BEVEN & BROCK
NEWS & VIEWS
for Homeowners Associations
November 2016

Addressing the Challenge of Rentals in Your HOA

By David Brock, PCAM

An issue of great importance to some HOA board members is problems that result from rental units in their association. Boards spend time in meetings discussing renters and absentee owners which they believe are the cause of problems in the association. The focus of the discussion usually involves how to reduce the number of rental units. The sentiments expressed by boards is that tenants have no regard for the rules of the community, and the owners who rent their units don't care either. This problem is exacerbated when the tenant population increases. Owner occupants do not want to live in a complex that feels more like an apartment complex. Due to the lack of decent real estate investment options, it is true that more investors are looking for condominium units to rent. Rental values in certain areas have increased dramatically in the past two years.

What are the solutions to this significant problem for HOA's? The solutions that most associations want to pursue, and believe, will solve the problems, takes two forms: 1) a rental cap or 2) a "seasoning requirement." The rental cap limits the number of units in a development that can

Addressing the Challenge ...: continued on page 6.

ANNUAL FINANCIAL DISCLOSURES

The preparation and distribution of the two annual disclosure packages to all owners is one of the most important requirements of the board of directors. The annual disclosures are now required to be organized into two distinct packets and there are also some new requirements as of 2014.

The disclosures that are required have now been placed into two different reports, now known as the "Annual Budget Report" and the "Annual Policy Statement".

November is the last month of the year in which this material must be assembled for associations which operate on a calendar year. If a management company is involved with your association they should be handling this for you.

The specific sections of the law that can be referred to for more specific information are Sections 5300 and 5310. Below is a summary of the requirements for each report.

ANNUAL BUDGET REPORT

1. Approved operating budget and reserve allocation for the next fiscal year.
2. The most current Reserve Study which contains the following information:

a) The Executive Summary from the most recently updated Reserve Study.

b) Reserve Funding Disclosure Form/ Table

c) Board statements regarding the reserve study.

3. Master Policy Insurance and information regarding other policies.
4. Insurance disclaimer language verbatim from Civil Code
5. Association Loan Statement (if applicable)
6. FHA Certification (new this year)
7. VA Certification (new this year)

ANNUAL POLICY STATEMENT

1. Communication with the Association statement
2. Overnight Mailing Address statement
3. Secondary Address statement
4. General Notices statement
5. Association Minutes statement
6. Assessment Collection Policies statement
7. Collection Policy
8. Association Rules and Regulations including Fine Policy, if any
9. Dispute Resolution Procedures (ADR/IDR Rules)
10. Architectural change rules and procedures

The deadline for all associations is thirty days prior to the end of the year, unless your documents have a more strict time frame. While these disclosures may appear excessive, they do also serve to alleviate the Board of future liability. These disclosures meet the annual requirement of the association to disclose important aspects of your association to owners, who are then responsible for disclosing it to future owners. Boards are encouraged to take this legal requirement seriously.

Judicial Foreclosure Is The Best Method To Collect – So Why Isn't It More Popular?

By Kelly G. Richardson, Esq. CCAL

There are three main methods of compelling delinquent homeowners to pay assessments: Small claims court, non-judicial foreclosure and judicial foreclosure. Small claims court allows the association only to sue for a limited amount of money. Non-judicial foreclosure only allows the association to take ownership of the delinquent owner's property. Judicial foreclosure allows pursuit of both money damages as well as ownership of the property.

Foreclosure is the process of a lienholder involuntarily taking another's property. Judicial foreclosure pursues that process under court supervision, and non-judicial foreclosure does so without court involvement.

Whether judicial or non-judicial foreclosure is ultimately pursued, the collection process starts the same way – the association imposes a late fee and then records a lien on the property. The processes diverge after that point, if the homeowner does not bring the account current. Most delinquencies are corrected by the homeowner at or before the lien stage. The foreclosure process becomes necessary when the owner, despite the lien, still does not correct the delinquency.

In the judicial foreclosure process, a lawsuit is filed in Superior Court asking for a money judgment and an order foreclosing upon the property. The lawsuit is normally filed as a "limited jurisdiction" case, reducing filing fees and time to trial. In the rare case in which the debtor contests the lawsuit, limited jurisdiction cases allow less pretrial activity, thereby limiting cost.

The threat of foreclosure does not compel the owner to pay their balance current if the owner simply does not fear or understand foreclosure. Sophisticated owners do not fear foreclosure when there is no equity in the property, because, if taken away, the owner loses nothing of value. Others do not fear foreclosure because they do not understand that their association can take their home. This was the situation in the notorious case years ago involving the Radcliffs of Copperopolis, in Northern California, who lost their home by non-judicial foreclosure over a debt of $120. Anita Radcliff said "It didn't occur to me that they could foreclose..." Similar news stories and quotes abound in recent years.

Judicial foreclosure is preferable for several reasons:

1. **The association has all the options.** If the property is overburdened with mortgages and liens so that there is no net value, the association can still ask for a money judgment. If there is sufficient equity in the property, the association can ask for an order of foreclosure. So the association has the flexibility to do what is best in that situation. On the other hand, when an association discovers after completing non-judicial foreclosure that the property is worthless, it is barred by law from doing anything else to pursue the money from the former owner.
2. **The process is usually faster than non-judicial.** Almost all judicial foreclosure actions are unopposed. A lawsuit goes to default if it is not opposed within 30 days. At the same time, a non-judicial foreclosure has prescribed waiting periods of several months.
3. **Even the most unsophisticated people understand** that a lawsuit is a bad thing, unlike non-judicial foreclosure. Like Mrs. Radcliff, they do not understand they can lose their home without a judge involved. So judicial foreclosure is fairer.
4. **The sophisticated delinquent is not able to simply "walk away"** because the association can obtain a money judgment, which lasts for ten years – and can be renewed for another ten. The judgment will show up on their credit report - so at some point, the likelihood is they will ultimately pay.
5. **The association is protected.** In judicial foreclosure lawsuits, in the rare occasion a homeowner challenges the delinquency, they simply file a response contesting the association's lawsuit. In non-judicial foreclosure, a homeowner seeking to stop the foreclosure typically sues the HOA, manager, and foreclosure company.

6. **The HOA attorney is involved** to guide the association in making reasoned decisions on a case by case basis. Non-judicial foreclosure companies are not law firms and cannot give advice. Completing a foreclosure is not always in the HOA's best interests, but non-judicial foreclosure firms proceed automatically, and associations often find out too late it spent thousands of dollars to take a worthless property.
7. **The homeowner is protected.** Stories of alleged non-judicial foreclosure abuse abound, but they are better protected by a court-supervised process.

With all its limitations and drawbacks, why is non-judicial foreclosure more common, particularly when the general public, the Legislature and media abhor the process? The cause is a few enduring myths – that judicial foreclosure takes longer (it doesn't) or costs more (it shouldn't). Trust your association attorney to pursue the safer and less controversial judicial method, and make sure their charges are reasonable for that work.

Kelly G. Richardson, Esq, is a Fellow of the College of Community Association Lawyers, National 2016 President of CAI, a columnist appearing weekly in 13 Southern California newspapers, and Senior Partner with Richardson Harman Ober PC.

RAIN, RAIN DID YOU GO AWAY?!
... El Nino Rain vs. Rain 2016-2017

This time last year all of Southern California was preparing for the huge forecasted El Nino winter that we were being told to expect. El Nino turned out to be "El Dud" for Southern California, but fortunately, it took a left turn and went north, which wasn't the worst thing.

So, for the winter of 2016-2017, we don't hear much in the news. Maybe the prognosticators are afraid to predict. So we checked in with Bill Patzert, the climatologist at NASA's Jet Propulsion Laboratory in La Canada Flintridge who has emerged as the leading expert on weather in Southern California and also a Beven & Brock Association Board President. Get ready; this is "breaking news": Bill says "the door is open, a crack, for some rain this winter. The irony would be a Godzilla, dry El Nino, and a puny, wet La Nina."

Bottom line--no one knows what will happen.

Just to add some substance to this discussion, ***The Old Farmer's Almanac 2017 Winter Weather Outlook is predicting:*** "winter temperatures and rainfall will be below normal, with below-normal mountain snows. The stormiest periods will be in late November, mid-December, and mid-January. The coldest temperatures will be in early and late December and mid to late January."

The real issue though for every association is to prepare for rain every year. While rainfall in Southern California is unpredictable, associations still need to prepare for rain. Any amount of rain can wreak significant havoc for your association if you didn't prepare. What does rain preparation look like for almost every association?

There are several issues that boards should undertake every year, in October or early November, to be ready for whatever rain we are fortunate enough to get.

1) ***Make sure that all area drains are cleaned out.*** This will include the ground level, subterranean garage, and roof drains.
2) ***Make sure all roof gutters are cleared of leaves and debris.***
3) ***Do a roof inspection.*** Most roof leaks are caused by the failure of "mastic." Mastic is used to seal the pipes th at extend through the roof. Mastic becomes deteriorated by the sun and has a shorter lifespan than your roof. A qualified roofer can check your roof and make repairs, which is much less expensive than that of dealing with the results of a roof leak.
4) ***Test your sump pumps*** - subterranean garages most often have pumps that pump the water out of the garage. Sump pumps should be tested every year to make sure they will function when you need them.
5) ***Review.*** If you can remember the last time it rained, perhaps, there are some troublesome areas of your property that usually cause problems when it rains. Pay attention to those this year.

There is nothing difficult or expensive about being prepared for the rainy season. The cost to prepare is a small fraction of the cost to clean up after a rain storm.
In closing, Bill Patzert would like you to know that his tenure as his association's Board President is better than his rain prediction last winter.

May your tenure as a Board member include appropriate preparation for whatever amount of rain we do receive this year.

3 COMMON MISTAKES MADE BY AGENTS
By Elliot Katzovitz

As anyone that specializes in associations can tell you, condominium and homeowners associations have many unique issues. The same is true for the insurance they require. These associations are not like any other commercial entity in many ways. It takes an expert in this type of insurance to properly evaluate what is needed and what is missing from an association's policy.

These are the most common problems that occur in HOA insurance, and why these errors are a potential problem for your association.

1. Wrong Coverage for Unit Interiors

Who is responsible for covering the unit interiors is dictated by the association's CC&Rs. In some instances, the CC&Rs will dictate "Full Coverage of Unit Interiors" on the master policy, and in others it will tell you to exclude them. In even other instances, the CC&Rs will dictate that the association must restore the

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NON-JUDICIAL FORECLOSURE AS A METHOD OF COLLECTING DELINQUENT ASSESSMENTS

By Sandra L. Gottlieb, Partner, SwedelsonGottlieb, Community Association Attorneys

One method for collecting delinquent assessments is the statutory non-judicial foreclosure process, which contrasts dramatically with the judicial foreclosure method. In a non-judicial foreclosure, if an owner does not pay their delinquency, an association may conduct a foreclosure sale through a private, independent trustee. This process occurs outside of the court system pursuant to the authority given in the California Civil Code and the association's governing documents. In other words, through non-judicial foreclosure, an association may foreclose on an owner's property to collect delinquent assessments without having to file a lawsuit, so long as the statutory procedure is followed.

Over the years, community association attorneys have debated what is the best method to collect delinquent assessments from owners. At our firm, and our affiliated assessment collection company, Association Lien Services, we favor non-judicial foreclosure, relying on the words of a very astute judge, who said when comparing the two, "Why use a cannon where a pistol will do?" Taking it a step further, why go to court and litigate with and against a fellow homeowner if you do not have to? There is ample support for this position.

The benefits of using the non-judicial process are self-evident. By opting to pursue non-judicial foreclose, an association can avoid the time and expense involved in filing a lawsuit against a homeowner. Non-judicial foreclosure is significantly less expensive than judicial methods for collection, such as filing a civil action to obtain a personal money judgment to collect the debt (in superior court or small claims court) or filing a lawsuit in superior court to foreclose on a recorded assessment lien (judicial foreclosure) and/or obtain a personal money judgment. We find the non-judicial foreclosure process is also more effective since the owner either pays the debt he/she owes the association or faces a forced sale of his/her home. Non-judicial foreclosure is also relatively quick. Based upon the time frame set forth in the Civil Code, the entire non-judicial foreclosure process, from pre-lien letter, to lien to sale, can be completed within approximately five to six months, assuming there are no hiccups in the process. We should note, however, that the association cannot proceed with the actual foreclosure sale until such time as the owner is either $1,800 delinquent in assessments, or the delinquency has exceeded 12 months. That being said, usually by the time an association is ready to take action against a delinquent owner, this threshold has already been met.

In any case, most owners, wishing to stop the foreclosure process and not lose their property, will pay the amounts owed after receiving a Notice of Default (if not before). This high response rate is not surprising in light of the relatively small amount of the delinquency to an association compared with the potential loss of equity the owner is likely to suffer if the property is sold by the association through a foreclosure sale. Of course, it is true if the owner has no equity to lose, the owner may not be as inclined to save their property from foreclosure sale. That being said, as a practical matter, it is generally much less expensive for an owner to pay the delinquency and save his or her home than it would be, in most cases, to pay a first, last and security deposit on a new rental property when the owner is forced

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out of his/her home. When you take into consideration the cost of moving and the upheaval this could have on the owner's family, paying the delinquent assessments and redeeming the property to "save it" before the foreclosure makes sense more often than not.

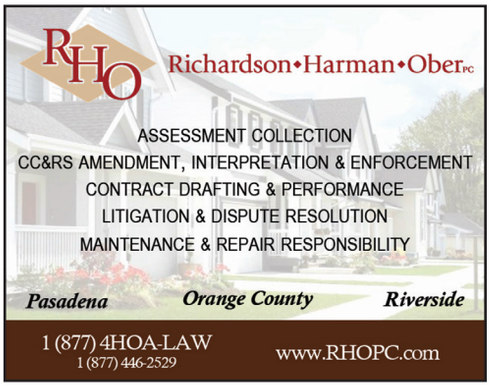
From the association's standpoint, although the Association is ultimately responsible since the costs of collection, including attorneys' fees, are typically added to the amount due by the delinquent homeowner, if the owner pays the amount of the delinquency prior to the foreclosure sale, the professional fees and costs of the foreclosure will be paid by the owner. In non-judicial foreclosure, as opposed to a law suit/judicial foreclosure, an owner making payment in full will be required to bring their account current, paying all amounts due to the association through the date of payment. On the other hand, in a lawsuit or judicial foreclosure, the owner would only have to pay the amount owed as of the date of a court judgment, which may have been entered months, or even years prior to the sale date, meaning that the association may not actually collect the full outstanding assessment debt from the owner and all the costs incurred by the association with regard to its collection efforts.

The principal "drawback" to pursuing the non-judicial foreclosure typically occurs where there is no equity in the property and the owner is ready to walk away from the property. In such a scenario, there may be no third-party purchaser of the property at the foreclosure sale, in which case the association would take title to the delinquent owner's property subject to any senior deeds of trust. In such a case, the property is said to "revert" to the association, who is, from that point in time, the owner of record of the property. Although this may not be what the association wants, it may be the association's only viable option if it appears the owner has no money or collectible assets. In the end, however, the association is at least in possession of the real property interest as opposed to owning a judgment on paper that is worthless and not collectible (if the prior owner has no assets). In such a scenario, the association has options as to the next steps it may take, which include waiting for a senior lender to foreclose on the property and take over the ownership of the property or possibly renting the unit while being mindful of rent skimming laws.

The most common mistake we see associations make with regard to delinquency and collection is inaction—in other words, doing nothing, which is different than making a decision to do nothing. The problem with doing nothing is that the Board is not sticking to its guns, the association's collection policy, and by failing to take action, the Board is not providing a true deterrent to delinquent owners. Why should owners be concerned with making timely assessment payments if there is no recourse for failing to do so? Further, the Board is not protecting itself and the association from claims that it failed in its duties by not adequately evaluating the situation and pursuing the course of action that was in the best interest of the association (as the Board is obligated to do).

In practice, the vast majority of owners pay their debt well before a non-judicial foreclosure sale takes place. Given the indisputable legal authority for holding non-judicial foreclosure sales, the main relevant factors in deciding between judicial and non-judicial foreclosure are often the time and expense involved and whether or not the association wants to be embroiled in litigation. With few exceptions, non-judicial foreclosure offers the quicker and less expensive assessment collection process. Therefore, when you need to record an assessment lien, use a pistol by designating a non-judicial trustee. No cannons allowed!

Sandra L. Gottlieb, Esq., CCAL, is the Managing Partner of SwedelsonGottlieb and a principal in Association Lien Services.



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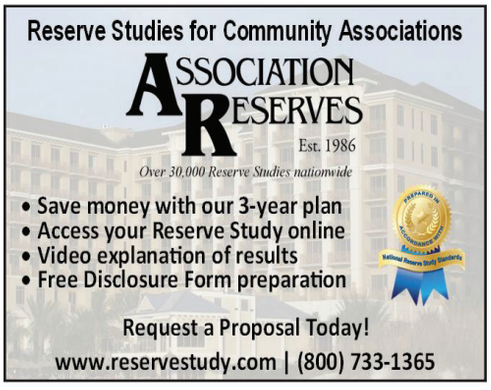

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be rented, such as 25%, of the total units. The seasoning requirement requires that an owner must occupy the unit for the first year of ownership before they can rent. The intent of this is to discourage investors from buying into the complex.

There are some challenges though to address in this process.

First, the law prohibits any retroactive restriction, which means you cannot pass a restriction that impacts current owners. Therefore, only future owners will be impacted by any restriction.

Secondly, according to one election inspection company, some associations have attempted to approve, by owner vote, revised C.C. & R's that contained rental restrictions, however, they could not get owner approval until the rental restrictions were removed.

Third, lenders to HOA's have issues with rental restrictions. For instance, according to the 2016 guidelines for FHA condo approval, leasing restrictions cannot provide for any "seasoning clauses." Further, the FHA guidelines do not permit the Board of Directors to have the power to approve leases or deny leasing. The unit owner must have the right to lease to any tenant, and the board cannot impose background checks, credit checks, or any other type of screening for prospective tenants. The current loan limits for FHA loans in LA County is $625,500.00, so this information may have no relevance to units that are valued over $650,000.00. However, lenders do not favor rental restrictions since it can create a potential challenge for owners who get into financial trouble and need to rent their unit to be able to make their mortgage payments. Lenders have a great amount of control over the real estate market, since most buyers require a loan. Most lenders today require a minimum percentage of owner occupancy, that is 50%. Similar requirements exist for reverse mortgages and VA loans.

Any restriction that an association may consider approving should include a hardship clause. For example, suppose you had a rental cap of eight units that could be rented at any one time. The problem with this is that since life is full of unforeseen situations, an owner who may need to rent their unit could encounter being over the cap. This owner may have a hardship, such as an unexpected job transfer, change in health or financial status that would require him or her to move out abruptly. Forcing this owner to sell, potentially in a soft market, is not a great solution. The effects of a low priced sale in your association would be detrimental to any other owner in the development who wants to refinance or sell their own unit shortly.

Hardship clauses are necessary, but also potentially complicated as they force the board to be subjective

in their role in determining if a hardship truly exists. Boards who are considering a restriction should seek a legal opinion on how they would operate with a hardship clause in place. It is too easy for boards to over-reach their authority in these types of situations.

Regarding property value concerns, a seasoning restriction in your documents will have a potentially negative impact on the marketability of units for sale. It is not difficult to understand that if you are trying to sell your unit and a segment of the potential buyers was immediately eliminated due to a seasoning restriction, it could negatively impact the value of the offers that would be received. This represents the classic conflict that exists within homeowner associations, which pits the short-term interests of some owners against the long-term interest of other owners.

The focus of this article has been on the legal side of this issue, but I would like to suggest that there is another perspective that may help make the situation better.

While tenants cannot have legal input into the affairs of the association, they could have an investment in the community in other ways that would benefit the association. Very few associations recognize that there are ways to help to stem the issues that they believe are caused by tenants. The legal relationship between the HOA and the tenant has always been through the owner, which is legally appropriate. However, there are no laws that prohibit tenants from being invited to social events or serving on a committee to help make the property better in some way. If you view your association as a community, then it would make sense that you would want to welcome new residents to the community, regardless of whether they rent or own. If your tenant residents were made to feel like legitimate members of the community, then they might act like they are. Again, yes, they can't vote or attend board meetings to express their view, but some tenants may care about where they live and about making it a nice place to live.

While the board can create an environment that attempts to involve tenants, boards should still take measures to protect the association's interests. The best mechanism for this is the Rules and Regulations. Rules are easier to pass, and if, done properly they are enforceable. Examples of some "rules" that associations should consider about owners who rent may be as follows:

- For owners who rent their units, the Association Rules and Regulations must be attached to the lease or rental agreement and signed as having been read by all adult occupants. A copy of the signed "Rules" must be provided to the association immediately.
- Owners who rent their units must have a local contact who has 24-hour availability in case

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of emergency. The local contact information must be provided to the association or managing agent immediately upon the signing of the lease.

- Owners who rent their units are strongly encouraged to take all proper measures to effectively screen their prospective tenants, including credit check, criminal background check, income, and prior rental history before renting.
- The tenants contact information must be provided to the association when the signed "rules" are provided, that includes cell phone and email contact.

In closing, while the issue of tenants in your association can be problematic, there are solutions. Even if a rental restriction doesn't quite make sense, there are ways to make the situation better in your community.

3 Common Mistakes Made by Agents: continued from page 3.

units to the original condition they were in at the time they were built.

If your master policy is not written to match the CC&Rs requirements, then the association can potentially be over-insured or dangerously under-insured and it can possibly create situations where coverage is purchased and then denied at the time of loss.

If the association's CC&Rs dictate that the association's policy provides coverage for the unit interiors, yet the agent fails to sell a policy that includes the necessary coverage, and there is a loss that includes the interior of the unit, the association will be required to pay that portion of the loss out of its own pocket. The master policy will decline coverage for the claim because it was excluded on their policy. The unit-owner policy will also decline coverage because owners will look to the CC&Rs, which state that coverage is to be provided by the association, and therefore the owner is not responsible for paying the claim.

Why expose yourself to these problems when a proper review of your CC&Rs by an expert in association insurance could help you avoid this problem?

On the other end of the spectrum, if the association's policy provides for "Full Coverage of Unit Interiors" when they should be excluded, you can end up with one of two possible problematic outcomes. The first outcome is that the association's policy will cover the loss when it should be denying it. This will lead to higher premiums and possible cancellation from your current insurer when your policy renews.

The alternative is that the association's adjuster will review the CC&Rs and deny the claim, insisting the association has no insurable interest in the interiors. In this situation, the unit-owner's policy should pick up coverage. However, some unit-owner contracts state that they will refuse to pay a claim if there is coverage stated under the master policy's contract. The result could be that you have purchased the coverage twice and neither insurance company will pay the claim.

2. Inaccurate Building Values

If the building is not covered for an amount that will adequately replace the building in the event of a total loss, there can be major problems, even if the building is not completely destroyed. By not insuring for the amount the building is valued at, you can trigger a policy's co-insurance clause. Co-insurance states that if the insured has not properly valued the replacement cost of the building, the insurance company can reduce a claim settlement to reflect the proportional amount that you insured, and then reduce it further by whatever the penalty is in the contract.

An example of how this works is if the actual replacement cost of the building is $1,000 and you only insure it for $800, you have now only insured to 80 percent of the building's value. You now have a $300 loss. They will say that you under-insured by 20%, so if there is a 150% co-insurance penalty, you will be penalized 30% on your claim settlement. They will pay you only $210. Now subtract your deductible and that will be the check that you receive.

On the other side, if the building is overvalued, you may be paying money for coverage that is not necessary, which will end up wasting the association's money.

How is a lay board supposed to come up with a proper valuation for the cost of rebuilding? Our solution to this problem is to provide the board with a Marshall and Swift replacement cost worksheet so that you can feel comfortable with value used to protect your assets.

3. Inappropriate Liability Limits

California law requires that you have $2 million of liability coverage if the association is less than 100 units and $3 million in coverage if it is 100 units or more. If you have less than that amount of coverage, each individual unit owner becomes susceptible to personal liability for

3 Common Mistakes Made by Agents: continued on page 8.

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lawsuits by the association.

These are just seven of the errors that are commonly made on association policies. There are others as well.

These errors tend to occur for two reasons:

1) The agent isn't an expert in association insurance. If the agent is not dealing with association insurance on a daily basis, he will not be aware of many of these issues. These are fine nuances that are not common to other types of insurance. The person that handles your auto and business insurance is not the person that you want handling your association insurance. You want an agent that represents hundreds of associations and is fluent in the nuances of association insurance.

2) An agent is in a competitive bid situation and believes the only item that the board is concerned about is price. You will find that he will get you the cheapest price by removing one or more of these items to gut the coverage he is selling you. Is that the price-reducing strategy you really want? It's no different than buying a stripped down version of a car versus the fully loaded version. The difference, though, is that the items that get left off the punch list can cost you dearly when you really need it.

These possible problems are why you need an expert in association insurance to review your policy and bid your insurance. You need one agent you trust, not three that you don't. By using a Broker, you will be able to obtain multiple bids using the same standard of coverage. It will also allow you to have an expert in this type of insurance make sure that these and other potentially costly oversights do not exist in your policy.

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