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FREEDOM FROM RESERVE REQUIREMENTS FOR COMMERCIAL ASSOCIATIONS - GOOD NEWS? Just because there is no statute requiring a commercial CID to establish a reserves fund, that does not mean commercial boards can safely stop contributing to reserves or fail to establish reserves. See page 6.



RENTAL OF COMMON AREA FACILITIES: Most people know that California common

interest developments are considered non-profit corporations, but that doesn't mean that common interest developments are prohibited from generating income beyond assessments. However, such rentals can be rife with legal and financial liability. See page 7.



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How Did Things Get So Expensive?

The Top Unbudgeted Association Expenses

BY JOHN D. HANSEN, ESQ. - BAYDALINE & JACOBSEN LLP

Budgets are ideal, budgets are helpful, budgets are required, but how many times have you run into major expenses that were not in your budget, or could not have been even if you had a crystal ball during budget prep? Managing the finances of a homeowners association – a multifaceted real estate asset – is a complicated process full of pitfalls and unanticipated

expenses, especially since Civil Code § 5600(b) only allows associations to levy assessments in the amount necessary to defray actual costs of the association (meaning no “rainy day” fund). However, with reasonable inquiry and big-picture planning, associations can tackle these big expenses without the pains of special assessments.

Following are five areas that are often overlooked when preparing and adopting a budget, and which can end up being a major expense.

CODE UPGRADES: Replacing a sidewalk, a clubhouse or a recreational area can require building code upgrades. Many local building departments require this as part of the permit and approval process,

and this can often increase construction costs by 30 percent or more. Your long-term planning for a project can quickly turn into a scenario where a special assessment is needed, and potentially on an emergency basis if a planning inspection reveals unsafe code violations. Careful consultation with your engineers and project managers

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How Did Things Get So Expensive?

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can help plan for these expenses and allow you to properly budget for and schedule a project.

WATER INFRASTRUCTURE:

Associations that own their streets generally own the water mains beneath them, which are not visible and often not considered. Those water mains usually have a life span of 30 to 40 years, and may need replacement when upgrades to water infrastructure are needed prior to the end of their life expectancy (which is occurring in some areas due to drought). Careful consultation with your reserve analyst, contractors and local water agency can help plan for these projects and defray the cost through future planning and gradual upgrades.

CONSTRUCTION DEFECTS: The reality is, not everything is built as it should be, and something that should last 20 years may last only until the day after the time to bring a claim against the contractor who performed the work or the manufacturer of the product. Having to re-stucco the buildings in your development, replace all of the roofs and replace internal pipes before average life expectancy is something not anticipated by a reserve study. Careful consultation with your contractors and regular inspections during routine maintenance can help anticipate those issues, can advance reserve timing and can help prepare a long-term replacement plan.

FLOOD INSURANCE: After Hurricane Katrina, FEMA has been reevaluating existing flood zone designations, and many associations have found themselves in a designated flood zone that requires flood insurance. This can result in an immediate expense of around \$20,000, which is due all at one time and cannot be postponed.

Consultation with your insurance professional, and even consulting with FEMA if you are in an area near flood zones, can help you prepare for this potential cost.

UNINSURED CLAIMS AND

DEDUCTIBLES: Every association buys insurance, but many boards do not fully understand the scope of their coverage and the reason why one policy is cheaper than another. Boards generally do not budget for deductibles either because they do not plan for claims while buying insurance in anticipation of a claim. An uninsured claim can cost hundreds of thousands of dollars to defend and pay, and deductibles can be tens of thousands of dollars. Careful consultation with your insurance professional, and increasing your budget for insurance expenses, is critical for protecting an association against uninsured claims and high deductibles.

Not every cost can be planned for, but many can with careful planning and reliance on experts. A \$2 advanced increase in monthly assessments is much less painful, and unpopular, than a \$5,000 special assessment.

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