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FUNDING OPTIONS FOR MAJOR REPAIRS

One of the most pressing financial issues facing many California Community Associations is the need to raise funds to pay for the major repair or replacement of common area components. Regardless of the cause of the need for the repairs (construction defects, deferred maintenance, or simple old age) in the vast majority of cases monies are not available from existing funds. The Board must proactively analyze the problem, define the scope of repairs, and most importantly, raise the necessary funds. The first step when considering funding options is to identify the proper authority under which the Board will seek to raise funds. The second step is to consider all available funding options. This should include both options that result in an increase in existing assessment levels, as well as some creative alternatives that do not result in an increase. The third step is to implement the selected option. This article will briefly discuss these three steps.

AUTHORITY FOR ASSESSMENTS

Community Associations find their primary funding authority in their Covenants, Conditions & Restrictions (CC&R's) and the Davis-Stirling Common Interest Development Act, which is contained in Sections 1350, *et seq*. of the California Civil Code.

Civil Code §1366(a) requires the Board of Directors of an association to levy assessments sufficient to meet its obligations under the Governing Documents and the Davis-Stirling Act. Thus, as a general rule, a Board has an affirmative duty to make a good faith attempt to raise funds, and to seek member approval when required. Section 1366(b) provides the Board with its most important fund-raising tool, by preempting any more restrictive provisions of an association's CC&Rs dealing with assessment increases. Thus, Civil Code §1366 is the primary authority to which you first look for the procedures and limitations governing assessments. After that, you look to the CC&Rs for assessment provisions that are not inconsistent with Civil Code §1366.

FUNDING OPTIONS

There are a variety of sources for funding. In considering possible choices, the Board should look at every available option and document that process. Nothing creates more confidence in the membership than knowing that the Board has exhaustively reviewed all alternatives. You might consider the following options:

Regular Assessments. Section 1366(b) provides that the Board of Directors can raise regular assessments up to 20% annually without a vote of the membership where there has been compliance with the financial reporting requirements of Civil Code §1365(a).

Special Assessments. Section 1366(b) further provides that the Board of Directors can impose one or more special assessments up to an annual total of 5% of the budgeted aggregate gross expenses of the Association for that fiscal year without a vote of the membership, again, where there has been compliance with the financial reporting requirements of Civil Code §1365(a).

Increases Over the Discretionary Limit. In order to raise either regular or special assessments over the discretionary amounts, the issue must be put to the membership for approval. Civil Code §1366 governs this vote. A quorum of the membership must participate in the vote. A quorum is defined as more than 50% of the owners. A majority of the quorum must approve the increase. The vote may be conducted at a meeting of the members or by written ballot.

Emergency Situations. Pursuant to Civil Code Section 1366, there are no restrictions on the Board's discretionary ability to raise assessments where an "emergency situation" is present. An emergency situation is specifically defined as any one of the following:

(1) An extraordinary expense required by an order of a court.

(2) An extraordinary expense necessary to repair or maintain the common interest development or any part of it for which the Association is responsible where a threat to personal safety on the property is discovered.

(3) An extraordinary expense necessary to repair or maintain the common interest development or any part of it for which the Association is responsible that could not have been reasonably foreseen by the Board in preparing and distributing the pro forma operating budget under Section 1365. However, prior to the imposition

or collection of an assessment under this subdivision, the Board shall pass a resolution containing written findings as to the necessity of the extraordinary expense involved and why the expense was not or could not have been reasonably foreseen in the budgeting process, and the resolution shall be distributed to the members with the notice of the assessment.

Please note that levying emergency assessments should be a last resort. Whenever possible, it is far preferable to use a special assessment approved by vote of the members. Should a true financial emergency situation arise, legal counsel should be consulted prior to utilizing this power.

Use Reserves or Borrow ("in-house") Directly from Reserves. If monies are "borrowed" from reserves, the funds must be accounted for on the books and be repaid within one year. (See Civil Code §1365.5(c)). Note that Civil Code §1365.5(c)(1) provides that the Board may expend reserve funds (without "borrowing" these funds) for litigation involving major components the Association is required to maintain, repair or replace. Pursuant to Civil Code §1365.5(d), when reserve funds are used for litigation, the Association must notify the members of that decision in the next available mailing to all members, and of the availability of an accounting of those expenses.

Seeking Funds From Responsible Parties. The Board and Management should always consider whether one or more third parties are legally responsible for the necessary repairs, and the legal rights of the Association as to those parties.

Borrow From a Lender Specializing in Loans to Homeowners Associations. Such loans are typically secured by the future assessment stream and are of two to seven years in duration. Using a loan may also require an increase in assessments to fund the debt service.

Defer Operating Expenditures. Another way to raise funds is to defer spending. Try to negotiate longer term payouts for routine services where possible. Examine every line item to see if certain expenditures can be delayed to free up existing funds.

Reduce or Eliminate Expenditures. Closely monitor the budget and actual expenses to see where costs can be cut.

Combination of Options. Within the criteria set forth above, there are no legal limitations on the Board's powers to mix and match options. Be creative in combining a variety of options.

Implementing the Option

As with most Association powers, it is important to avoid surprising your members. Commit to educating them about the circumstances, let them know what options are being considered and explain the process and general time frames with which the Board is working. Involve them in the process as much as possible. Once an option is selected, send a detailed memorandum itemizing the decision-making process, and the reasons for selecting that particular option. Remember that for the members, ***confidence in the process*** is one of the most important ingredients to successful fund-raising.

It is also prudent to have an informational meeting prior to putting an increase in assessments to a vote. Nothing can be more polarizing than a looming vote on a large special assessment. A vote scheduled prematurely is bound to inflame the members and erode their confidence in the process.

After you have done your best to educate and communicate with the members, only then should you put an assessment increase to a vote. This voting must be conducted by "mail-in" ballot (Civil Code Section 1363.03). While that can be supplemented by voting at a meeting, we do not recommend adding that layer of complication. Distribute the ballot and informational package ahead of time, and invite the members to an "informational" Board meeting on or shortly before the balloting is due to close. That meeting will be far more productive and not so emotionally charged if participants know that they have time to consider the issues, raise their questions and concerns, and then cast their votes.

In sum, tackling an Association's funding issues for major repairs is always a challenge, but it is one that you must master. Methodically considering funding options, involving the membership in the process, and carefully implementing the selected option is the key to success.

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