

New Davis-Stirling Act & Reserve Funding



December 2013

Updated Law Amounts to New Set of Civil Code References for Reserve Funding Matters

by Robert Nordlund, Association Reserves (www.ReserveStudy.com) and David Swedelson, SwedelsonGottlieb (www.LawforHOAs.com)

The body of statutory law (as opposed to case law) governing California Community Associations, known as the Davis-Stirling Common Interest Development Act, went into effect on January 1, 1986. As the industry developed and matured over the last 27 years, approximately 50 changes and amendments were made to the Act. While those adjustments were well-intended, the net effect yielded a disorganized and confusing body of law. To address this problem, a multi-year effort was launched to rewrite the Davis-Stirling Act. This “new” Davis-Stirling Act, signed into law in 2012, becomes the guiding law for California residential community associations on January 1, 2014. So you are probably asking what are the major changes and how does the re-write affect Reserve Funding issues? The answer is no major changes have been made.

Fortunately, the majority of the changes are just re-organization and renumbering. With respect to Reserves, verbiage we’ve been accustomed to finding in Civil Code Sections 1365 and 1365.5 will now be found in the general category of Civil Code Section 5300. The annual Assessment and Reserve Funding Disclosure Summary (ARFDS), which was introduced as an amendment to the new Davis-Stirling Act as Section 1365.2.5, will now be called Civil Code Section 5570. The Civil Code requirements for Reserves and Reserve Studies have for the most part remain, except for the Code Section, unchanged in the new Davis-Stirling Act.

Reserve requirements we have become familiar with are now stated in new Civil Code Section 5300. As it relates to Reserves, each California residential community association is **still** responsible to distribute an annual budget report 30 to 90 days before the end of its fiscal year that includes, among other things:

- A summary of the association's Reserves, prepared pursuant to Section 5565;
- A summary of the Reserve Funding Plan adopted by the board, as specified in paragraph (5) of subdivision (b) of Section 5550;
- A statement as to whether the board has determined to defer or not undertake repairs or replacement of any major component with a remaining life of 30 years or less;
- A statement as to whether the board, consistent with the Reserve Funding Plan adopted pursuant to Section 5560, has determined or anticipates that the levy of a special

assessments will be required to repair, replace, or restore any major component or to provide adequate Reserves therefor;

- A statement as to the mechanism or mechanisms by which the board will fund Reserves to repair or replace major components; and
- A general statement addressing the procedures used by the board to calculate and establish the Reserves.

Recognizing that Reserve contributions are (or should be) one of an Association's largest budget line items (often 15-40% of the total budget), Board members will **still** have a responsibility to update their Reserve Studies annually, and make sure the update is conducted on the basis of a "diligent visual site inspection" at least every third year. While California Community Associations are still **not required** to fund Reserves, they are still **required** to communicate and disclose the condition of their Reserve components, their Reserve Fund, and their Funding Plan to the homeowners on an annual basis. And when we say condition, we are referring to the obligation to disclose things such as the common area components for which the Association is reserving for future repair or replacement, the remaining life of these components (that have an anticipated remaining life of 30 years or less), how much the Association has allocated as reserves for each component, etc. The new Davis-Stirling Act, as with the old Act **still** has no requirement that an Association use an outside or credentialed professional to prepare their Reserve Studies, except the requirement that an Association have a competent visual inspection of the common area components for the purposes of determining the amount of reserves has been carried over and is in the new Davis-Stirling Act. Finally, Associations **are still required** to prepare their annual ARFDS as a way to simply and directly communicate important Reserve disclosure information to their homeowners.

Outside of the annually updated Reserve Study and ARFDS, Board members and Managers **still** have a daunting amount of information to assemble for inclusion in the annual package of information and disclosures that are required to be provided to the homeowners annually. In this package, disclosure statements are **still required** if decisions are made to defer repair/replacement of major reserve components, levy special assessments, or adopt other significant financial policies that impact the Association's reserve funding disclosure.

The new Davis-Stirling Act requirements regarding Reserves are in almost all cases identical to the old Davis-Stirling Act. And again, the new and re-organized Davis-Stirling Act goes into effect on January 1, 2014. With respect to reserve funding and disclosure, California's community association industry volunteers and professionals will need to become familiar with a new set of Civil Code references, but will be relieved to know that nothing of substance has changed at least as it relates to Reserves generally. But note that the Reserve disclosures, while

the same, are now part of a Annual Budget report, which is new and supersedes and adds new requirements to what was formally called the pro-forma operating budget.

It is important to point out that the new Davis-Stirling Act does **not** apply to commercial or industrial common interest development. Along with the new Davis-Stirling Act, the legislature has adopted a new and separate Commercial and Industrial Common Interest Development Act, Sections 6500-6876 of the Civil Code. This new Commercial CID Act does not include all of the sections required by the new Davis-Stirling Act for residential CIDs, and this includes the definitions of Reserve Accounts, Reserve Account Requirements, as well as the requirement to distribute an Annual Budget Report or the ARFDS. Commercial and industrial CIDs will, however, be required to comply with the Reserve disclosure requirements set forth in the Association's Bylaws or CC&Rs.

For questions about Reserve Studies, disclosures, or to request a proposal, see www.ReserveStudy.com.

For questions about Davis-Stirling Act compliance issues, see www.LawforHOAS.com and www.HOALAWBLOG.com.