

HOA HOMEFRONT

WHAT AMOUNT IN RESERVES IS REQUIRED?

BY KELLY G. RICHARDSON

Q. Is there any legal requirement for the reserves to be at any levels or is it a recommendation by the state? Can a homeowners association be taken over by the state if it is underfunded and if so, at what percentage? P., Newport Beach

Q. Please tell me if there is a Civil Code requiring a certain percentage of funds to be kept in the HOA reserve fund? Also, would you know if there is an average or median level that is known for California HOAs? Ours is over 100 percent. J.D., El Cajon

A. The Davis-Stirling Act contains several requirements regarding reserves. Civil Code Section 5550 requires a full study be performed every three years, with annual reviews in between. Civil 5550(b)(5) requires a long-term funding plan, and Civil 5560 requires that plan include scheduled assessment increases and be adopted in an open board meeting. Civil 5565 requires a detailed written disclosure of the status of each common area component in the reserve study, which disclosure must be in the form prescribed by Civil 5570. This disclosure, per Civil 5300(b)(2) is part of the Annual Budget Report, and so is distributed annually to members and to prospective buyers. Civil 5510(b) requires that reserve



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funds be spent only on the items reserved for, and per Civil 5515 any other withdrawal of reserve funds is considered borrowing which must be disclosed to the members per Civil 5520.

The Davis-Stirling Act does not specify any minimum funding of reserve accounts and does not specify a percentage the fund must be in comparison to the reserve study recommendation. If the reserve study is prepared and annually reviewed and all the disclosures to members and prospective member are made, a reserve fund could be empty and still technically comply with the law. This makes sense, because

the percentage of funding depends upon the remaining anticipated life of each component. Associations should follow the funding recommended by their reserve studies.

Financially healthy associations adequately fund their reserve accounts, while short-sighted association boards often try to artificially keep assessments lower by cheating — avoiding the scheduled monthly deposits into the reserve account. Regular reserve deposits are necessary because roofs, asphalt and other common components in the association deteriorate each day. That deterioration can

be calculated quickly using the reserve study. For example, if a new roof is expected to last 15 years, once the anticipated replacement cost is determined one can quickly determine the daily cost of ongoing roof deterioration. If the association does not set aside a corresponding amount of money to offset that deterioration, the association quietly but inexorably falls into insolvency. When a new roof is necessary and the HOA has not accumulated enough funds in its reserve account, it will be forced to ask the members to approve a major new special assessment or obtain a major loan.

The Legislature has done its job, by enacting a group of statutes forcing association boards to think about and disclose the HOA's reserve status and whether the HOA is prepared to meet its future needs for major refurbishment.

Wise homebuyers and their agents should place a higher value upon the well-reserved HOA home and be cautious about poorly funded associations.

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