Assembly Bill 2100 (Effective January 1, 2007):
How It Changes Reserve Studies and Related Disclosures

Overview

With the passage of Assembly Bill 2100 – effective January 1, 2007 – new California Civil Code 1365 changes require homeowners associations to disclose yet even more financial information to their members annually.

In retrospect, part of the changes seem to address a problem created when the Legislature introduced the requirement in July 2005 that associations must fill out the *"Assessment and Reserve Summary Disclosure"* form and distribute it to their members 30-90 days prior to the first day of their next fiscal year.

The problem was that *Question #6* on the form required an annual calculation of the *"required amount in reserves"* (in actuality, they meant the 100% funded amount). But at the same time, the Civil Code only requires that a reserve study be performed every 3 years. So how were the associations supposed to disclose the *"required amount in reserves"* on an annual basis without having a reserve study done *every* year instead of every 3 years?

To solve this dilemma, the State Legislature added a *Question #7* to the *"Assessment and Reserve Summary Disclosure"* which asks for the next 5 years of "required amount in reserves" and the next 5 years of "percent funded estimates." Thus, associations will have that data already calculated in advance for the next few years in which they are not required to do a full reserve study.

Note that larger associations often do an annual reserve study update in the intervening two years. Even though it is not required, they do it for sound financial planning reasons. Many small-to-medium sized associations simply follow their reserve study plan for 3 years, only making minor adjustments to reserve funding for each new budget year.

Also as of January 1, 2007, Question #6 on the *"Assessment and Reserve Summary Disclosure"* was changed to require disclosure of the *Percent-Funded Estimate* (the ratio of how much cash is in reserves relative to the depreciation-to-date on reserve components) as of the current year.

The changes to the *"Assessment and Reserve Summary Disclosure"* and other new requirements are described in more detail below:

Your Pro Forma Operating Budget Must Now Include:

1. **Civil Code 1365 (a)(2)(D)** – The current deficiency in reserve funding must be expressed on a per unit basis…

$$\frac{\text{(Amount of money reflecting the 100\% Funded Amount)} \quad \text{MINUS} \quad \text{(Cash in Reserves)}}{\text{(Number of Units)}}$$

For example, if your association has 40 units and the depreciation-to-date is $100,000, but your association only has $60,000 in reserves, the "current deficiency in reserve funding" would be $40,000. Expressed on a per-unit basis for a 40-unit association would be a $1,000/unit deficiency.

2. Civil Code 1365 (a)(2)(A) – A statement as to whether the board of directors of the association has determined to defer or not undertake repairs or replacement of any major component – with explanation.

3. Civil Code 1365 (a)(2)(D) – A statement whether the association has any outstanding loans, as specified.

Your Reserve Study Must Include a "Reserve Funding Plan:"

Civil Code 1365.5 (e) (5) *-- [The reserve study must include…] "A reserve funding plan that indicates how the association plans to fund the contribution identified in paragraph (4) to meet the association's obligation for the repair and replacement of all major components with an expected remaining life of 30 years or less, not including those components that the board has determined will not be replaced or repaired. The plan shall include a schedule of the date and amount of any change in regular or special assessments that would be needed to sufficiently fund the reserve funding plan. The plan shall be adopted by the board of directors at an open meeting before the membership of the association as described in Section 1363.05. If the board of directors determines that an assessment increase is necessary to fund the reserve funding plan, any increase shall be approved in a separate action of the board that is consistent with the procedure described in Section 1366."*

So, just what does this "plan" look like?…

If you've been having a diligent reserve study prepared, you probably already have a recommended reserve funding plan in the form of a 30-Year Cash Flow Analysis if it shows a schedule of projected future reserve expenses and future regular assessments and special assessments that will fund those projected expenses. You simply have to "adopt the plan."

In order to do so, consider writing a brief narrative indicating the *Optimized 30-Year Cash Flow Analysis* is the association's "Reserve Funding Plan" and that the current board plans to follow this plan with regular & special assessments as shown. Make sure that the adoption of this plan is cited in your Board meeting minutes. And you might want to include a disclaimer that the current board has no control over how future board members implement the plan and that the plan assumes that future reserve expenses will occur as projected. Make sure your members understand that *the reserve study is a projection, not a prediction*.

New Question #7 Added to "Assessment & Reserve Disclosure Summary"

As of January 1, 2007, the *"Assessment and Reserve Summary Disclosure"* form you distribute to your owners must now include new measurements of financial status:

- The *<u>Required Amount In Reserves</u>* at the end of each of the next 5 fiscal years
- The *<u>Percent-Funded Estimate</u>* at the end of each of the next 5 fiscal years
- The *<u>Projected Reserve Fund Cash Balance</u>* at the end of each of the next 5 fiscal years

Note there are two components to this question:

- The reserve study must indicate 5 years of the foregoing data "…*Taking into account only assessments already approved and other known revenues"* and,
- You must also indicate similar data assuming the "reserve funding plan" is implemented.

Here's the new Civil Code section:

> ***1365.2.5 (a) (7)*** – *Based on the method of calculation in paragraph (4) of subdivision (b) of Section 1365.2.5 of the Civil Code, the estimated amount required in the reserve fund at the end of each of the next five budget years is $______, and the projected reserve fund cash balance in each of those years, taking into account only assessments already approved and other known revenues, is $______, leaving the reserve at ______ percent funding. If the reserve funding plan approved by the association is implemented, the projected reserve fund cash balance in each of those years will be $______, leaving the reserve at ______ percent funding.*

The data requested above might be more clearly summarized in the sample table below (data in the table is sample data also):

> ***1365.2.5 (a) (7)*** *– Based on the method of calculation in paragraph (4) of subdivision (b) of Section 1365.2.5 of the Civil Code, the estimated amount required in the reserve fund at the end of the next five budget years is $ (Refer to line #1 in the table below) , and the projected reserve fund cash balance in each of those years, taking into account only assessments already approved and other known revenues, is $ (Refer to line #2 in the table below) , leaving the reserve at (Refer to line #3 in the table below) , percent funded. If the reserve funding plan approved by the Association is implemented, the projected reserve fund cash balance in each of those years will be $ (Refer to line #4 in the table below) , leaving the reserve at (Refer to line #5 in the table below) , percent funded.*

End of Fiscal Year That Begins in→	2008	2009	2010	2011	2012
1. Estimated amount required in reserves	$198,165	$233,114	$263,564	$342,346	$421,012
2. Projected Reserve Fund Cash Balance *(Only assessments already approved)*	$72,473	$59,941	$38,190	$57,539	$69,624
3. Projected Percent Funded Estimate *(Only assessments already approved)*	36.6%	25.7%	14.5%	16.8%	16.5%
4. Projected Reserve Fund Cash Balance* *(If reserve funding plan is implemented)*	$108,812	$136,009	$157,554	$223,955	$287,047
5. Projected Percent Funded Estimate* *(If reserve funding plan is implemented)*	54.9%	58.3%	59.8%	65.4%	68.2%

*Fund balance & Percent funded projections in the #4 & #5 calculations above assume the optimized cash flow analysis plan is adopted for the next 5 years.

In summary, while these new disclosure requirements are time-consuming to calculate and require more effort on the part of your board of directors to understand and disseminate, they will help provide more financial transparency for prospective new home buyers and for current owners.

In addition, these new requirements signify that the State Legislature is serious about requiring associations to implement fiscally prudent financial planning. With the preponderance of financial disclosure requirements and a requirement to have a reserve funding plan, they are making it more difficult for board members to ignore the realities of proper reserve funding – and rightly so!

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