



BEVEN & BROCK

NEWS & VIEWS

for Homeowners Associations

March 2016

CELEBRATING HOA BOARD VOLUNTEERS!

By David F. Brock, PCAM

National Volunteer Week, a program established by Points of Light in 1974, is about inspiring, recognizing and encouraging people to seek out imaginative ways to engage in their communities. It's about demonstrating to the nation that by working together, we have the fortitude to meet our challenges and accomplish our goals.

National Volunteer Week is about taking action and encouraging individuals and their respective communities to be at the center of social change - discovering and actively demonstrating their collective power to make a difference.

In the vast world of volunteers that exists for many worthy organizations there is no greater volunteer, in my opinion, than homeowner association board members who serve as volunteer board members for their community. Association board members are not like the volunteers at the hospital, museum, church or the local school, who faithfully show up and serve. Why do I believe association board members are special? Because they live in the community in which they serve and many association board members make themselves available at a moment's notice to handle issues and problems in their community, sometimes at



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BEVEN & BROCK PRESENTS: "FREE LEGAL Q & A, AND A FEW NEW LAWS YOU NEED TO KNOW ABOUT!"

APRIL 7, 2016

Speakers:

- Matt Ober, Esq., CCAL - Senior Partner of Richardson Harman Ober PC with over two decades of extensive experience in common interest development law.
- Brian Moreno, Esq., CCAL - A Senior associate with Swedelson Gottlieb, an experienced litigator and community association attorney, having practiced common interest development law since 2003.

The evening will provide a Q & A time, as well as address the following topics:

- Exclusive use maintenance changes in 2017
- Pools - new requirements - but should you be concerned?
- New annual disclosure requirements: FHA and VA
- Drones - who is watching you!
- Clothes Lines - Are they back?
- Electric vehicle charging stations

Plus... find and meet and service vendors in the areas of insurance, termite, landscaping, general contractors and more.

Registration is required in one of the following ways:

- 1) By email to HOASeminars@bevenandbrock.com. Please provide your name, the name of your association, and the number of guests.
- 2) By phone to (626) 243-4162.

The seminar location is in Pasadena at the First Church of the Nazarene, located at 3700 E. Sierra Madre Blvd. The doors are open at 6:30, the seminar begins at 7 PM.

Refreshments will be provided. Great Prizes will be raffled.

HOMEOWNER ASSOCIATION NEWSLETTER

ANNUAL TAX RETURNS REQUIREMENTS

Common Interest Developments typically are non-profit mutual benefit corporations and are not subject to income taxes, however they must file income tax returns, both with the California's Franchise Tax Board (FTB) and with the Federal Internal Revenue Service (IRS) and, if necessary, pay taxes. In addition, An unincorporated association is treated the same as a corporation for tax purposes and is also required to file tax returns. Failure to file returns could result in penalties, back taxes and interest. Incorporated community associations must pay a minimum annual corporation tax of \$800.00 unless they receive an exemption by filing FTB Form 3500. If granted, HOAs are still required to annually file Form 199 and pay taxes on net non-member income.

According to Timothy Bradley, a CPA, who provides tax preparation services to many common interest developments, the most common mistakes in tax preparation are when board members choose to utilize tax preparation services that are commonly used by individuals in filing the Association returns. It is not uncommon to find that these returns are completed improperly.

There are two different forms that homeowner associations may utilize in filing the annual return, the 1120 or the 1120H. Form 1120 is the regular corporate filing with a 15% tax rate on the first \$50,000 of taxable income. This 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. If an association files tax Form 1120, any excess assessment, such as budget surplus at the end of the fiscal year must be applied to next year's assessments or refunded to the membership, according to Revenue Ruling 70-604. If the money is applied to next year's budget, members must approve an "excess income resolution". On the other hand, the form 1120-H form 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, such as interest earnings, laundry income and

rental income. This filing does not require the "excess income resolution".

According to Bradley, homeowner associations should not be filing the corporate return Form 1120, rather, the Form 1120H, which is appropriate in 99% of the cases. The 1120 opens up the association to greater tax liability and those associations that do file using this form do so in the belief that Revenue Ruling 70-604 represents some kind of protection but it does not.

In addition, California requires the completion of 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.

Tax returns must be filed within 75 days of the end of the association's fiscal year. The deadline may be extended for six months by filing the appropriate form. Boards should seek the advice of a CPA who specializes in HOA's when it comes to preparing and filing the association's income tax returns.

While this task is necessary and important, this process doesn't have to be complicated. It is best to keep this and all board functions as routine as possible and it is always best to keep the same accountant from year to year providing they are qualified and performing well for the Association.

Every Homeowner Association with income in excess of \$75,000.00 per year is required by the Davis-Stirling Act to have an independent CPA conduct a "review" of the financial statement of the association each year. Fortunately, the requirements of a review are less than those of an audit. While this is only a requirement of associations with incomes greater than \$75,000, every association should be concerned that their books are being handled properly. The potential for improper financial activity can still exist in small and

self-managed associations, in fact the risk may be greater. If all of the accounting functions are handled by one board member and no statements or bank reconciliations are being provided to the other board members, there is a much greater opportunity for theft of association funds. At a minimum, quarterly financial statements are legally required to be provided to all board members. Some of the more common abuses are a Board member not paying their own assessments, or bills being paid that cover more than just the common area, such as individual units.

According to certified public accountants who provide this type of review, there are some common problems that occur in the process of a review. They are as follows:

- Boards do not sign the engagement letters and/or letters of representation.
- Boards have reserve statements mailed to their residences. The official address for the corporation is where the Agent for Service of Process resides. That is usually the management company's address. There is absolutely no reason for any official correspondence to be addressed to a personal residence.
- Board members purchase items themselves and expect reimbursement. On the whole, associations are corporations and should be treated as such. Coffee and cookies are about the only items requiring board members' purchase.
- Boards pay for reserve studies and then don't follow the

ANNUAL TAX RETURNS REQUIREMENTS: continued on page 3.

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WHEN IS THE RIGHT TIME TO AMEND YOUR GOVERNING DOCUMENTS?

By: Matthew A. Gardner, Esq., Matt D. Ober, Esq., CCAL and Richardson Harman Ober, PC

From time to time we are asked whether an association should amend its CC&Rs. As one can expect, there is no black and white standard. Many factors go into the decision and age of the documents alone is not determinative. But among the key factors driving a CC&Rs amendment is a change in the law that renders CC&Rs outdated. A recent amendment to Civil Code Section 4775, addressing exclusive use common area responsibility, is one example.

Among the most fertile ground for community association disputes is the line between repair and maintenance of exclusive use common area. Many CC&Rs, particularly those in older communities, do not adequately identify or define maintenance and repair responsibility for exclusive use common area components such as patios, balconies, doors and similar components. And when there is uncertainty between owner and association about who repairs what, enforcement challenges and disputes are inevitable. In the absence of well-defined CC&Rs, we look to existing Civil Code Section 4775 which currently provides:

“Unless otherwise provided in the declaration of a common interest development, the association is responsible for repairing, replacing, or maintaining the common area, other than exclusive use common area, and the owner of each separate interest is responsible for

maintaining that separate interest and any exclusive use common area appurtenant to the separate interest.”

The problem with the above language is that it is vague and ambiguous and for years left much to interpretation as to what exactly the owner was responsible for and where does maintenance begin and repair or replacement end. Fortunately our legislature has heard our concerns and provides a degree of relief 4775 in the following amendment to Civil Code 4775 (a) (3) as follows:

“Unless otherwise provided in the declaration of a common interest development, the owner of each separate interest is responsible for maintaining the exclusive use common area appurtenant to that separate interest and the association is responsible for repairing and replacing the exclusive use common area.”

This revised language seeks to clarify the line between **maintenance** of the exclusive use common area and **repair and replacement** of that exclusive use common area. Although the amendment was signed into law during the 2014 legislative session, the law does not take effect until January 2017, giving associations an opportunity **now** to amend their CC&Rs to specify maintenance and repair responsibility for balconies,

patios and similar exclusive use components. Otherwise, the statutory language will control, leaving associations to be responsible for and fund what could be costly exclusive use common area repairs.

Other factors driving the decision to amend CC&Rs, communities know when it is time to make changes. It becomes apparent when the board and the owners are spending considerable time addressing routine issues: who is responsible for repairs or damage, what rights do I have to rent or alter my property, and what are the limitations on the board's authority to impose and collect assessments? The struggle is often deciding when and where to implement those changes. If you find yourself asking these types of questions, it may be time to consider the **Three Rs** for your Governing documents: 1) a **Review** of the existing documents, 2) identify specific provisions for **Revision**; and, evaluate the need for, and whether your community will support a complete **Restatement**.

REVIEW

The first step in deciding whether
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professional guidance in the studies.

- Boards are reluctant to write-off delinquent assessments for units foreclosed years ago. Once foreclosed, write them off. The accounting system should reflect reality. Writing off foreclosed delinquencies does not mean that the collection process necessarily ends.

- Do not use vendors who don't carry workers compensation and liability insurance. One workers' compensation claim can ruin an

association.

- Budget in the best interests of the association, not just to keep assessments low. Eventually the special assessment will be needed.

- The Civil Code requires that each and every bank statement be reconciled (including reserve statements) at least quarterly. Using the out of sight, out of mind mentality, there is little follow up when statements have not been received for months. This is easily resolved if all statements are sent to the management company.

- Board members expend association monies and "verbalize"

the transaction. No activity should ever be recorded as a payment without an invoice.

The solution to each of these issues is the same: board members should always remember that they have a fiduciary duty to the association, which includes acting in a "best practices" manner.

This review shall be distributed within 120 days after the close of the fiscal year. Board members and owners should pay particular attention to any opinions expressed by the CPA as a part of the review.

EIGHT THINGS HOA BOARDS DO TO MAKE THEIR LIVES HARDER!

Every common-interest-development board member who steps up to serve on the board of their association is to be commended for their willingness to serve. However, many do not desire the position of board member, and are ill-prepared for what they face. While serving on

a HOA board doesn't have to be difficult there are aspects to the job that have the potential of making it more challenging than it needs to be. The HOA board member position requires a shift in thinking that eludes many board members. The all-important paradigm shift requires boards to view issues and make decisions from a perspective of the entire association and disregard their own personal view and preferences. This is not natural or easy, and it must be learned.

Sometimes the learning curve is exacerbated by the complete turnover of the board. Ideally, HOA boards should transition in stages, and not create a situation where an entire new board starts at the same time. This is a recipe for chaos in the association and definitely not best for the association. While seminars and courses are available for new board members, sometimes their timing does not allow for attendance when it is needed.

It is not uncommon for new Board members to approach their role in a very different way than the former board members did. Perhaps the new board members are correct in the changes that they believe are necessary, but often new and inexperienced board members make abrupt changes that are not the best for the association.

Here is a summary of potential pitfalls that some new board members should try to avoid:

1) Don't take issues personally. Not everyone gets their way all the time, disagreement among the board is fine. But don't ever let the disagreement impair your ability to work with the board in making future decisions for the association.
2) Personal agendas: it is very easy to view your position on the board as an extension of yourself, and your own needs and desires. The role of serving on the Board requires you to take a different perspective. As a board member

you lose the ability to impose your personal desires on the association. You now have a new hat to wear, that may likely be in conflict with your "homeowner" hat. Your job is to decide what is best for the association as a whole.

3) Meetings: it's no surprise that people really dislike meetings. Many see them as a waste of time and unnecessary. After all, "we can use email to decide things, right?" Wrong! The law requires at least four actual face to face meetings per year. No one says they have to be long and drawn out. It is possible to conduct a meeting in 60 minutes, or less. Also, all but one of the Board members can be on a speaker phone. This is actually a good law, as things decided out of the view of the owners create suspicion and mistrust in the association.



4) No decisions: some boards have difficulty making decisions, and consequently, nothing gets done. Indecision is likely due to a lack of strong leadership by the President. The major function of the board is to make decisions. One of the great aspects of Board service is the collaborative process where the five (or sometimes three) board members work together to decide issues for the good of the community.

5) Micromanagement of vendors: one area that causes more work and stress for some board members is to directly oversee and manage the association vendors. If you have vendors that require

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to amend or restate the governing document is to review what you have. Associations should form a committee of owners and board members who can focus on the task at hand, working with legal counsel to help them identify the provisions in need of amendment. Many communities come to legal counsel already armed with a list of provisions to update or amend. Community history and custom and practice are particularly helpful in developing this list. The board should also consider reaching out to owners to discover other issues that challenge the community. Often either an informal survey or questionnaire will generate more than enough material for a new draft.

What follows is a list of the types of issues, questions and concerns that often lead to a community's desire to make changes to the documents. Deciding whether to revise (amend a few provisions in the current governing documents), or to restate (draft an entire new set of documents) will depend on the number of items the community wishes to tackle.

- Do the CC&Rs contain Declarant or developer rights, or provide for two classes of voting, when the developer is no longer involved in the property?
- Do the CC&Rs contain adequate definitions of all common area and individually owned components? Are the defined terms clear and unambiguous?
- Is the community concerned about the number of rentals within a community?
- Does the CC&Rs have a disciplinary process that is clear, fair, and reasonable, and complies with minimum due process protections for owners?
- Do the CC&Rs contain use restrictions which are outdated, no longer applicable to the community, or not enforced.
- Does the association have adequate, clear, and easy to understand standards in place to inform owners about permissible

modifications and the architectural approval process?

- Are there outdated limitations on how much the association is permitted to spend on capital improvements or common area repairs without membership approval?
- Do the CC&Rs contain references to old Civil Codes or requirements or outdated laws. (e.g. Civil Code Sections 1350-1378)?
- Has the association consulted with legal counsel more than three times within the last year for assistance in interpreting its governing documents with respect to maintenance and repair responsibility, restriction enforcement and/or insurance coverage matters?
- Does the association struggle to achieve quorum for ownership meetings or key association votes?

Once the board has a general list of items that need to be addressed, the community should consult its or with legal counsel to identify other unresolved or problematic provisions. In addition to voluntary changes the community wants to make, communities might be surprised to learn that their documents contain provisions contrary to current laws, outdated industry practice, or other requirements they may not have known existed. Learning a little more about what information belongs will give the communities a thorough interest in moving the revision process forward.

TO AMEND OR RESTATE?

Answering "yes" to one or two of the above issues suggests that your community should at least consider amendments to your governing documents. Amendments are usually best for those limited situations where the community decides that for the most part the CC&Rs serve the community well but could benefit from some refinement or the addition of some essentials; overall documents remain sound. For example, if your CC&Rs are unclear

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very inconvenient times of day and sometimes in the midst of highly charged circumstances.

Yes, I really believe HOA board volunteers are truly amazing and valuable.

For over 40 years, National Volunteer Week has been celebrated in April and this year April 10-16, 2016, has been declared as National Volunteer Week. This week is about

inspiring, recognizing and encouraging people to seek out imaginative ways to engage in their communities. It's about demonstrating that by working together, we have the fortitude to meet our challenges and accomplish our goals.

National Volunteer Week is a time to celebrate people doing extraordinary things through service. Established in 1974, National Volunteer Week focuses national attention on the impact and power of volunteerism and

service as an integral aspect of our civic leadership. Beven & Brock would like to take this week to honor many, many HOA board volunteers who give faithfully and tirelessly to serve their community for no pay, and very little recognition.

As board members, celebrate your own Board. The decisions that you undertake for your fellow owners, and the investment value of your property, is worthy of commendation and celebration.

BOARD MEETINGS: THE FIVE P'S OF SUCCESS!

By David F. Brock, PCAM

Anyone familiar with investing in mutual funds is aware of the Morningstar risk rating system that has been around for about thirty years. If you invest in mutual funds, you are likely concerned that you are making the best possible investment, with safety and growth being of paramount importance. The Morningstar system is a research tool that provides an analysis of publicly traded funds and there are five pillars by which stocks are evaluated: process, performance, people, parent, and price.

Ownership of a home in a common interest development (CID) is not only a place to live, but also an investment. The increase in value of any real estate depends, in part, on the decisions and actions of the owners. The board is responsible for representing the owners, thus the board plays an important role in the investment value of the property.

While there is no formal rating system for common interest developments there are definite factors that influence the value of the property that depend on the board meeting regularly and making good decisions. Board meetings, with one rare exception, are the only place where decisions can be made legally. Meetings are the proper place to make decisions for the benefit of your investment. Unfortunately, some board members believe that having no meetings or very few meetings is fine, and some board members miss meetings, which keeps the board from taking action. Let me ask you to consider the five

"P's" of effective association leadership and productive board meetings: purpose, preparation, punctuality, patience and policy.

First, what is the **purpose** of CID meetings? The primary purpose of the board is to make the best possible decisions for the entire community. Decision making is the primary function of the board meeting, and a sound process for making good decisions is crucial. In order to do this effectively, the board must learn the art of healthy deliberation and discussion. The President must not allow one board member (including the President) to dominate the discussion. The quiet board member should have an opportunity to express their opinion. It is important that each board member approach every issue with an open mind. The best decisions are those that are made by a group that has healthy disagreement and discussion. This process should also include input from outside experts as well as your constituency, the owners. Owners who want to voice their opinion should have the opportunity to do so.

The second important "P" is **preparation**. The President should insist that the information for board members to make informed decisions is in the board members hands at least four days prior to the meeting. This will mean that you will have to establish deadlines with your vendors, especially the association manager, who submits items for the meeting. It seems obvious, but it must be said, that board members should actually

read the material prior to the meeting. The meeting itself is not the time to get up to speed on the issues, unless of course you particularly enjoy long meetings. Posting the Agenda four days in advance of the meeting, which is required legally, helps to keep the meeting focused. The board cannot discuss anything that is not on the Agenda. Once the meeting begins, any conversation among board members which does not pertain to the Agenda items and related decisions should be deferred until after the meeting adjourns. The President or Chair of the meeting is responsible to make sure the meeting stays focused.

Punctuality and consistency are important factors for the success of board meetings. Meetings lose effectiveness after sixty to ninety minutes. Meetings should begin on time, providing you have a quorum, and not drag past ninety minutes. Do you ever wonder why owners don't want to serve on the Board? Perhaps the meetings are too long and wander off subject easily.

The governing documents of your association may specify a certain number of meetings that you should have, whether monthly or quarterly. But if not, in order for a board to function effectively it is recommended that you have ten meetings a year. A board may elect to not meet in one month of the summer, and during the month of December. If the Association is

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about balcony maintenance requirements, or if your community is ready for some type of leasing provision, a simple, relatively inexpensive one or two issue amendment would be sufficient. Further, if your documents contain the outdated Civil Code references (Civil Code 1350), the association can offer a simple amendment to replace outdated references without needing to change the substance of the document or requiring a complete re-write of your CC&Rs. Civil Code Section 4235 facilitates the association to update their CC&Rs to incorporate the current Civil Code sections and to replace the outdated ones.

RESTATEMENT

Restatement refers to a complete rewrite of the association's CC&Rs. Through this process, the association maintains the essential, community specific provisions but ends up with a completely new, updated CC&Rs. When the documents have too many missing maintenance requirements, incorrect code references, or

unenforceable restrictions, it can be detrimental to basic governance. Boards and owners who cannot rely on the accuracy of the information presented in the documents will effectively view them as useless. That works against both the interest of the board and the owners.

So if your community finds itself answering, "yes" to several of the above factors; if the documents are unreadable, filled with legalese, inconsistent with current law, and difficult to understand, interpret and enforce, the governing documents are probably suitable for restatement, and your community could benefit from a restatement that is consistent with updated Civil Code references, legal requirements, industry practice, and other provisions tailored exclusively for the community's specific needs.

Whether in the end you eventually decide to amend or restate your CC&Rs, or do nothing, the best place to start is by a survey of your community: 1) evaluate the issues that come before the board on a regular basis; 2) consider the issues addressed by legal counsel on an annual basis.

EIGHT THINGS HOA BOARDS DO:
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supervision, you may have the wrong vendors. If this is the case, the board should appoint a representative to speak to the owner of the company about their service. Vendors should want to make their customers happy, so if you are not happy they may not be aware of that. Generally it is easier to work with your current vendor to make things right, than starting over with new vendors. Bottom line, don't feel the need to supervise the daily work product of the vendor. Remember, you are not the on-site manager. Stay focused on the big picture.

6) Operate as a business: many board members don't realize that their association is a business and business minded decisions must be made. The value of the business is the combined value of all the units, and your association is a multi-million dollar business. Decisions to hire vendors should be based on

the qualifications of the vendor as opposed to cost. This includes deciding on contracts, not only based on cost, but on the long term value.

7) Boundaries: board members need to recognize that this is also their home, and that they are board members only at meetings, and in rare cases of emergency. Unless you don't have a management company, board members should not undertake directly issues of rule enforcement except in the context of a meeting. 8) HOA leadership was intended to be a group effort. Serving on a board that has empty seats is ill-advised. If you don't have a full board, make this an agenda item at every meeting. You should want to avoid liability and extra work created by not having a full board to share the load.

May your service to your HOA result in great enjoyment and satisfaction as you work together to meet the needs of your community.

Is there a pattern or commonality. Would a clear CC&Rs provision aid the board in enforcement and perhaps reduce legal fees or disputes; 3) review the reasons the board is fining owners or the other frequent enforcement issues the association encounters over the year, and consider whether a more clearly stated use restriction section would encourage compliance and aid the board in enforcement. And finally, consider surveying your owners about their CC&Rs. Feedback from owners about their concerns, their level of understanding and their opinion about whether the CC&Rs fit the needs of the community can assist that board in making the decision about whether to amend, and begin the important process of building community support for the amendment process should the board decide to take on the amendment or restatement



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smaller, and there are no major issues, meeting quarterly may be adequate providing the governing documents allow this. It is best to set a specific day of the month for your meetings. At the first meeting of a new board, establish the best day or evening in the month that works for everyone. The board members can then set other regularly scheduled events around this meeting, thus increasing the likelihood that all members will be present.

Patience is a virtue especially with Board meetings and decisions. The best decisions by groups always take longer, but groups generally make better decisions. Don't be frustrated by the process involved, rather let your desire for the best result for your community and your investment win. It takes time for all Board members to deliberate and voice their opinions, but that should be worth the wait.

Finally, a **policy** making board is the best kind of volunteer board. Boards who develop policy as opposed to deciding every similar

issue separately are able to operate more efficiently over time. Simply, once you have decided how you operate with a given set of facts, there is no future discussion unless you believe your policy is flawed. It also helps those who work with you, such as the Association manager, help you by having the ability to speak on the Board's behalf and not come to the Board each time a similar issue arises. Board members should recognize the importance of their role as decision makers and how good decisions impact the investment value of the property. The likely combined value of the units in your association is easily in the millions so it is important to take a business-like posture in your meetings. If you view the decision making process in the proper ways you will help to enhance value in your association. Regularly held and properly managed meetings may also motivate some owners to be more willing to serve, if only to protect their investment. Finally, remember the following primary principles of meetings: **purpose, preparation, punctuality, patience and policy.**



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