

# RISK MANAGEMENT SELLING IN A COMMON INTEREST DEVELOPMENT CIVIL CODE 4525 AND 5300

**Selling a Home in a Common Interest Development (Condominiums and Planned Unit Developments) is not as RISK FREE as many people think when it comes to the Association's Disclosures requirements.**

**When we sell a property in a Common Interest Development, we are selling the Living Space which is driven by the Purchase Agreement between the Parties in the transaction (Buyers and Sellers) AND a Quasi-Government entity (the Association) that maintains all or portions of the structures, common areas and recreation facilities governed by Civil Code. These are two vastly different Disclosure requirements, both of which are parts of the Sale.**

DOUBLE DISCLOSURES are required therefore we have Double Jeopardy. There are different Disclosure requirements for each. (1) Disclosures for the Real Estate (property/structure) and (2) Disclosures for the Business side of the Association (the Corporation).

**Who is responsible** to prepare the required disclosures in accordance with the Davis-Stirling Act civil codes for the Business operations? **The Association's Board of Directors.** If not compliant with the Davis Stirling Act the Board is at RISK of their Fiduciary duties and Non-disclosure to its members.

**Seller Duty to Disclose** - The Association is not a party to the sales transaction between Seller and Buyer and has no duty to make disclosures directly to the Buyer. That duty falls to the Seller.

Sellers and the agents of sellers cannot mislead buyers about the association and must fully disclose to Buyers that they are buying into a deed restricted community with rules and regulations. The Financial health of the Business side of Association (Operations) must also be disclosed. Associations are established as Non-profit corporations.

**THE SELLER** in accordance with Section 4530 of the Civil Code, provide to the prospective purchaser, at no cost, current copies of any documents specified by Section 4525 that are in the possession of the seller. This presents a HIGH RISK FOR NON-DISCLOSURE. Best practice is for the Seller to purchase the required documents from the Association through their designated source. Board member, Management Company or a third-party delivery service.

***It should be noted that generally there is little if any Quality Control of these disclosure documents by the Association's Board of Director's, Management Company or document delivery service. You cannot judge a book by its cover!***

***Seller cannot rely solely on the documents from the Association to be fully compliant with the Davis Stirling Act. Simply delivering the documents purchased from the Association may not and often does not fulfill the Sellers duty and requirement to disclose.***

## **THERE ARE TWO COMPONENTS OF THE BUSINESS OPERATIONS DISCLOSURES**

**1. ADMINISTRATIVE** component is the day to day operations such as billing, collecting assessments, preparing monthly financial reports, contracting and bill paying for common utilities, landscape, lighting, security, recreational facilities and upkeep. Establishing and enforcement of the governing documents. The Board has the right to delegate any or all these services but cannot relive themselves of the ultimate responsibilities or liability.

Community Association DataSource  
COMMON INTEREST DEVELOPMENT Civil Code Compliance Review Company  
408-226-2437 | e-fax 408-351-0606

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As of 1/1/19, The Board of Directors are required to review 6 financial documents on a monthly basis and ratify them at the next Board meeting indicating that they have read and understand them and are knowledgeable of the financial health of the Association.

**2. FINANCIAL** component is comprised of the BUDGET and the RESERVES.

The Budget is comprised of income and expenses reported on the accrual basis. A budget must be created in order to administer the duties of the association which are listed above in Paragraph 1 under Administrative.

The Reserves are for future maintenance of the buildings, common areas and recreational facilities. Reserve studies include a physical inspection every 3 years. The Reserves are updated annually to reflect any changes in a component's life expectancy or costs associated with repairs or replacement. The financial funding is required to be reported on the Accrual Accounting Basis Not Cash Flow.

**The Seller** is at Risk for non-disclosure if the disclosure package provided is not compliant with Davis-Stirling. A Seller needs to complete their due diligence and review the disclosures or hire a qualified professional to review and verify the disclosures provided have fulfilled the Seller(s) disclosure requirements regarding the Business operations and make note of what is not in compliance and why.

**To Sellers:** Your property is one of or may be the largest investment you have. When you sell your property there are two separate values to be considered.

- 1) The Association Business value is based on costs of operations and the value of the Reserves for future maintenance.
- 2) Market value is based on recent sales in the community or other similar like properties.

Sellers are required to disclose the financial health of the Business Operations of their Homeowners Association expressed in Dollars as well as the corresponding percentages. For example: Required in Reserves for 2020 \$4,622,222.00 currently in Reserves as of 4/30/20 \$2,922,342.35 divided by 120 homes equates to a deficit per home of \$24,352.85 per home they are 36.78% funded.

Calculated as follows: The amount required to be fully funded, less what is currently in the reserves, divided by the number of units, equals the percentage funded.

## Funding Levels

- 00 – 30% expect frequent and significant special assessments
- 31 – 69% expect significant increases in monthly assessments and special assessments
- 70 – 100% considered financially strong and special assessments should be rare

The major concern for both the Sellers and the Buyers is the Financial Health of the Association. Deficits may affect the value of the property that may become negotiable between the Sellers and the Buyers. From the Business Operations perspective the Value of the Property is related to the value of the Reserves on hand.

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The concept is that the Owners pay their fair share of the usage during the time they own the property. Any deficit in the reserve funding will pass to the Buyers unless negotiated.

**The Buyers** are to conduct their due diligence to review and understand the disclosures and fully understand what they are purchasing. In other words, they are buying more than the property they will live in. They are also buying into the Business Operations of the Association. Buyers need to make well informed decisions based on the information that has been provided.

Buyers must understand they are purchasing into a Multi-Million Dollar Corporation. The duties of the Corporation are to Maintain, preserve and enhance the property value and can designate what Owners can and cannot do with the property.

## REQUIRED DOCUMENTS UNDER CIVIL CODE 4525 List for the Year 2020

### GOVERNING DOCUMENTS INCLUDE

- Articles of Incorporation – *Verified Status with the Secretary of State - Active, SUSPENDED*
- Bylaws - (Verify Signed and dated copy)
- Bylaws amendments
- CC&R's, CC&R amendments - (Verify all recording on Preliminary Title Report with ones from the HOA)
- Operating Rules & Regulations - (May Also be attached to the Budget package)

### FINANCIAL DOCUMENTS INCLUDE

- Budget Package in accordance with Civil Code 5300
    - Assessments - Monthly, Quarterly, Yearly
    - Assessment Reserve Funding Disclosure
    - Reserve Study with Physical Inspection Done within the past 3 years
    - Annual Policy Statement Civil code 5310
  - CPA Year-End Review (\$75,000 of income) *(Due to members with in 120 after the fiscal yearend)*
  - Annual Report (HOA with \$10,000 to \$75,000) *(Due to members with in 120 after the fiscal yearend)*
- Current Balance Sheet *(NOT REQUIRED BUT HELPFUL WHEN TRYING TO DETERMINE FINANCIAL HEALTH OF THE ASSOCIATION)*

### ADMINISTRATIVE

- Operating Rules
- Assessment
- Age restrictions
- Rental restrictions
- Litigation statement
- Minutes for the Past 12 months (Upon request)

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- **Governing Document, violations, fines or penalties Clearance (Estoppel Notice)**
- **Maintenance work of exterior that needs to be done prior to closing**

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