

# COMMUNITY ASSOCIATION ALERT

SPECIAL EDITION  
SEPTEMBER 2005

ADDRESSING THE CHANGES  
AND CHALLENGES OF THE  
COMMUNITY ASSOCIATION  
ENVIRONMENT

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## The Bell Is Tolling For New Budget Rules

OCTOBER 3RD, 2005 commences "budget season" for FY 2006; December 2nd is the last day budgets can be distributed. Between now and then, managers, directors and reserve study preparers will be working hard to meet the deadline and comply with the new laws.

Many of you were able to attend our workshop addressing amendments to Davis-Stirling and so are aware of the several new laws concerning the timing of budget disclosures and assessment increases, reserve borrowing and repayment and, perhaps most importantly, the new mandated budget summary form which must accompany the budget mailing.

Last, as we said at our budget workshop, the summary form should be authorized by the Board but only after getting a great deal of input from the reserve study preparer (annually, not just every third year when a new study is prepared). The new form will telegraph to owners and buyers projected special assessment increases and so will have an impact on sales; it can also be a wonderful planning tool that involves all community members in developing funding and maintenance strategies.

*continued on page 2*

## Our Alert This Month

STEVE WEIL

This is another special edition Alert and it addresses one thing: money. From the federal side, we've got an article dealing with current news about bankruptcy law and new protections for "planned developments" and claims against Landlords in bankruptcy. Closer to home, this issue contains several short practical pieces concerning the budget laws that went into effect July 2 and impact budgets for fiscal year 2006. Also, for "form junkies", we've got several to assist in making disclosures, preparing budgets and borrowing and repaying reserves.

## Check Out Our New Forms

Attached to this Alert are seven forms for use in distributing new budgets, notices and resolutions concerning reserve borrowing and repayment and assessment increases. Check them out, use them wisely.

What are the new laws? They can be read on our website at [www.berding-weil.com](http://www.berding-weil.com) and are all in the Civil Code:

- |                         |  |
|-------------------------|--|
| <b>Section 1365</b>     | <b>Special assessments and reserve funding; timing</b> |
| <b>Section 1365.2.5</b> | <b>The new budget summary form</b>                     |
| <b>Section 1365.5</b>   | <b>Reserve borrowing and repayment; meetings</b>       |

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**FOR FURTHER INFORMATION**

*THE BELL IS TOLLING - continued from page 1*

**WHAT ARE THE NEW BUDGET DISCLOSURE WINDOWS**

Associations must distribute budgets each year not less than 30 days or more than 90 days before the beginning of the next fiscal year. This "60 Day Window" is:



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<b>If the Fiscal Year Begins...</b>	<b>The 60-Day Window is...</b>
January 1	October 3 - December 2
February 1	November 4 - January 2
March 1	December 1 - January 30
April 1	January 1 - March 2
May 1	January 31 - April 1
June 1	March 3 - May 2
July 1	April 2 - June 1
August 1	May 3 - July 2
September 1	June 3 - August 2
October 1	July 3 - September 1
November 1	August 3 - October 2
December 1	September 2 - November 1

**ARE THE NEW BUDGET DISCLOSURE WINDOWS AFFECTED BY CHANGES IN ASSESSMENTS?**

Does the budget include an increase in regular assessments or the imposition of a special assessment ("assessment changes") effective on the first day of the fiscal year? If yes, other timing rules may affect when you choose to distribute the budget.

Notices of assessment changes must be distributed by first class mail at least 30 but not more than 60 days' prior to the assessment due date. Thus, including that notice in a budget that is distributed 60 - 90 days before the new fiscal year (as is now permitted), would not provide members adequate notice of the increase! And, making the thing even more complicated, the budget can be sent via bulk mail or newsletter while the assessment increase requires the old familiar first class mail.

Here are the choices:

1. Use first class mail to distribute the budget and mail it between 30 and 60 days prior to the beginning of the fiscal year; or

2. Distribute the budget by bulk, newsletter or first class mail during the 30 - 90 day window and send a separate simple notice announcing the assessment change via first class mail between 30 and 60 days prior (a form for this is attached).
3. If there is no budget increase, distribute the budget by bulk, newsletter or first class mail 30 - 90 prior to commencement of the fiscal year.

**A GUIDE TO UPDATED DISCLOSURES**

What if, during the course of the fiscal year, the Association's finances change so dramatically as to cause the original summary to be arguably misleading? The Davis-Stirling Common Interest Development Act laws do not specifically mandate "amendments" to the original form but prudence suggests it would be wise for a board to consider issuing a revised summary form. We've listed below the type of scenarios that can arise which might prompt review and revision of the summary form distributed with the budget.

They are:

- Mid-year change in regular assessments
- Change in governing documents' allocation of per unit/lot share
- Newly-anticipated special assessment
- Disclosing a prospective special assessment in a materially different amount
- Borrowing from reserves
- Decision not to restore funds borrowed from reserves
- Obtaining a bank loan
- Indicating more funds now in reserves
- Adding information from additional method of calculating reserves
- Annexation / Phasing
- Infusion of capital from special assessment, litigation proceeds, insurance proceeds
- Permanent removal of an improvement

### Borrowing from Reserves

Association boards of directors have the power without a membership vote to borrow from reserves for purposes reasonably related to the proper operation of the community. This power, however, cannot be exercised secretly or arbitrarily.

The decision to borrow from reserves must be made at an open board meeting. Notice of the meeting must be given at least four days prior and must indicate that the board will consider borrowing ("transferring") monies from reserves and other related information. Generally, the monies borrowed must be repaid to the reserve account within one year; a decision not to repay the monies within one year must also be considered at a noticed board meeting.

### Using our Forms

Attached are seven (7) different forms, including (the seventh) the new budget summary form. You know how we lawyers are about forms; nervous. It's because forms are based on certain assumptions that are not always obvious; also a form that works for one association will not work for another, or at least not completely. For example, the law now requires a board to spell out the reasons it concludes that reserve funds should be used for operating or other short term purposes. For one board, the reason may be a cost overrun; for another, it could be an unforeseen insurance increase or an unbudgeted landslide repair. Forms are good tools but only as good as the care used to modify them to suit the needs of a particular community. So you know the blah blah blah here: please do not use the forms without conferring with qualified association counsel and if you use the forms after 2006, please be sure they reflect current law. As we know, the only thing we can say for sure about the Davis-Stirling Act is that it keeps changing. So, good luck and be careful out there!



## Bankruptcy Reform Brings Both Relief and Uncertainty to Homeowner Associations

THE FORMAL CEREMONY LASTED ONLY A FEW MINUTES, but it took credit card companies, banks, and large retailers eight years to win Congressional approval of the Bankruptcy Abuse Prevention and Consumer Protection Act President Bush signed into law April 20.

"This law will protect those who legitimately need help, stop those who try to commit fraud, and bring greater stability and fairness to the system," President Bush said of the new law, which mandates the most comprehensive overhaul of the nation's bankruptcy rules in more than 25 years. The reforms will generally make it more difficult for consumers to eliminate their debts via bankruptcy by establishing a "means test," under which most debtors earning above the median income for their state (and able to repay at least \$6,000 over a five-year period) will be required to accept a Chapter 13 repayment plan; a Chapter 7 filing, which erases most debts, will no longer be an option for many financially-strapped consumers, as it was under the old law.

Critics argued unsuccessfully that the changes treat consumers too harshly, foreclosing the "fresh start" that bankruptcy is supposed to provide. Supporters insisted that tighter rules were needed to prevent abuses that, they said, allowed many consumers to escape debts they could, and should be required to repay.

### A Victory for Community Associations

Although community associations were not on the front lines of this prolonged and very expensive lobbying battle, they did have a horse in the race and claimed a significant victory in the outcome. The 500-page law includes language advocated by the Community Associations Institute (CAI) clarifying the treatment of delinquent fees and assessments in a bankruptcy proceeding. A bankruptcy filing "stays" or halts actions to collect outstanding debts until the bankruptcy is processed and decisions are made about how much, if any, of those debts the consumer must repay. Minor revisions in the bankruptcy rules enacted in 1994 had specified that community association fees assessed after an owner filed for bankruptcy protection would be collectible as long as the owner continued to occupy the home or rented it to a tenant and collected rents.

But that language created a loophole exploited by some owners, who moved out of their units, left them vacant, and argued that they did not have to pay post-petition fees as a result. The wording of the 1994 revisions applied to residential condominiums and residential cooperatives, but omitted

planned developments, time-share condominiums, and commercial condominiums. As a result, while judges in some jurisdictions applied the statutory language to all common interest ownership developments, others did not, ruling that planned developments, time-share condominiums, and commercial condominiums could not collect post-petition assessments even if the owners continued to occupy their units.

The bankruptcy reform law addresses both problems. It adds planned developments, time-share condominiums, and commercial condominiums to the list of covered entities, and it closes the collection loophole that had frustrated many associations, by linking the obligation to pay post-petition fees to ownership rather than occupancy of the unit. The new language states that the liability for payments continues "for as long as the debtor or the trustee has a legal, equitable, or possessory ownership interest" in the unit.

The inclusion of bankruptcy trustees in the liability chain represents another significant change for at least some community associations. In some jurisdictions, the trustees charged with disposing of a debtor's property often try to negotiate a reduction in the fees paid to the association, or refuse to pay them at all. The new language should shift the balance in those negotiations in favor of the associations by eliminating any question about their right to collect post-petition fees.

### Relief for Landlords

Residential and commercial landlords will also benefit from three additional changes in the bankruptcy law.

- **Eviction stay.** Under the old law, the automatic stay triggered by a bankruptcy filing halted residential eviction proceedings, allowing tenants to remain in their units for months rent-free while awaiting the processing of their petition. The new law allows landlords who have already won an eviction judgment before a tenant files for bankruptcy protection to proceed. The law also lifts the automatic stay if the landlord is seeking eviction because of a tenant's illegal drug use.
- **Lease assumption.** Commercial tenants will now have to decide within 210 days whether to assume a non-residential lease after a bankruptcy filing. The old law gave them 60 days, but permitted indefinite extensions, which bankruptcy judges regularly granted. This enabled companies with

expensive leases to continue occupying their space rent-free during bankruptcy proceedings, and then cancel their leases with little or no notice at the end of the process.

- **Single-asset bankruptcy.** The new law changes the treatment of single-asset bankruptcies, in which a single real estate asset generates most of the debtor's income. The old law limited the automatic stay to 90 days for properties valued at \$4 million or less but allowed stays of six months or more for larger properties, to provide additional time to devise more complicated work-out plans in business bankruptcies. The new law eliminates that distinction, applying the 90-day maximum stay to all single-asset bankruptcy filings.

### Limits on Homestead Protection

Most of the changes mandated by the bankruptcy reform statute will take effect October 17, 180 days after the president signed the law. But some provisions become effective immediately. One that may affect community associations is the new cap on the "homestead exemption," allowing homeowners to protect a portion of the equity in a primary residence from the claims of creditors. Different states set different limits on the amount of protection provided, and a few states provide unlimited protection. The bankruptcy law aims to prevent debtors from shielding their assets by buying expensive homes in those no-cap states.

Under the new rules, debtors will be limited to the federal homestead cap (\$125,000) on any property purchased within 40 months of their bankruptcy filing, even if the state cap is higher. And they will not be able to claim any homestead protection at all on properties owned for less than two years, unless they previously owned a property in the same state on which a homestead existed. The law will also nullify a homestead filed within 10 years preceding the bankruptcy, if the intent was "to hinder, delay, or defraud" creditors. That means a debtor who created a homestead 10 years ago to shield assets from a negligence suit could not apply the homestead protection to a bankruptcy filed today. In the same vein, the homestead protection will be capped at the federal limit (\$125,000) if, within five years preceding the bankruptcy, the debtor was found guilty of an "intentional tort" that caused severe injury or death to another.

### What to Expect

Most analysts agree that the immediate result of the new bankruptcy law will be a surge in bankruptcy filings, as financially-troubled consumers race to file before the more restrictive rules take effect. Beyond that, community associations and others in the collection line can expect to feel the ripple effects of many provisions that don't affect them directly. For example, because bankruptcy will be a less appealing and (for some) a less viable option, some debtors may try to deal with their problems sooner, before they reach a point of financial no return. This could trigger an increase in requests for repayment plans to resolve delinquent association fees.

Association boards should be prepared to deal with these requests in an even-handed manner that balances efforts to work with troubled homeowners against the need to protect the financial interests of the community as a whole. Associations should establish detailed policies and procedures for dealing with delinquent owners, those policies should be in writing, and they should be communicated clearly to all residents.

Some analysts predict that the new law may discourage some debtors from seeking bankruptcy protection, subjecting them to the collection efforts of unsecured creditors with claims against them. Because common area fees and assessments are secured by the unit, associations will typically stand above that fray. Even so, board should move quickly to deal with delinquent owners (good advice quite apart from the new bankruptcy law), especially if there is any question about whether the owner's equity is sufficient to cover the secured claims.

### A Cumbersome Process

Supporters of the bankruptcy law expect it to reduce bankruptcy filings significantly, but that may not be the case. While the reforms may make bankruptcy more difficult, they won't eliminate the problems that force consumers to seek bankruptcy protection in the first place. However, there is no question that for those who do file, the bankruptcy process will become more cumbersome, because the new law creates a number of procedural hurdles that did not exist before.

For one thing, consumers must obtain (and pay for) credit counseling before filing for bankruptcy, and they must complete a financial education course before their bankruptcy is discharged. This could delay some bankruptcy filings and extend the period of time that debtors struggle with unpaid bills – including delinquent homeowner association fees – before

working out a plan to deal with them. The new means test – the central feature of the new law – may add to those delays, because consumers will almost certainly contest rulings that they are ineligible for Chapter 7 debt relief, and creditors will almost certainly contest rulings that they are.

Although the law is aimed primarily at “abusive” debtors, it targets bankruptcy attorneys as well, with provisions requiring them now to certify the accuracy of the financial statements their clients file, and imposing steep fines on the attorneys if that information is found to be misleading or erroneous. Bankruptcy attorneys have not welcomed these changes, to put it mildly. Some have dubbed the new bankruptcy law the “Bankruptcy Abuse Reform Fiasco” – BARF for short – predicting that many attorneys will boost their fees, while others will abandon the field entirely.

Higher fees will lead at least some debtors to forego legal assistance and represent themselves, requiring bankruptcy judges either to dismiss their filings because of technical flaws,

or provide the legal guidance consumers will need to get through the process. Either way, it seems likely that the bankruptcy courts will become even more clogged with pending cases that will take longer to resolve. If so, homeowner associations and other creditors may find that collecting pre-petition debts will become even more difficult and less certain under the new bankruptcy law than it was under the old one.

All of this is speculative, of course; we won’t really know how the bankruptcy reforms will work out until they take effect. Congress has already approved a bill, which the President has signed, making the increased bankruptcy filing fees effective October 17, 2005. Although several other bills revising the law have been introduced, there does not appear to be any strong support for advancing them. But given all the concerns and the uncertainty about the bankruptcy reform law, it would not be surprising to see a move at some point to substantially reform it, and there is no telling where that will lead.

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