an element of the cause of action or defense.
>
> Intentional, grossly negligent or other culpable conduct , done for the purpose of destroying or preventing the use of evidence or without reasonable concern for preserving evidence, and proximately causing the destruction or unavailability of relevant evidence in known pending or reasonably imminent litigation, may result in exemplary or punitive sanctions in order to adequately compensate the victim of such conduct or to deter future culpable conduct.

Record Keeping

For the purposes of this article, the following definitions shall apply:
(a) “Association records” means all of the following: [Old: Civ. Code §1365.2(a)(1)]

(1) Any financial document required to be provided to a member in Article 7 (commencing with Section 5300) or in Sections 5565 and 5810.

(2) Any financial document or statement required to be provided in Article 2 (commencing with Section 4525) of Chapter 4.

(3) Interim financial statements, periodic or as compiled, containing any of the following:

(A) Balance sheet.

(B) Income and expense statement.

(C) Budget comparison.

(D) General ledger. A "general ledger" is a report that shows all transactions that occurred in an association account over a specified period of time.

The records described in this paragraph shall be prepared in accordance with an accrual or modified accrual basis of accounting.

(4) Executed contracts not otherwise privileged under law.

(5) Written board approval of vendor or contractor proposals or invoices.

(6) State and federal tax returns.

(7) Reserve account balances and records of payments made from reserve accounts.

(8) Agendas and minutes of meetings of the members, the board, and any committees appointed by the board pursuant to Section 7212 of the Corporations Code; excluding, however, minutes and other information from executive sessions of the board as described in Article 2 (commencing with Section 4900).

(9) Membership lists, including name, property address, mailing address, and email address, but not including information for members who have opted out pursuant to Section 5220.

(10) Check registers.

(11) The governing documents.

(12) An accounting prepared pursuant to subdivision (b) of Section 5520.

(13) An "enhanced association record" as defined in subdivision (b).

(14) "Association election materials" as defined in subdivision (c).

(b) "Enhanced association records" means invoices, receipts and canceled checks for payments made by the association, purchase orders approved by the association, credit card statements for credit cards issued in the name of the association, statements for services rendered, and reimbursement requests submitted to the association. [Old: Civ. Code §1363.2(a)(2)]

(c) "Association election materials" means returned ballots, signed voter envelopes, the voter list of names, parcel numbers, and voters to whom ballots were to be sent, proxies, and the candidate registration list. Signed voter envelopes may be inspected but may not be copied.

Unit Owner Roster

Right to Review. Corporations are required to keep a record of its members, with their names and addresses. (Corp. Code §8320(a).) Except for telephone numbers and email addresses, members have the right to inspect and copy the association's membership list (Civ. Code §5210). The other exception on copying names and address are those who chose to opt-out of the membership list. A membership list is defined to include a member's name, property address, and mailing address. (Civ. Code §5200(a)(9).)

Copy Costs. Associations can bill the requesting member for the direct and actual cost of copying the membership list. Associations must first inform the member of the costs before copying the requested documents. (Civ. Code §5205(f).)

Deadline for Producing. The right to inspect is at reasonable times, upon five business days' written demand. (Civ. Code §5210(b).)

Purpose for Request. The member requesting the list shall state the purpose for the request, which purpose shall be reasonably related to the requester's interest as a member. If the board reasonably believes that the information in the list will be used for another purpose, it may deny the member access to the list. If the request is denied, in any subsequent action brought by the member the association will have the burden to prove that the member would have used the information for purposes unrelated to his interest as a member. (Civ. Code §5225.)

A corporation has the burden of proving that the member will allow use of the information for purposes unrelated to the person's interest as a member. ...Mere speculation that the member will use the information for an improper purpose is not sufficient to nullify inspection rights; any suspicion must be based on adequate facts in order to justify denial of inspection. (Tract No. 7260 Association, Inc. v. Parker, internal cites deleted.)

Mailing Labels. Members do not have the right to demand that the association print the membership list as mailing labels nor do they have the right to demand that delinquent owners be identified on the list. Some associations keep their list in a form that can be used to print mailing labels and the association can but is not required to present the list in that form to an owner.

Corporate Asset. A membership list is a corporate asset. (Corp. Code §8338(a).) Without the consent of the board a membership list may not be:

> (1) Used to solicit money or property unless such money or property will be used solely to solicit the vote of the members in an election to be held by their corporation.
> (2) Used for any purpose which the user does not reasonably and in good faith believe will benefit the corporation.
> (3) Used for any commercial purpose or purpose in competition with the corporation.
> (4) Sold to or purchased by any person.

Penalty for Misuse. Any person who misuses a membership list is liable for any damage caused by the misuse, including punitive damages for a fraudulent or malicious misuse. (Corp. Code §8338(b).)

Denial of Request. If a demand is made by a single member and the association believes the demand is for an improper purpose, the board may deny the member access to the list. (Corp. Code §8330(b)(1).) If the demand is made by an authorized number of members, and the board believes the demand is for an improper purpose, it can petition the court for an order setting aside the demand. (Corp. Code §8331(a).)

Annual State Filing

All CIDs. All common interest developments are required to file statements of information with the Secretary of State. As required by Civil Code §5405, every association, whether incorporated or unincorporated, must file Form SI-CID with the Secretary of State biennially (every other year) in the month of July. In addition, if the street address of the association's onsite office or the street address of the responsible officer or managing agent of the association changes, the association must file a completed statement within 60 days of the change. The CID statement requires the following information:

Address of the association's onsite office or, if none, the responsible officer or managing agent of the association;
Address and daytime telephone number or e-mail address of the president of the association.
Type of common interest development and number of units.

Incorporated Associations. As required by Corporations Code §8210, incorporated associations must additionally file a Statement of Information Form SI-100, with the Secretary of State, within 90 days after filing of its original articles of incorporation, and biennially thereafter during the applicable filing period. Failure to file this statement by the due date may result in the assessment of a penalty. The penalty for domestic nonprofit corporations is $50. Corporate statements require the following information:

Names and business or residence addresses of the association's president, secretary and treasurer.
Address of the association's principal office.
Agent of the corporation for the purpose of service of process.
The name, if any, of the association's managing agent and whether or not the agent is certified.

Failure to File. Failure to make the above filings can result in a suspension of an association's corporate status.

Owner access to Records

(a) The association shall make available association records for the time periods and within the timeframes provided in Section 5210 for inspection and copying by a member of the association, or the member's designated representative.

(b) A member of the association may designate another person to inspect and copy the specified association records on the member's behalf. The member shall make this designation in writing. [Old: Civ. Code §1365.2(b)]

(c) The association shall make the specified association records available for inspection and copying in the association's business office within the common interest development.

(d) If the association does not have a business office within the development, the association shall make the specified association records available for inspection and copying at a place agreed to by the requesting member and the association.

(e) If the association and the requesting member cannot agree upon a place for inspection and copying pursuant to subdivision (d) or if the requesting member submits a written request directly to the association for copies of specifically identified records, the association may satisfy the requirement to make the association records available for inspection and copying by delivering copies of the specifically identified records to the member by individual delivery pursuant to Section 4040 within the timeframes set forth in subdivision (b) of Section 5210.

(f) The association may bill the requesting member for the direct and actual cost of copying and mailing requested documents. The association shall inform the member of the amount of the copying and mailing costs, and the member shall agree to pay those costs, before copying and sending the requested documents. [Old: Civ. Code §1365.2(c)(1)-(4)]

(g) In addition to the direct and actual costs of copying and mailing, the association may bill the requesting member an amount not in excess of ten dollars ($10) per hour, and not to exceed two hundred dollars ($200) total per written request, for the time actually and reasonably involved in redacting an enhanced association record. If the enhanced association record includes a reimbursement request, the person submitting the reimbursement request shall be solely responsible for removing all personal identification information from the request. The association shall inform the member of the estimated costs, and the member shall agree to pay those costs, before retrieving the requested documents. [Old: Civ. Code §1365.2(a)(2), §1365.2(c)(5)]

(h) Requesting parties shall have the option of receiving specifically identified records by electronic transmission or machine-readable storage media as long as those

records can be transmitted in a redacted format that does not allow the records to be altered. The cost of duplication shall be limited to the direct cost of producing the copy of a record in that electronic format. The association may deliver specifically identified records by electronic transmission or machine-readable storage media as long as those records can be transmitted in a redacted format that prevents the records from being altered.

Lender Questionnaires & Resale Certificates

Seller Duty to Disclose. The association is not a party to the transaction between buyer and seller and has no duty to make disclosures to the buyer--that duty falls to the seller. (Ostayan v. Nordhoff; Kovich v. Paseo Del Mar.) Realtors, as agents of sellers, cannot mislead buyers about the association and must fully disclose to buyers that they are buying into a deed restricted community with rules and regulations.

Deadline for Production. Upon written request, the association shall, within ten days of the mailing or delivery of the request, provide the owner of a separate interest, or any other recipient authorized by the owner, with a copy of the requested documents. (Civ. Code §4530.)

Costs & Fees. As required by Civil Code §4530, prior to the close of escrow sellers must provide buyers with ten different categories of documents. (Civ. Code §4525.) By statute, it is the responsibility of the seller to pay those costs. (Civ. Code §4530(b)(8).) Associations may pay a person or entity to assemble the documents on behalf of the association. (Civ. Code §4530.) Associations are allowed to collect a reasonable fee (including those charged by a management company) based on their actual costs but are prohibited from charging additional fees for electronic delivery of documents. Delivery of the documents may not be withheld for any reason nor subject to any condition except the payment of the fee. (Civ. Code §4530.) The document costs may or may not be in an association's transfer fees.

Statutory Form. As provided for in Civil Code §4530, associations must fill out a form showing the documents being submitted pursuant to Section 4528 and an estimated cost for those records.

Fine for Willful Violation. There is a $500 fine for anyone who willfully violates the disclosure requirement. In addition, in an action to enforce this liability, the prevailing party shall be awarded reasonable attorneys' fees. (Civ. Code §4540.)

Estoppel Certificate. Submission of an estoppel certificate may also be required.

RULES AND REGULATIONS

Required Rules. Rules and regulations are adopted by boards of directors as a means to establish orderly and peaceful relations between residents and their use of the common

areas. By statute, associations are required to adopt and publish to the membership the following rules and regulations:

- **Architectural Application.** Associations must adopt written procedures for reviewing architectural applications. (Civ. Code 4765.)

- **Assessment Collection Policy.** Associations must adopt and annually distribute their collection policies. (Civ. Code §5310.)

- **Dispute Resolution Policy.** Associations must provide a "fair, reasonable and expeditious" procedure for resolving disputes between the association and its members without charging a fee to the member participating in the process. (Civ. Code §5910.)

- **Election Rules.** All associations are required to adopt election rules that comply with Civil Code §5105.

- **Fine Policy.** Associations must adopt and distribute to each member, in the annual policy statement describing the association's discipline policy, if any, including any schedule of penalties for violations of the governing documents. (Civ. Code 5310(a)(8).)

- **OPTIONAL Rules.** The following kinds of rules are optional but common in most associations: parking, pets, swimming, clubhouse usage, nuisance noise, etc. Care must be taken in the drafting of rules that they not be discriminatory.

Rules & Regulations

(a) "Operating rule" means a regulation adopted by the board that applies generally to the management and operation of the common interest development or the conduct of the business and affairs of the association.
(b) "Rule change" means the adoption, amendment, or repeal of an operating rule by the board.

An operating rule is valid and enforceable only if all of the following requirements are satisfied:
(a) The rule is in writing.
(b) The rule is within the authority of the board conferred by law or by the declaration, articles of incorporation or association, or bylaws of the association.
(c) The rule is not in conflict with governing law and the declaration, articles of incorporation or association, or bylaws of the association.
(d) The rule is adopted, amended, or repealed in good faith and in substantial compliance with the requirements of this article.
(e) The rule is reasonable.

Application of Rulemaking Procedures

(a) Sections 4360 and 4365 only apply to an operating rule that relates to one or more of the following subjects:

(1) Use of the common area or of an exclusive use common area.

(2) Use of a separate interest, including any aesthetic or architectural standards that govern alteration of a separate interest.

(3) Member discipline, including any schedule of monetary penalties for violation of the governing documents and any procedure for the imposition of penalties.

(4) Any standards for delinquent assessment payment plans.

(5) Any procedures adopted by the association for resolution of disputes.

(6) Any procedures for reviewing and approving or disapproving a proposed physical change to a member's separate interest or to the common area.

(7) Procedures for elections.

(b) Sections 4360 and 4365 do not apply to the following actions by the board:

(1) A decision regarding maintenance of the common area.

(2) A decision on a specific matter that is not intended to apply generally.

(3) A decision setting the amount of a regular or special assessment.

(4) A rule change that is required by law, if the board has no discretion as to the substantive effect of the rule change.

(5) Issuance of a document that merely repeats existing law or the governing documents.

Adopting and Amending Rules

Rulemaking Authority. Before enacting rules and regulations, associations must have rulemaking authority either statutorily or through its governing documents.

Procedure. Following is a summary of the procedure used for adopting new rules or amending existing rules:

- Board prepares rules and legal counsel review them (or attorney prepares rules).
- Board reviews, approves and gives general notice (we recommend mailing) to members. Notice should include purpose and effect, text of rules and set a deadline

for written comments at least 28 days later. Notice should also set an open meeting at least 28 days later.
- At open meeting, allow more comments at open forum. Consider all comments. Vote to approve or not.
- Give notice of approval within 15 days.

"**Operating Rules**" are broadly defined as any rule or regulation that applies to the management and operation of a common interest development or the conduct of its business and affairs. (Civ. Code §4340.) As provided for in Civil Code §4355(a), "Operating Rules" are specifically defined as a rule or regulation that applies to:

1. Use of the common area or of an exclusive use common area.
2. Use of a separate interest, including any aesthetic or architectural standards that govern alteration of a separate interest.
3. Member discipline, including any schedule of monetary penalties for violation of the governing documents and any procedure for the imposition of penalties.
4. Delinquent assessment payment plans.
5. Resolution of assessment disputes.
6. Reviewing and approving or disapproving a proposed physical change to a member's separate interest or to the common area.
7. Election rules. (No amendments are allowed within 90 days of an election.)

Exceptions. Per Civil Code §4355(b), the following do not fall under the definition of an "Operating Rule" and are free of the requirements of Civil Code sections 4360 and 4365:

1. A decision regarding maintenance of the common area.
2. A decision on a specific matter that is not intended to apply generally.
3. A decision setting the amount of a regular or special assessment.
4. A rule change that is required by law, if the board has no discretion as to the substantive effect of the rule change.
5. Issuance of a document that merely repeats existing law or the governing documents.

Notice of Proposed Change. Before adopting or amending an Operating Rule or changing the fine schedule, the board must provide notice of a proposed rule change at least 28 days before making the rule change. (Civ. Code §4360(a).)

- *Text of Change*. The notice must include the text of the proposed rule change and a description of its purpose and effect.

- *Emergency*. Notice is not required if the board determines that an immediate rule change is necessary to address an imminent threat to public health or safety or imminent risk of substantial economic loss to the association.

See additional 90-day restriction for Election Rules.

Comments by Members. A decision on a proposed rule change must be made at a board meeting, after consideration of any comments made by association members. (Civ. Code

§4360(b).) The board must consider comments by members but is not required to adopt them.

Notice of Adoption. Within 15 days of making the rule change, the board must deliver general notice pursuant to Section 4045 of the rule change. (Civ. Code §4360(c).)

Membership Veto. The membership has a limited right to veto new rules and rule changes.

Emergency Rule Change. If the board determines that an immediate rule change is required to address an imminent threat to public health or safety, or an imminent risk of substantial economic loss to the association, it may make an emergency rule change; and no 28-day noticed waiting period is required. An emergency rule change is effective for 120 days, unless the rule change provides for a shorter effective period. (Civ. Code §4360(d).)

Nonsubstantive Changes. If the board is doing nothing more than correcting grammar or renumbering provisions, the 28-day notice period is not triggered since the rules are not being changed. Even so, the board must distribute a copy of the clean set along with an explanation of what was done and that no changes were made to the rules.

Enforceable. To be enforceable, operating rules must meet certain criteria.

Fines

(a) If an association adopts or has adopted a policy imposing any monetary penalty, including any fee, on any association member for a violation of the governing documents, including any monetary penalty relating to the activities of a guest or tenant of the member, the board shall adopt and distribute to each member, in the annual policy statement prepared pursuant to Section 5310, a schedule of the monetary penalties that may be assessed for those violations, which shall be in accordance with authorization for member discipline contained in the governing documents. [Old: Civ. Code §1363(f)]

(b) Any new or revised monetary penalty that is adopted after complying with subdivision (a) may be included in a supplement that is delivered to the members individually, pursuant to Section 4040.

(c) A monetary penalty for a violation of the governing documents shall not exceed the monetary penalty stated in the schedule of monetary penalties or supplement that is in effect at the time of the violation.

(d) An association shall provide a copy of the most recently distributed schedule of monetary penalties, along with any applicable supplements to that schedule, to any member upon request.

FINANCIAL

Assessments

Assessment Types.

1. Regular. Regular assessments are determined by the board during the annual budgeting process to cover normal operations for the association. They are normally paid monthly or quarterly. Boards cannot increase regular assessments more than 20% without membership approval.
2. Special. Special assessments levied against the membership are often needed for unexpected expenses or capital improvements.
    a. Board Approved. If the assessment is 5% or less of the annual budget, the assessment can be approved by the board.
    b. Membership Approved. If the assessments is more than 5% of the annual budget, it must be approved by the membership. (Civ. Code §5605(b).)
    c. Emergency. Emergency special assessments do not have a cap and do not need membership approval if it meets statutory requirements for an emergency.
3. Reimbursement. Reimbursement assessments are most often used to reimburse the

association for expenses incurred repairing common areas damaged by members or their guests or tenants.

Fees Defined. Fees are treated differently than assessments. They are most often imposed against one or more owners for goods and services such as parking stickers, remotes, keys, cable tv, etc. They are limited to the amount necessary to defray the costs for which they are levied.

Delinquent Owners

Delinquent Assessments. Associations may suspend a member's rights and privileges provided the right to suspend is in the association's collection policy and due process is followed.

1. ALLOWABLE SUSPENSIONS

a. Cable TV. If an association has a bulk contract with the cable company, those services can be suspended.

b. Clubhouse. Use of the clubhouse for functions unrelated to association elections can be suspended.

c. Committee Membership. A delinquent owner can be removed from committees.

d. Laundry Facilities. If laundry machines are paid through owners' dues, the service can be suspended. If they are coin operated, the service cannot be suspended.

e. Miscellaneous. Receiving and sending calls through the association's switchboard (mostly high-rise associations) can be suspended as well as signing for packages and deliveries (mostly associations with onsite staffing). The announcement of guests can be suspended (mostly gated communities and high-rises), i.e. guests can be turned away and told to contact the owner and have him/her meet the guest at the front gate or building entrance.

f. Parking. Associations that provide valet parking (mostly high-rise associations) can suspend those privileges to delinquent owners and their family and guests. Guest parking can also be suspended.

g. Recreational Facilities. Use of the recreational facilities such as the pool, gym, tennis courts, etc. may be suspended.

2. DISALLOWED SUSPENSIONS

a. Elevators. Associations cannot suspend elevator service. Elevators have been classified in landlord-tenant law as a utility that cannot be suspended. Moreover, if an elderly or medically challenged owner or guest is forced to walk up stairwells and has a heart attack, the association will likely be sued.

b. Ingress/Egress. Associations cannot bar owners and guests from walking through the lobby. Owners have the right of ingress/egress.

c. Meeting Attendance. Board meeting attendance may not be suspended.

d. Trash Collection. Trash collection may not be suspended.

e. Utilities. The courts treat associations as landlords when it comes to utilities. Under landlord-tenant law, landlords may not interfere with or terminate utility services (gas, electricity, heat, etc.).
f. Voting Rights. As of January 1, 2020, a member's voting rights can no longer be suspended. (Civ. Code §5105(g)(1): a ballot cannot be denied to a member for any reason other than not being a member at the time when ballots are distributed.)

Impact of Suspension. If there are multiple owners of a unit/lot, the suspension of rights/privileges for one owner suspends the rights/privileges of all residents of that unit/lot. The suspension also extends to renters.

Late Fees & Interest on Late Payments

As provided for in Civil Code §5650(b), regular and special assessments are delinquent 15 days after they become due (unless an association's governing documents provide a longer period of time). If an assessment is delinquent, associations may recover all of the following:

1. **A late charge** not to exceed 10% of the delinquent assessment or $10.00, whichever is greater (unless the CC&Rs specify a smaller amount).
2. **Interest** on delinquent assessments, reasonable fees and costs of collection, and reasonable attorney's fees, at an annual interest rate not to exceed 12%, commencing 30 days after the assessment becomes due, unless the CC&Rs specify a lower interest rate, in which case the lesser rate applies.
3. **Reasonable attorneys' fees** and costs incurred in collecting the delinquent assessment.

Authority to Collect. The authorization to collect late charges and interest need not be in the governing documents. Authority is granted by Civil Code §5650(b).

Fee or Penalty? Some try to argue that late fees cannot be greater than documented expenses to the HOA due to the delinquency. They use Civil Code §5600 to make their argument because the statute restricts associations from imposing assessments or fees that exceed the amount necessary to defray the costs for which it is levied. This fee restriction does not apply to late charges. Associations are allowed to charge a 10% fee regardless of the true costs incurred. That's because the "fee" is actually a penalty to encourage owners to be on time with their payments.

One Late Charge Per Assessment. Associations cannot levy late charges month after month on the same unpaid assessment. A late charge is a one-time penalty of 10% or $10 (whichever is greater) to encourage timely payment of assessments. (Civ. Code §5650) Thereafter, the

association can charge interest at 12% until the assessment is paid (unless the governing documents set a lesser amount). (Civ. Code §5650)

No Interest on Fines. Associations cannot charge interest on unpaid fines. Civil Code §5725 prohibits an association from characterizing or treating a monetary penalty "imposed by the association as a disciplinary measure for failure of a member to comply with the governing instruments, except for the late payments" as an assessment. As provided for in Civil Code §5650(b)(3):

Interest on all sums imposed in accordance with this section, including the delinquent assessments, reasonable fees and costs of collection, and reasonable attorney's fees, at an annual interest rate not to exceed 12 percent ...
Since a monetary penalty does not fall into any of the categories described above, associations cannot charge interest on fines.

No Late Charges on Unpaid Fines. When delinquent, homeowners will sometimes pay the delinquent assessment but refuse to pay late charges. If they received fines for rules violations, they may refuse to pay those as well. When that occurs, are associations allowed to charge late fees and interest on unpaid late fees and unpaid fines? No. The Davis-Stirling Act provides for a late fee of 10% or ten dollars, whichever is greater (unless the CC&Rs specify a lesser amount), against delinquent *assessments*. (Civ. Code §5650) That means late charges cannot be charged against unpaid late charges or unpaid fines.

Reducing Delinquent Owner Past Due Fees

Previously, the industry standard was to reject partial payments once foreclosure had been initiated. Doing so ensured full payment of the delinquency as well as any collection costs incurred by the association. That changed in October 2014 in Huntington Continental v. Miner.

Court Ruling. The court in that case ruled that homeowners associations are required to accept partial payments from owners who are in the lien or foreclosure stages of collection and, if the amount of the payment reduces the delinquent assessments to less than $1,800, the association cannot foreclose (judicially or non-judicially) unless, after receipt of the partial payment, there remain overdue assessments that are more than 12 months delinquent.

Liens Remain in Place. Although this decision may impact some pending and future collection actions, it is also important to note what the court did not say. The court did not say that assessments liens must be released after receipt of a partial payment. The court did not say that associations are required to accept payment plans.

Payment Priority, Fees & Costs. The court also reiterated that any payments made by the owner shall be applied to assessments first. (Civil Code §5655.) The court did not say that the order of application of payments could not be waived by the owner in a payment plan. Nor did the court say that owners who reduce their balances can avoid payment of foreclosure fees and costs.

Conclusion. So long as an owner is not misled into believing that partial payment cures the owner's default, it does not stop a foreclosure unless the balance of assessments due falls below $1,800.

Liens on Delinquent Owners

The decision to record a lien for delinquent assessments must be made by the board by a majority vote in an open meeting and recorded in the minutes of that meeting prior to recording the lien. (Civ. Code §5673.) This can be done by a simple motion or by a formal resolution. The requirement of confidentiality of owners' names for lien purposes is unclear.

Competitive Bids

Three Bids. There is no statute requiring three bids whenever a board authorizes projects. However, good business practice requires bidding for large projects. The threshold amount for seeking bids will depend on the association's budget. Associations with a $5 million annual budget will have a higher threshold before going out to bid than will associations with a $50,000 budget.

Small Projects. Boards will have difficulty obtaining bids for small repairs. Many contractors will not waste time preparing written proposals for a $500 repair. For routine plumbing repairs, most boards call a plumber who is familiar with the development and pay him as-needed to repair leaks. This is an acceptable business practice.

Large Projects. When it comes to large projects, such as replacing a roof, painting buildings, paving streets, etc, bidding is a good business practice. If a board receives a single bid of $220,000 to paint buildings, it is impossible to determine the fairness of the proposal without competing bids. If the next two bids (from licensed and insured companies) come in at $160,000 and $152,000, then the board will know that the first bid is too high.

Large Variances. Ideally, bids should be within 10% of each other. If there are significant variances, one of the bidders has made a mistake and improperly bid the project or is intentionally misbidding it. An unusually low bid may be undercutting legitimate bids and plans to substitute inferior materials or make up the difference with change orders. Boards need to investigate any large variances that may exist before making a decision.

Low Bid. Boards are not required to accept the lowest bid. Low bid is not always the best bid. The company may be small and inexperienced and may be operating on a shoe-string budget with low levels of insurance, limited equipment, and minimal staffing. If someone quits or equipment fails, your project may suffer. With a more established company, the chances are better that the work will be done on time and within budget.

Specifications. A critical factor for bidding projects is the preparation of specifications. It will be impossible to properly compare bids if companies are not bidding the same work. For a

large painting project, are all bidders power washing the exterior? Are they filling cracks and caulking around window frames? Are they using the same quality paint and applying it to the same thickness? To compare apples to apples, have a consultant prepare the specifications. Only then can boards truly compare bids.

Sealed Bids. Boards should use a sealed bid policy when soliciting bids. Boards are allowed to review and discuss bids in executive session but may, if they choose, review and vote on them in open session.

Annual Financial Statement.

At the end of the fiscal year, a CPA prepares a written report of the financial condition of the association based in part on management representations. This annual financial statement of the association's assets and liabilities, including any litigation that could have an unfavorable outcome for an association (pursuant to FASB Statement No. 5, Accounting for Contingencies) and is done on an accrual basis using GAAP as required by Civil Code §5305. If the association's gross income exceeds **$75,000**, the report is either audited or reviewed, depending on which level is called for in the association's governing documents. If an association's documents are silent, at a minimum a "review" must be performed. (Civ. Code §5305.)

1. Distribution of Statement. A copy of the review of the financial statement shall be distributed to the members within **120 days** after the close of each fiscal year. (Civ. Code §5305.) Board members and owners should pay particular attention to any opinions expressed by the CPA in the financial statement.
2. Method of Delivery. Boards cannot merely notify members that the report is available, they must physically deliver the report by one of the following methods (Civ. Code §5305; §4040):
    - first-class mail, registered or certified mail, express mail, or overnight delivery by an express service carrier;
    - email, facsimile, or other electronic means, if the recipient has consented, in writing, to that method of delivery.

Budget

RAISING DUES. Boards have a duty to assess the membership sufficient to carry out their duties as directors. Any increase in annual assessments (dues) requires the preparation, approval, and distribution of a budget within certain statutory guidelines and deadlines as described below.

1. Pro Forma Budget. A pro forma operating budget is typically prepared by management or a budget committee or the board (or a combination of the three). An operating budget encompasses all expenses for the fiscal year including contributions to reserves. The budget must estimate revenue and expenses on an accrual basis. (Civ. Code §5300(b)(1).)

2. Basis for Budget. As nonprofit organizations, associations must budget so that revenues

do not exceed expenses, i.e., total income minus expenses should equal zero. There are two techniques for preparing budgets:

A. Zero-Base Budgeting. This approach starts each year's budget from a zero base, i.e., at the beginning of the budgeting process all budget line items have a value of $0 and must be justified.

i. Advantages. Since each line item starts at zero, the budget committee must justify each item in the budget. This should bring to light any wastage and obsolete operations.

ii. Disadvantages. This approach can be very time consuming.

B. Incremental Budgeting. In incremental budgeting the current year's budget serves as a basis for next year's budget and is simply adjusted. The most common methods of adjustment are:

i. CPI Adjustment. The easiest and least effective method is to simply take the Consumer Price Index (the measure of inflation published by the government) and apply it to all line items. The disadvantage is that not all items in a budget are affected by the CPI. This results in some line items being over-budgeted and others being under-budgeted.

ii. Variance Projections. This is the method used by most associations. Since most line items in an association's budget are necessary rather than discretionary (utilities, insurance, maintenance, etc.), the budget committee starts with the current year's budget and looks at variances projected through the end of the fiscal year. This gives the committee an estimate of actual expenses for the year for each line item so it can adjust expenses up or down, as needed.

3. Approve the Budget. The draft budget is put on the agenda of an open board meeting for review and approval by the board. Approval of the budget is sufficient for any increase in assessments (up to 20%) that might be contained in the budget. Approval requirements are found in Civil Code §5605.

4. Annual Budget Report. Once the budget has been approved by the board, an "Annual Budget Report" must be prepared. The Report must contain the following (Civ. Code §5300(b)):

- A pro forma operating budget.
- A summary of the association's reserves.
- A statement regarding any deferral of reserve item repairs.
- A statement whether special assessments are anticipated related to reserves or reserve components.
- A statement of how reserves will be funded.
- A statement of how the reserves were calculated.
- A statement regarding any outstanding association loans.

5. Distribute the Report. The Annual Budget Report must be distributed to the membership not less than 30 nor more than 90 days before the end of the association's fiscal year. (Civ. Code §5300(a).)

a. Summary. In lieu of a full report, the board may distribute a summary and reserve

summary with a written notice (in at least 10-point bold type on the front page of the summary of the budget) that the complete budget is available at the business office of the association or other location and copies can be made, if requested, at the association's expense. (Civ. Code §5320.)

b. Request for Full Report. If a member requests a copy of the full budget report rather than a summary, the association must provide it (Civ. Code §5320) by individual delivery (Civ. Code §4040.)

c. Email Distribution. Unless members authorize delivery by email, budgets must be distributed in non-electronic form, i.e., paper.

d. Disclosure Checklist.

e. Remailing Budget Report. Sometimes absentee members forget to update their contact information and the budget package is returned to the association. See remailing the budget report.

Failure to Meet Deadline. Failure to distribute the annual budget report at not less than 30 nor more than 90 days prior to the end of the fiscal year voids any increase in regular assessments approved by the board of directors. Any such increase must then be approved by a majority of a quorum of members. (Civ. Code §5605(a).)

Limited Common Element (Exclusive Use) Repair Costs

Separate Interest. When someone buys a condominium, their "real property" is typically defined as a cube of air bounded by the unfinished surfaces of the perimeter walls, ceilings and floors. All improvements contained in that space, such as carpets, cabinets, light fixtures, plumbing fixtures, etc., are part of the real property defined as the owner's "separate interest" because it is separate from real property that is owned in common with other members of the association, i.e., common areas.

Common Areas. Common area is defined as "the entire common interest development, except the separate interest therein." (Civ. Code §4095(a); Pinnacle Museum Tower v. Pinnacle Market Dev'l.) It means that everything in a condominium development is either a separate interest or common area.

Exclusive Use Common Area. Exclusive use common area (EUCA), sometimes referred to as "restricted common area" or "limited common element," is a subset of common area. "Exclusive use common area means a portion of the common area . . ." (Civ. Code §4145(a).) EUCAs are those common areas outside the owner's separate interest which are for the exclusive use of that owner.

1. CC&Rs. Newer CC&Rs specify areas for owners' exclusive use such as balconies, patios, storage areas, parking spaces, plumbing, electrical, etc. Older documents (pre-1985) normally

do not use the term. Sometimes, even when the term is used, maintenance responsibilities are unclear.

2. Condominium Plan. The association's condominium plan typically designates areas, such as balconies and parking spaces, set aside for an owner's exclusive use.

3. Davis-Stirling Act. The Davis-Stirling Act contains a default definition of exclusive use common areas if none is found in the CC&Rs or condominium plan. Civil Code §4145 defines the following as exclusive use common areas:

- shutters, awnings, window boxes
- doorsteps [a step or series of steps leading to the outer door of a house], stoops [a porch with stairs], porches [a covered area extending from a door]
- balconies and patios
- exterior doors, door frames, and hardware
- screens and windows
- fixtures designed to serve a single interest but existing outside the boundaries of the separate interest
- telephone wiring

Reserves

There is no statute that specifically requires associations fund their reserves. The legislature has repeatedly amended the reserve provisions in the Davis-Stirling Act and has had many opportunities to impose funding requirements but has not done so. Instead, it keeps increasing notice requirements.

Indirect Duty. An argument can be made that there is an implied requirement to fund reserves because boards have a duty to impose regular and special assessments sufficient to perform their obligations under the governing documents. (Civ. Code §5600(a).) Setting aside sufficient funds to repair and replace major components is arguably one of those duties. In Raven's Cove v. Knuppe, the court held that the failure of the developer-controlled board to fund the reserves was a breach of the board's fiduciary duty.

Special Assessment. Boards must exercise prudent fiscal management in maintaining the integrity of the reserve account, and shall, if necessary, levy a special assessment to recover the full amount of the expended funds within the time limits required by this section. (Civ. Code §5515(e).) This special assessment is subject to the limitation imposed by Civil Code §5605(b) (unless the expenditures were for emergencies as defined by Civil Code §5610). The board may, at its discretion, extend the date the payment on the special assessment is due. Any extension shall not prevent the board from pursuing any legal remedy to enforce the collection of an unpaid special assessment. (Civ. Code §5515(e).)

Fee Limitation Argument. A member of the Foothills Townhomes Association sued his association claiming that a special assessment to fund the reserve account violated Civil

Code §1366.1 [now Civ. Code §5600(b)]. He argued that it "exceeded the amount necessary to defray the costs for which it is levied" because there was no requirement that reserves be funded. The court disagreed and ruled that replenishment of the association's reserve account was a valid basis for a special assessment. Plaintiff also argued the special assessment was unnecessary because the reserves could be funded incrementally over time.

The court again disagreed:
Whether the fund could have been replenished over time is irrelevant to whether the assessment exceeded costs for which it was levied. As a matter of law, an assessment does not violate Civil Code section 1366.1 merely because the costs could have been recouped incrementally. Nothing in the language of the statute suggests that is so. (Foothills Townhomes v. Christiansen.)

Prudent Funding. Even though there is no mandate by the legislature to fund reserves, the prudent course is to fund reserves in accordance with the association's reserve funding plan. Bank Loans. If reserves are underfunded and associations are faced with large-scale repairs, boards may have no choice but to levy a special assessment to raise the funds needed to make repairs. To lessen the burden on members, associations often seek bank loans that allow them to make immediate repairs but spread the cost over 3, 5, 7 or 10 years so members can more easily pay for the repairs.

Reserve Studies Required

Purpose. The purpose of a reserve fund is to repair, replace, restore, or maintain the major common area components. (Civ. Code §5510(b); §5565(b)(1).) The reserve study process can be simplified as follows:

1. A reserve company retained by the board identifies all major common area components, the cost to repair/replace them, and their remaining life span.
2. The reserve company calculates how much money is needed and when.
3. The board decides how to fund the reserves--whether through increased assessment contributions, special assessments or a combination of the two.
4. The funding plan is annually disclosed to the membership in the year-end budgeting process.

Study Required. All associations, regardless of size, are required to prepare a reserve study (Civ. Code §5550), unless the total replacement costs are less than 50% of the gross budget of the association, excluding the association's reserve account for that period. (Civ. Code §5550(a).)

Every Three Years. 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 major components that the association is obligated to repair, replace, restore, or maintain.

(Civ. Code §5550(a).) A reserve study is not actually a "study" of the roofs, boilers, streets, etc. Instead, it is a list of the major common area components with an estimate of their remaining useful life. Reserve studies should be done by someone who specializes in reserve studies.

Annual Updates. The allocation of reserve items is not written in stone. Allocations are only projections and subject to revision annually as roofs, boilers, etc. wear out at their own rates. As a result, boards must review the reserve study, or cause it to be reviewed, annually and implement appropriate adjustments to the reserve account requirements. (Civ. Code §5550(a).)

FHA Loans. Reserves and reserve studies are also required for FHA backed mortgages.

Small Associations. Small residential associations, even as small as two units, must perform reserve studies if they have common areas--unless the total replacement costs are less than 50% of the annual gross budget. (Civ. Code §5550(a).)

Comingling of Reserve Funds

California Financial Institutions. As provided for in Civil Code §5380, managing agents, either persons or entities, who for compensation or, in expectation of compensation, exercise control over the assets of the association who receive funds belonging to an association must deposit them into:

- An escrow account with a bank, savings association, or credit union in California, which is insured by the federal government, or
- An account under the control of the association, or
- A trust fund account maintained by the managing agent in a bank, savings association, or credit union in California.

A "managing agent" does not include a full-time employee of the association or a regulated financial institution operating within the normal course of business, or an attorney at law acting within the scope of his or her license.

Separate Accounts. Associations must establish at least two accounts, operating and reserves. Funds must be kept separate, distinct, and apart from the funds belonging to the managing agent or to any other person or entity for whom the managing agent holds funds in trust. The managing agent must maintain a separate record of the receipt and disposition of all funds, including any interest earned on the funds. With a limited exception, the managing agent may not commingle the funds of the association with his or her own money or with the money of others.

Interest. No interest earned on funds in the account shall inure directly or indirectly to the benefit of the managing agent or his or her employees.

Attorneys' Fees. The prevailing party in an action to enforce this section shall be entitled to recover reasonable legal fees and court costs.

Surplus Income

If an association files tax Form 1120, any excess income at the end of the fiscal year (a budget surplus), must be applied to next year's assessments or refunded to the membership. Revenue Ruling 70-604 and 75-371. If the money is applied to next year's budget, members must approve an excess income resolution. Since the resolution does not require a vote by secret ballot, the membership can approve it by (i) a voice vote at the annual meeting and record the vote in the minutes of the meeting or (ii) include it on the ballot with the election of directors.

Tax Returns

Income Taxes. Even though associations are nonprofit and generally not subject to property taxes, they must file income tax returns both with California's Franchise Tax Board (FTB) and with the Federal Internal Revenue Service (IRS) and, if necessary, pay taxes. (Internal Rev. Code 528).

Minimum Annual Tax. Incorporated community associations must pay a minimum annual corporation tax of $800 unless receive an exemption by filing FTB Form 3500. If granted, HOAs are still required to annually file Form 199 and pay taxes on net nonmember income.

Failure to Pay. Current boards are not relieved from their duty to file tax returns even if prior boards failed to file them. Failure to file returns can result in penalties, back taxes and interest.

Tax Forms. Following are typical tax forms for homeowners associations.

1. *Federal Form 1120*. This is a regular corporate filing with a 15% tax rate on the first $50,000 of taxable income. The return is more difficult to prepare and requires associations to use more restrictive accounting procedures during the year. It also has a higher audit risk and tax resolution may need to be approved by the membership.
2. *Federal Form 1120-H*. This filing is specific to associations, is easier to prepare, and has a lower audit risk. It applies a 30% tax rate to all non-dues income (interest earnings, laundry income, rental income, etc.). This filing does not require an excess income resolution. Even so, many associations routinely include the resolution on their annual ballot thereby giving their CPA the flexibility to file either tax form.
3. *California Form 100*. If an association has more than $100 in non-membership income, a return must be filed with the State at the same time as the Federal filing. Failure to file Form 100 can result in the suspension of the corporation.

When to File. Tax returns must be filed within 2 1/2 months of the end of the association's fiscal year. The deadline may be extended for six months by filing the appropriate form.

Annual Budget and Policies Disclosures

As seen at https://www.davis-stirling.com/HOME/Annual-Budget-Policy-Disclosures#axzz3OtyTLrVr

Each year, associations must distribute an "ANNUAL BUDGET REPORT" and an "ANNUAL POLICY STATEMENT" as described below. Other disclosures are required which are also described below.

Upon written consent of members, associations may distribute documents and disclosures electronically; otherwise, all documents must be distributed by "First-class mail, postage prepaid, registered or certified mail, express mail, or overnight delivery by an express service carrier." (Civ. Code §4040.) See "Notice Requirements."

At least 30 days before distributing Annual Budget Report	
1.	**Contact Information**. Notify members of their obligation to provide the association with their contact information. (Civ. Code §4041.)
ANNUAL BUDGET REPORT **30 to 90 days Prior to Start of Fiscal Year** **(Civil Code §5300)**	
1.	**Pro Forma Budget**. A full budget or a summary (Civ. Code §5320) showing the estimated revenue and expenses on an accrual basis. [NOTE: Boards must notify members, not less than 30 nor more than 60 days prior to any increase in regular assessments or any special assessment. (Civ. Code §5615.)]
2.	**Reserve Summary**. A summary of the reserves.
3.	**Reserve Funding Plan**. A summary of the reserve funding plan.
4.	**Major Component Repairs**. A statement as to whether the board will defer or not undertake repairs or replacement of any major component with a remaining life of 30 years or less, including a justification for the deferral or decision not to undertake the repairs or replacement.
5.	**Anticipated Special Assessments**. A statement as to whether one or more special assessments will be required to repair, replace, or restore any major component or to provide adequate reserves. If so, the statement shall set out the estimated amount, commencement date, and duration of the assessment.
6.	**Reserve Funding Mechanism**. A statement as to the mechanism or mechanisms (including assessments, borrowing, other assets, deferral of selected replacements or repairs, or alternative mechanisms) by which reserves will be funded to repair or replace major components.
7.	**Procedures for Calculating Reserves**. The procedures used for the calculation and establishment of those reserves to defray the future repair, replacement, or additions to major components the association is obligated to maintain. The statement shall include, but need not be limited to, reserve calculations made using the formula described in paragraph (4) of subdivision (b) of Section 5570, and may not assume a rate of return on cash reserves in excess of 2% above the discount rate published by the Federal Reserve Bank of San Francisco at the time the calculation was made.
8.	**Outstanding Loans**. A statement as to whether the association has any outstanding loans with an original term of more than one year, including the payee, interest rate, amount outstanding, annual payment, and when the loan is scheduled to be retired.
9.	**Insurance Summary**. Distribute a summary of the association's insurance.
10.	**Assessment & Reserve Form**. The Assessment and Reserve Funding Disclosure Summary form, prepared pursuant to Section 5570, shall accompany each annual budget report or summary of the annual budget report.
11.	[FOR CONDOS ONLY] **FHA/VA Certification**. As part of the annual budget report, condominium associations must disclose in 10-point font on separate pages whether they are or are not certified by the FHA and VA. For the language to use in the disclosure, see FHA/VA disclosure.
12.	**Charges for Documents Provided.** The completed "Charges For Documents Provided" disclosure identified in Section 4528.

NOTE #1: Full Report. If a member requests full reports, the association must deliver full report to that member, rather than a summary of the report. (Civ. Code §5320.)
NOTE #2: Secondary Address. Upon request pursuant to Section 5260, an additional copy of those notices must be delivered to a member's secondary address. (Civ. Code §4040.)

ANNUAL POLICY STATEMENT

30 to 90 days Prior to Start of Fiscal Year

(Civil Code §5310)

1.	**Designated Recipient**. The name and address of the person designated to receive official communications to the association, pursuant to Section 4035.
2.	**Right to Notice to Two Addresses**. A statement explaining that a member may submit a request to have notices sent to up to two different specified addresses, pursuant to subdivision (b) of Section 4040.
3.	**General Notice Location**. The location, if any, designated for posting of a general notice, pursuant to paragraph (3) of subdivision (a) of Section 4045.
4.	**Right to Individual Delivery**. Notice of a member's option to receive general notices by individual delivery, pursuant to subdivision (b) of Section 4045.
5.	**Right to Minutes**. Notice of a member's right to receive copies of meeting minutes, pursuant to subdivision (b) of Section 4950.
6.	**Collection Policy**. A statement of assessment collection policies per Section 5730.
7.	**Lien Policy**. A statement describing the association's policies and practices in enforcing lien rights or other legal remedies for default in the payment of assessments.
8.	**Rules Enforcement Policy**. A statement describing the association's discipline policy, if any, including any schedule of penalties for violations of the governing documents pursuant to Section 5850.
9.	**Dispute Resolution Procedures**. A summary of dispute resolution procedures, pursuant to Sections 5920 and 5965.
10.	**Architectural**. A summary of any requirements for association approval of a physical change to property, pursuant to Section 4765.
11.	**Overnight Payments**. The mailing address for overnight payment of assessments, pursuant to Section 5655.
12.	**Miscellaneous**. Any other information that is required by law or the governing documents or that the board determines to be appropriate for inclusion.

NOTE #1: Full Report. If a member requests full reports, the association must deliver full report to that member, rather than a summary of the report. (Civ. Code §5320.)
NOTE #2: Secondary Address. Upon request pursuant to Section 5260, an additional copy of those notices must be delivered to a member's secondary address. (Civ. Code §4040.)

120 days
After Close of Fiscal Year

Financial Statement. Unless the governing documents impose more stringent standards, a review of the financial statement of the association must be prepared per GAAP by a CPA for any fiscal year in which the gross income to the association exceeds $75,000 and distributed to members. (Civ. Code §5305.)

Secretary of State
Secretary of State Filing. Every association, whether incorporated or unincorporated must annually and biennially file statements of information with the Secretary of State.
As-Needed
Assessment Increases. Notify members, not less than 30 nor more than 60 days prior to any increase in regular assessments or any special assessment. (Civ. Code §5615.)
Board Meetings. See notice requirements for board meetings, executive session meetings and emergency meetings.
Board Minutes. The minutes, draft minutes or a summary of the minutes, of any board meeting (other than an executive session) must be available to members within 30 days of the meeting.
Borrowing from Reserves. Disclose both intent to borrow as well as actual borrowing from reserves. Any delays in repayment of monies borrowed from reserves also requires disclosure to the membership. (Civ. Code §5515 and §5520.)
Committee Minutes. Minutes of meetings of committees with decisionmaking authority for meetings commencing on or after January 1, 2007, within 15 calendar days following approval.
Construction Defects. Disclose litigation against the declarant (i) any agreements with the developer; (ii) any defects needing correction or replacement, (iii) an estimate of when defects will be corrected or replaced, and (iv) which defects will not be corrected or replaced. "Defects" includes damage resulting from the defects and (v) an settlement agreements. (Civ. Code §6100 and §6150.)
Copy Costs. Allow inspection of books and records. Disclose in advance, any copying costs that will be billed to the requesting party. (Civ. Code §5205.)
Disciplinary Hearings. Give notice of disciplinary hearings and the results of those hearings. (Civ. Code §5855.)
Election Results. Publish the results of membership elections (special assessments, amendments, board elections, etc.). (Civ. Code §5120.)
Escrow Disclosures. Within 10 days of written request by a unit owner, provide information and documents to seller or seller's agent for escrow disclosures. (Civ. Code §4525, §4528, §4530.)
Fine Policy Changes. Give notice of any changes in the association's fine policy.
Hazardous Materials. Notify members of known hazardous materials such as asbestos. (H&S Code §25915.2.)
Insurance Changes. Notify members if insurance policies are canceled and not immediately replaced or if there are any significant changes.
Lawsuits. Give notice of lawsuits when appropriate.
Lender Foreclosures. Boards should record a blanket " Request for Notification" of lender foreclosures so the association will know who to bill for assessments.
Litigation Expenses. Prepare an accounting of litigation expenses on at least a quarterly basis and make it available for inspection by members. (Civ. Code §5520.)
Management Change. Within 60 days of a change in management, file a notice with the Secretary of State. (Civ. Code §5405(c).)
Manager Certification. Managers must disclose to the board their certification status.

Membership Meetings. Publish notice of membership meetings.
Rule Changes. Give notice of proposed rule changes. (Civ. Code §4360.)
Security Disclosure. Although not required, associations should annually notify members they are responsible for their own safety and security.
Transaction with Officer or Director. Provide notice of any transaction between the association and a director involving more than $50,000. (Corp. Code §8322.)
Unlawful Restrictions. Provide cover page for CC&Rs containing language prohibiting discriminatory restrictions. See statute for specific language and size of type-font. (Gov. Code §12956.1.)
Workplace Hazards. Notify employees of workplace hazards. (Labor Code §6401.7.)

Credit: Davis-Sterling https://www.davis-stirling.com/

INSURANCE

Directors and Officers Insurance

Purpose. Directors and Officers ("D&O") Insurance protects volunteers from personal liability for decisions they make while on the board. D&O insurance is in addition to the association's general liability policy and covers board negligence, breach of fiduciary duties, etc., provided the errors or omissions were:

- within the scope of the officer or directors' duties,
- performed in good faith, and
- not willful, wanton, or grossly negligent.

Defense Costs. Typically, insurance policies pay the cost of defending against a claim in addition to paying for any settlement or judgment that might be levied against an association or its directors (within policy limits). Insurance carriers handle defense costs in one of the following ways:

Unlimited Defense. There is no limit in the policy on defense costs. If an association has a $1 million policy and the carrier pays $600,000 in legal fees and expert costs, the association still has $1 million available to pay for any settlement or judgment that might arise.

Wasting Policy. A "wasting policy" pays defense costs out of the policy limits. If an association has a $1 million policy and the carrier pays 600,000 defending the board, only $400,000 will be left to settle the case or pay any judgments. These policies are also known as self-liquidating, cannibalizing, self-consuming or defense within limits policies.

Coverage. Boards should talk to their insurance broker to make sure the following are included in the policy:

- current and former directors and officers,
- committee members and other volunteers,

- employees, and
- manager and management company.

Exclusions. All policies contain exclusions, i.e., claims the carrier will not cover. Following are examples of common D&O exclusions:

- Insured vs. insured (the board is sued by one of its directors),
- Breach of contract (an action by members or third parties for breach of CC&Rs or breach of contract). However, some carriers will pay for associated defense costs.
- Failure to carry sufficient insurance (a lawsuit by owners against the board for its failure to carry sufficient limits or its failure to purchase insurance to cover certain losses)
- Bodily injury and property damage are always excluded in D&O policies.
- Discrimination and employment practices liability are typical exclusions but still available from some companies. If an association has employees, the board should ask for "employment practices liability" coverage.

Statutory Protection. The Davis-Stirling Act protects volunteers from personal liability while on the board of directors provided the association maintained and had in effect at the time the act or omission occurred and at the time a claim is made D&O insurance of (i) at least $500,000 if the development consists of 100 or fewer separate interests or (ii) at least $1,000,000 if it has more than 100 separate interests. (Civ. Code §5800.) EXCEPTION: The statutory protection against personal liability in excess of insurance coverage afforded volunteer directors is not available to director who own more than two units:

> This section shall only apply to a volunteer officer or director who is a tenant of a residential separate interest in the common interest development or is an owner of no more than two separate interests and whose ownership in the common interest development consists exclusively of residential separate interests. (Civ Code §5800(e).)

Definitions. Not all policies use the same definitions. When it comes to matters such as: "who is an insured" and what constitutes a "wrongful act," the definition can significantly alter coverage.

Minimum Policy Limits. As with general liability policies, certain minimum levels of coverage must be carried by the association's D&O policy. Extra coverage can be obtained through the use of an umbrella policy. Such coverage should be obtained for the entire board, not just one director.

Reporting Requirements. Actual and potential claims must be timely reported to the association's insurance carrier or the association risks loss of coverage.

Fidelity Insurance

Beginning January 1, 2019, associations are required to purchase what the statute refers to as a "fidelity bond." (Civ. Code §5806.) This is in addition to D&O Insurance.

Terminology. Although the statute calls it a fidelity bond, associations will actually purchase an insurance policy that covers employee dishonesty (fidelity) plus non-employee theft. A bond is a three- party arrangement. Insurance is not. The preferred terminology is a Fidelity/

Crime policy. The policies are two sides of a coin. On one side is Fidelity/Employee Dishonesty and on the other side is non-employee crime coverage.

Employee Dishonesty. Employee dishonesty coverage protects an association against dishonest acts such as embezzlement committed by an employee as defined by the policy. In a common interest development, the definition of "employee" must be broadened to include the board of directors as non-compensated employees of the association, as well as the community manager and management company.

Computer and Funds Transfer Fraud. This protect against dishonest acts committed by third parties. Unlike a typical local embezzler who would be inclined to steal a little bit at a time to avoid detection, these individuals don't live in the association, are not on the board, and have no emotional connection to the community. Depending on their geographic location, they may feel they are unlikely to be tracked down and prosecuted for the crime. As a result, they are more likely to transfer as much money as they can, as quickly as they can, from an association's accounts.

Standalone Policy. Associations should explore standalone policies. Sometimes required coverage an association's Master Package Policy does not comply with Davis-Stirling requirements, or Fannie Mae and Freddie Mac requirements. Sometimes they do not cover wire transfer fraud, computer fraud, or social engineering. Boards should ask if the policy covers the following:

Fidelity. Employee theft, ERISA fidelity where there is a defined benefits plan, and client property.

Forgery or Alteration. Loss caused by forgery or alteration of a financial instrument.

Premises Coverage. Robbery, theft or safe burglary.

Transit Coverage. Robbery or theft of money or destruction or disappearance of money while in transit.

Computer Crime. Losses from computer fraud by someone who has gained unauthorized access to the association's computer system. Also, loss due to a computer virus designed to damage or destroy electronic data.

Restoration Expense. Reasonable costs incurred restoring a computer system following a computer crime.

Funds Transfer Fraud. Loss of money resulting from a fraudulent instruction directing a financial institution to transfer, pay or deliver money from the association's account.

Amount of Coverage. As required by Civil Code §5806, associations must:

- purchase a fidelity policy with coverage limits in an amount equal to or greater than the combined amount of the reserves and total assessments for three months unless the governing documents call for greater limits),

- cover all persons handling funds, including officers, directors, employees, managing agents and the management company, and

- include in the policy coverage for “computer and funds transfer fraud” in the same amount or greater (unless the governing documents call for greater limits).

Management Companies. Management companies should carry their own fidelity insurance to protect against losses resulting from the dishonest acts of management company employees.

Reporting Requirements. Actual and potential claims must be timely reported to the association’s insurance carrier or the association may lose coverage.

Internal Controls. Internal controls can help avoid losses but cannot guarantee it. Thus, the need for insurance.

Association Employee Insurance

Workers’ compensation insurance provides lost wages, medical benefits, and rehabilitation costs to employees injured “in the course and scope” of their job. By carrying the insurance,

general pain and suffering damages, and punitive damages are not available to employees. With the insurance in place, employees do not have to file suit to receive medical benefits.

The insurance is **mandated** by the state of California for all employers, even if the company only has one employee. Sole proprietors are generally exempt unless they are a roofer.

If an employer provides a safe work environment for employees so that employees do not suffer injuries, "experience rating" allows for lower insurance premiums. Those employers with high injury rates pay higher premiums. This provide incentive for employers to provide safe working conditions.

Worker's Compensation Self-Insurance

Certificate of Consent. Workers' compensation insurance can be costly and some associations wonder about self-insurance as a way to save money. Self-insurance is permissible under Labor Code §3700 if an association obtains a certificate of consent from the Director of Industrial Relations. The certificate will only be awarded upon proof of ability to pay any compensation that may become due to the association's employees.

Deposit & Annual Report. If approved, the association must file a self-insured employer's annual report and make a security deposit of the greater of $220,000 or 125% of the estimated future liability for compensation plus 10% of future liability for administrative and legal costs (Labor Code §3701). The security must be in the form of cash, securities, surety bonds or irrevocable letters of credit. Because of these requirements, only a small percentage of corporations statewide self-insure.