

First Supplement to Memorandum 2006-33

Statutory Clarification and Simplification of CID Law: Discussion of Issues

The staff draft attached to Memorandum 2006-33 would reorganize existing law on the funding of CID reserve accounts. See proposed Sections 5555-5560. Those provisions incorporate changes that are proposed in pending legislation, Assembly Bill 2100 (Laird). That bill has been approved by the Legislature and is awaiting review by the Governor.

Adam Dondro, of Assembly Member Laird's staff, reviewed the staff draft and noted a few instances in which it differs from AB 2100. Those discrepancies are discussed below, followed by proposed revisions to bring the staff draft into closer conformity with AB 2100.

All statutory references in this memorandum are to the Civil Code.

Deferred Repair

AB 2100 would require that an association adopt a reserve funding plan, indicating how it proposes to provide the funding necessary to meet its future maintenance obligations. The bill would expand on an existing requirement that an association prepare an annual statement of "the mechanism or mechanisms by which the board of directors will fund reserves to repair or replace major components" Section 1365(a)(3)(B).

Under existing law, the reserve funding mechanism can include a decision to **defer** the repair or replacement of a component. *Id.* That rule is continued in proposed Section 5560(b).

AB 2100 would go a step farther. In preparing a reserve funding plan, a board could decide that a component **will not** be replaced or repaired. In accord with that change, the annual reserve study summary would disclose:

Whether the board of directors of the association has determined to 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.

Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

AB 2100 (Laird) (emphasis added).

Proposed Section 5560 would continue the existing authority to defer maintenance, but would not authorize the board to permanently forego maintenance of a component.

The staff was concerned that the broader grant of authority might give a board the power to disregard an obligation that is established in the declaration. For example, suppose that a CID's declaration provides that the common area will include a tennis court for the use of the members. The tennis court is used infrequently and is falling into disrepair. It might make sense to abandon the court, rather than pay to rehabilitate it. Should the board acting alone be able to make that decision, despite the fact that the declaration calls for maintenance of the court? Or should such a decision require the approval of the members (as would be the case if the board were proposing to amend the declaration)?

On further reflection, that issue is probably too substantive to be resolved in the context of the current project. **The staff recommends** that proposed Section 5560 be revised to conform to AB 2100 on this point. See "Proposed Revisions," below. The question of who may decide to forego maintenance should be studied as a separate issue.

Borrowing

Existing Section 1365(a)(3)(B) provides that an association's reserve funding mechanism may include, among other things, borrowing. That provision is continued in proposed Section 5560(b).

Mr. Dondro notes that proposed Section 5560 calls for specific detail on a proposed assessment increase, but does not require a similar level of detail about proposed borrowing. He suggests that the board should be required to state the amount, interest rate, and term of any proposed loan. That seems sensible. See "Proposed Revisions," below.

Distribution of Reserve Funding Plan

AB 2100 would require that a **summary** of the reserve funding plan be delivered to members annually. The summary would include a statement that the full reserve funding plan is available to a member on request. Mr. Dondro notes that the staff draft omits those requirements.

The omission was inadvertent. **The proposed law should be revised to include similar distribution requirements.** See "Proposed Revisions," below.

Operative Date of Reserve Funding Plan Provisions

The reserve funding plan provisions of AB 2100 would not become operative until January 1, 2009.

If this study is not completed until 2007, as seems likely, then implementing legislation would probably not be introduced until 2008. In that case, the earliest effective date of the new law would be January 1, 2009. That would be consistent with the operative date provided in AB 2100.

If, however, legislation is introduced sooner, the proposed law might become effective before January 1, 2009. In that case, the Commission would need to add a specific provision deferring the operation of proposed Section 5560. **The staff recommends** that a note be added to make clear that we do not intend to hasten the operation of the reserve funding plan provisions. See "Proposed Revisions," below.

Proposed Revisions

The staff recommends that the following changes be made to the staff draft, in order to address the issues discussed above and make minor editorial improvements:

§ 4800. Annual budget report

4800. (a) From 30 to 90 days before the end of the fiscal year, the board shall prepare an annual budget report.

(b) The annual budget report shall include all of the following information:

(1) The estimated revenue and expenses for the operating and reserve accounts, on an accrual basis.

(2) The reserve funding study prepared pursuant to Section 5555.

(3) The reserve funding plan prepared pursuant to Section 5560.

(4) The statement of the association's insurance coverage, prepared pursuant to [subdivision (e) of Section 1365].

(c) The board shall promptly deliver a copy of the current annual budget report to any member who requests a copy, at no cost to the member.

(d) The type used in the annual budget report shall be at least 12 points in size.

Comment. Section 4800 continues part of the substance of former Sections 1365(a) & (e); 1365.2.5.

§ 5560. Reserve funding plan

5560. (a) At least once every three years, the board shall prepare a reserve funding plan that describes how the association will

contribute sufficient funds to the reserve account to meet the association's obligation to repair and replace the major components included in the most recent reserve funding study.

(b) The plan may provide for an increase in the general assessment, a special assessment, borrowing, use of other assets, ~~deferral of selected replacement or repairs a decision to defer or not undertake the repair or replacement of a major component, or other mechanisms.~~

(c) If the plan proposes an increase in the general assessment, it shall include the date that the increase would take effect, the amount of the increase per unit per month, and the purpose of the increase. If more than one increase is proposed, the plan shall include the aggregate increase per unit per month. If the separate interests in the development do not pay equal assessments, the plan shall include a schedule that provides the required information for each class of separate interest.

describe the proposed increase in the following form:

Date- assessment takes effect	Amount- per unit per month	Purpose of- the assessment
	Total:	

(d) If the plan proposes ~~an increase~~ one or more special assessments, it shall include the date that the special assessment would take effect, the amount of the special assessment per unit, and the purpose of the special assessment. If more than one special assessment is proposed, the plan shall state the aggregate amount assessed per unit. If the separate interests in the development do not pay equal assessments, the plan shall include a schedule that provides the required information for each class of separate interest.

describe the proposed increase in the following form:

Date- assessment takes effect	Amount of- the- assessment	Purpose of- the assessment
	Total:	

~~(e) If the separate interests in the development do not pay equal assessments, the plan shall indicate the amount of any increase or special assessment for each class of separate interest.~~

(e) If the plan proposes borrowing, it shall include the amount, term, and interest rate of each proposed loan.

(f) If the plan proposes to defer or not undertake the repair or replacement of a major component, it shall include a description of the component and the reason for the decision.

(g) The plan shall be considered by the board at a board meeting.

~~(g)~~ (h) Board approval of the plan does not constitute approval of an assessment increase described in the plan. Any assessment increase must be considered separately by the board and is subject to the procedure provided in Section 5580.

~~(h)~~ (i) The plan may not assume a rate of return on cash reserves in excess of 2 percent above the discount rate published by the Federal Reserve Bank of San Francisco at the time the plan is prepared.

(j) A summary of the reserve funding plan shall be included with the notice of availability of the annual budget report that is delivered to members pursuant to Section 4820. The summary shall indicate that the full plan is available on request.

Comment. Section 5560 restates the substance of former Sections 1365(a)(3)-(4); 1365.5(e)(5).

Staff Notes. (1) Proposed Section 5560 would incorporate changes to Section 1365.5(e) that are proposed in AB 2100 (Laird). If that bill is amended or is not enacted, the Commission will revisit this provision.

(2) The reserve funding plan provisions of AB 2100 would not operate until January 1, 2009. If the proposed law will operate before that date, the Commission will add a provision deferring the operation of proposed Section 5560 until January 1, 2009.

Respectfully submitted,

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