

100's—Fixed Costs

101. Property Taxes

Stock Cooperatives

Under Revenue and Taxation Code section 2188.7, effective January 1, 1981, the governing body of a stock cooperative may request segregated taxes and separate tax bills upon satisfying certain conditions of the code. Because of the time involved, the budget for a stock cooperative or community apartment project should include the estimated annual property tax against all unsecured real property comprising the subdivision.

Under provisions of the Revenue and Taxation Code, if a unit in a stock cooperative or community apartment project is purchased or otherwise changes ownership, only that unit can be reappraised by the assessor. Because of these provisions, it is incumbent upon county assessors to separately assess the individual units in stock cooperative and community apartment projects. A single tax bill covering the entire property may be issued the first year.

Planned Developments

In planned developments, common area taxes are normally assessed on a pro rata basis to the individual dwelling units that make up the development in accordance with Section 2188.5 of the Revenue and Taxation Code. There is ordinarily no need for the association to budget for property taxes against common areas and facilities in a planned development. There are reports, however, that some county assessors may assess a portion of the value of common area and improvements to the association having title to the property as a means of assuring that the property does not escape a fair assessment. It is, therefore, strongly suggested that an owners' association consult with the county assessor on his proposed plan for assessment of the common areas and facilities before preparing the budget. Common area lots might also be assessed property taxes under provisions of Mello Roos Special Tax Districts.

Condominiums

In the case of a condominium development in which the owners' association holds title to recreational common area, it is possible that this property will be separately

assessed to the association. Again, this is information that should be obtained from the county assessor before a budget is prepared.

Common area which is owned by owners of individual units as tenants in common must be assessed on a prorated basis to each owner of a condominium unit pursuant to section 2188.3 of the Revenue and Taxation Code.

Lien Date

Real property is assessed in California on March 1 of each year (lien date). Under section 75.12 of the Revenue and Taxation Code, property will be reassessed at the date the new construction is deemed complete. Availability for use and occupancy may affect this date if proper notice is given to the assessor's office. If the first sale of a unit in a subdivision has not been closed as of that date, the tax collector may bill the association or builder for the entire subdivision. Shortly thereafter, the first or supplemental tax bill will be sent to the new owner.

102. Corporation Franchise

Most associations can qualify for tax exempt status under State law if they are able to meet federal requirements for treatment as tax exempt organizations under Federal Income Tax Codes. If an exemption is granted by the Franchise Tax Board, an incorporated association will not have to pay the minimum State franchise tax (currently \$800 per annum). If granted, all associations—both incorporated and unincorporated—must annually file an informational tax return with the Franchise Tax Board. The annual fee is currently \$10 and the initial fee is \$25. As in the case of the federal law, an association must file a tax return and pay income tax to the State for its non-exempt income.

103. Insurance

The following information is not intended to cover all facets of insurance for common interest subdivisions. There are a great many aspects that should be considered to give the association proper coverage. The purpose of this section is to alert governing bodies to the need of tailoring casualty insurance and commercial liability insurance to the needs of the owners and association collectively.

The minimum insurance coverage required to be carried by a common interest subdivision association is usually specified in the governing documents for the development as well as governed by Civil Code 5805 and 5800. However, the governing body will have many factors to consider in determining the most adequate insurance coverages to obtain for the most reasonable cost. It may not be in the association's best interest to obtain only the minimum insurance as required in the Covenants, Conditions and Restrictions. All common interest developments should consider insurance covering commercial property, commercial liability, directors and officers liability, fidelity insurance, workers compensation insurance, and earthquake insurance.

Fire and Allied Coverage Insurance

A Broad Form Endorsement is now generally considered to be the basic minimum casualty insurance coverage that governing instruments stipulate. The causes of loss covered under this type of policy include:

Fire losses covering fire and lightning; extended coverage endorsement losses covering smoke damage, explosion, riot, civil commotion, falling aircraft, vehicle, hail, and wind.

Policies may be written with a special form coverage endorsement more commonly referred to as Risk of Direct Physical Loss. This endorsement covers losses not specifically excluded in the policy form. Typical losses excluded are: wear and tear, earthquake, flood, earth movement, loss occasioned by an ordinance, war, and nuclear reaction. Typical property items excluded are: plumbing, heating, air conditioning, steam boilers, machinery, electrical appliances, metal smoke stacks, limited glass, lawns and fences. Many of the losses specifically excluded may be added to the policy or other policies obtained covering specific losses. Examples of coverages that may be added to the policy for additional cost are losses due to: earthquake, boiler and machinery, and glass breakage. A flood insurance policy can be purchased separately.

Flood Insurance

If the development is located in a designated Flood Hazard Area, as determined by the U.S. Department of

Housing and Urban Development, the lender will require flood insurance. Contact a local insurance agent or broker for further information.

Planned Development Coverage

Fire, casualty and other insurance carried by the homeowners' association in a planned development is customarily limited to coverage attributable to destruction, damage and injuries that occur on the property owned by the association or by the owners in common. The individual owner in a planned development normally carries fire and liability insurance on the individually owned lot. In some cases, however, where the planned development involves clustered or townhouse-type residential structures, the association obtains a blanket policy covering all dwelling units. An advantage to the blanket policy is the lower premiums for equal coverage.

Condominium Insurance Coverage

In a condominium development, there are two distinct ownership interests in real property to be insured. There is commonly owned property, which normally comprises all of the real property except that which is enclosed by the interior surfaces of the cubicles of space. Within the cubicles of space are such items of insurable real property as built-in cooling systems.

Lenders financing the condominium development with attached units, as a whole, will insist upon a blanket insurance policy providing single coverage for all of the insurable real property within the development. An association must obtain coverage sufficient to satisfy the requirements of all lenders involved in rebuilding units in the project in case of a major loss. Failure to do so could result in creating problems between some unit owners and their mortgagees. Each individual owner should satisfy themselves that the master policy adequately covers their insurable interest in the real property. If it does not, the individual owner may (if allowed by CC&Rs) secure their own insurance for the real property as well as the personal property located within the cubicle of space that is individually owned.

Package Policies

Package policies are available which usually offer more coverages at a lesser cost than coverages sold separately. Optional coverages are available to meet specific needs.

Clauses Affecting Fire and Other Hazard Coverages

Some of the features of commercial property insurance policies with which governing bodies should be familiar in discussing coverage with the insurers or insurance agents include the following:

Suspension of Coverage

Many standard policies include a condition under which insurance is suspended if the particular hazard insured against is increased by means within the control or knowledge of the insured. Governing bodies negotiating insurance policies should seek the deletion of this clause or at least modification.

Co-Insurance Clause

Some policies include a co-insurance clause which will operate to limit the insurer's liability (with a corresponding reduction of policy premium) in the event of a loss if the improvements are insured at less than 80% of their current replacement value at the time of loss. A "co-insurance clause" places the responsibility of insuring the improvements at 80% or more upon the owners to avoid having a depreciated value given to the improvements in settlement of a loss. The effect of this clause is that if the amount of insurance falls below the required percentage of current replacement value the insured will co-insure replacement costs with significant out-of-pocket costs involved. In most cases a "co-insurance" clause can be deleted through a waiver of co-insurance with an "Agreed Amounts" endorsement. In this case the insurance company agrees to pay a "flat" amount of the actual loss up to the agreed amount limit per occurrence per year.

Commercial Liability Insurance

Liability insurance in the past few years has become the single most important coverage available to any common-interest subdivision association. The possibility of financial loss from a liability claim is many times greater than a loss by fire.

The primary coverage under any commercial liability insurance is the protection against financial loss caused from being legally liable for the death or bodily injury of another and/or for damage to property of another. Liability coverages must be designed to conform to the unique features of each development to preclude any lapse in coverage which could financially peril the common-interest association. General liability policies do not cover all incidents which could result in financial loss. Care must be taken to determine what is covered and what additional coverages are needed to fully protect the individual association.

The commercial liability policy should be written to insure the association, its governing body and members of the association. It may also be advisable to include employees of the association as additional insureds.

Umbrella Commercial Liability Coverage

This type of liability coverage is usually written above a base coverage amount. Then the so-called liability umbrella coverage may then be purchased in increments of \$1,000,000. Also available in umbrella policies are "first dollar defense" coverage which provides for payment of all cost incurred in legal defense even without being held legally liable. Refer to Civil Code 5805 regarding civil liability protection to owners.

Workers' Compensation

Workers' compensation is a form of liability insurance coverage that by California law must be maintained by any entity which falls within the statutory definition of "employer" to secure the payment of compensation to employees or their survivors in case of the injury or death of the employee attributable to his employment. **Because the definition of an "employee" is extremely broad, it is recommended that an allowance for this be included in all budgets.**

Other Insurance

Insurance can be purchased for protection against loss not ordinarily provided by fire or liability policies. These include fidelity insurance for loss through the fraudulent or dishonest acts of employees, and errors and omissions insurance to protect the association against loss resulting

from negligent acts, errors, omissions, or breach of duty by officers or directors of the association.

Costs

The best estimate can be obtained from an insurance agent prior to premium renewal or before start-up of a new association. **IT IS STRONGLY RECOMMENDED THAT A BID OR RELIABLE ESTIMATE BE OBTAINED FROM AN INSURANCE BROKER WHENEVER POSSIBLE. BEFORE CONTACTING AN AGENT, IT IS IMPORTANT TO READ YOUR GOVERNING DOCUMENTS TO DETERMINE YOUR INSURANCE REQUIREMENTS.** A proposal for insurance should be included as backup to the budgeted figure. Also, your lender may have additional requirements that should be considered.

Associations that have a deductible of \$1,500 to \$5,000 or more should consider setting up a fund to cover small claims not normally covered by the policy and to cover the deductible expense.

If your documents require additional coverage such as directors and officers, fidelity bond, workers compensation, earthquake, etc., this amount should be included with your proposal.

Note: Ordinarily the fidelity amount should include three months of operating income plus an amount equal to the accumulated balance of the reserve fund.

The rate for your area should be determined by contacting several agents or insurance companies.

104. Local License and Inspection Fees

Local governing bodies (city and county) require license and inspection fees on swimming pools, elevators, and tot lots. The dollar amount for these annual inspection and license fees vary from city to city. Elevator fees may run from \$350-\$450/year, swimming pool inspection fees may run \$250-\$300/year, and tot lot inspection fees may run from \$400-\$500/year. Check local agencies for actual amounts.

Business licenses may be required if homeowners associations install vending machines or coin operated laundry machines.

105. Estimated Income Taxes

Under provisions of the Federal Tax Reform Act of 1976, a condominium or planned development association may elect to be treated as a tax-exempt organization for federal income tax purposes for taxable years after 1973 if certain prescribed conditions are met. Among other conditions, the association must be organized and operated for “exempt function purposes,” not less than 60 percent of its gross income for the taxable year must consist of dues or assessments from members who are owners of dwelling units in the subdivision and at least 90 percent of the expenditures of the association for the taxable year must be for “exempt function purposes.”

Exempt function purposes is defined to mean the acquisition, construction, management, and maintenance of property held by the association or property commonly owned by members of the association or governmental property that is used for the benefit of residents of the association.

If a homeowners association qualifies as a tax-exempt organization, net non-exempt function income is still subject to income tax. Non-exempt function income includes fees from nonmembers for use of the facilities of the association and amounts paid by members over and above regular dues and assessments for special use of facilities. The situation is now quite similar with respect to the payment of State income taxes.

The amount to be budgeted for federal and State income taxes will depend in large part upon the anticipated extent of income-producing, non-exempt functions of the association. The governing body of the association should seek advice from a CPA or good accountant with respect to obtaining tax-exempt status and in reporting non-exempt function income.

The required filing of the Statement By Domestic Nonprofit Corporation, Form 100, must be filed annually to the Secretary of State in California. The filing fee must accompany the statement and designate the agent for service of process.