

## BACKGROUND INFORMATION

### COMMON INTEREST DEVELOPMENT (CID), E.G., CONDOMINIUM

- Individual ownership with the right to use common areas and facilities.
- Governed by a homeowners' association (HOA).
- Every homeowner is AUTOMATICALLY a member of the HOA.
- Homeowners can elect a board of directors to operate the HOA, but the board answers to the homeowners.
- Owners maintain their individual property, and the HOA maintains all the common use areas and exclusive use common areas.

#### Harborwalk:

- Built 1974-1976
- 244 units
- Income: \$460 HOA fee  
\$112,240 monthly/\$1,346,880 annual

### ASSESSMENTS

- The cost of maintaining the common areas is shared by all homeowners through regular and special assessments
  - *Regular assessments:*
    - operating expenses (day-to-day maintenance)
    - reserve (long-term maintenance)
  - *Special assessments:*
    - for major repairs, replacement, or one-time unanticipated expense which cannot be covered by the regular assessment (e.g., insurance premiums that unexpectedly increase significantly)

Annually, the board may increase assessments without the approval of the homeowners.

*Regular* assessments can be increased 20% and a *special* assessment that does not exceed 5% of the budgeted annual gross expenses can be imposed.

### RESERVES AND RESERVE STUDY

- A percentage of homeowners' monthly assessments are put into a reserve fund—much like a savings account—that pays for long-term maintenance and repair of an association's property, such as roof replacement, and parking lot resurfacing.
- An inadequate reserve fund can result in special assessments when repairs/replacements are needed. Over time, inadequate reserve funds can lead to physical deterioration and a decline in property values.
- A Reserve Study provides a current estimate of the costs of repairing or replacing major common area components over the long term. Ideally, all major repair costs will be covered by funds set aside as reserves, so that funds are there when needed.
- A Reserve Study must be completed every 3 years but the exact amount that needs to be held in reserve is difficult to estimate and is not specified in California law.

Reserve accounts are not required by law, and a Reserve Study is the opinion of the study's author and an estimate of how much money might be needed.

## **BACKGROUND INFORMATION**

### **DAVIS-STIRLING COMMON INTEREST DEVELOPMENT ACT**

- California Civil Code section 1350-1378, passed in 1985 and amended various times. It consolidated, clarified, and simplified many aspects of Common Interest Development law to one area of the Civil Code, and governs condominiums.
- The board must prepare and distribute a budget with estimated revenue and expenses, and reserve account balance.
- Requires the board to initiate a Reserve Study every 3 years to make sure the HOA is collecting adequate reserve funds.
- The Reserve Study must:
  - Identify the major components that the association will need to repair or replace in the next 30 years
  - Identify the remaining useful life of the components;
  - Estimate the cost to repair or replace the components during their lifetime
  - Estimate the total annual contribution necessary to repair or replace each component during and at the end of the their lifetime, and subtract that amount from existing reserve funds.

### **ISSUES TO CONSIDER**

- HOAs must adequately save for future maintenance expenses or they will find themselves without the necessary funds to maintain the quality of their buildings. This could cause economic hardship for owners in the form of large special assessment when repairs are needed, and unfairly burden current owners.
- Reserve funds that are earmarked for maintenance and the replacement of components are often under-funded due to low assessments and borrowing for other expenses. There is no required funding level or standard for determining whether or not funding is adequate.
- Boards feel pressure from homeowners to keep assessments low, which may undermine the long-term financial stability of the HOA, and could lead to deterioration and a decline in property values.
- Special assessments are supposed to be for unanticipated costs. The board should not use special assessment to pay for regular maintenance if monthly assessments are too low instead of raising monthly assessments.