

- f) Transfers of greater than \$10,000 or 5% of an HOA's total combined reserve and operating account deposits, whichever is lower, shall require prior written approval from the HOA board.
- 3) Requires the managing agent to maintain a separate record of the receipt and disposition of funds, including any interest earned.
 - 4) Prohibits the managing agent from commingling HOA funds with the managing agent's own money or with the money of others that the managing agent receives or accepts, unless a series of specified requirements are met, including that the funds were commingled prior to 1990 pursuant to agreement with each of the HOAs.
 - 5) Requires the HOA board, unless the governing documents impose more stringent standards, to:
 - a) Review a current reconciliation of the HOA's operating accounts on at least a quarterly basis.
 - b) Review a current reconciliation of the HOA's reserve accounts on at least a quarterly basis.
 - c) Review the current year's actual reserve revenues and expenses, compared to the current year budget, on at least a quarterly basis.
 - d) Review the latest account statements prepared by the financial institutions where the HOA has its operating and reserve accounts.
 - e) Review an income and expense statement for the HOA's operating and reserve accounts on at least a quarterly basis.
 - 6) Requires an HOA, unless its governing documents require greater coverage amounts, to maintain fidelity bond coverage for its directors, officers, and employees in an amount that is equal to or more than the combined amount of the HOA's reserves and total assessments for three months. Requires the HOA's fidelity bond coverage to include computer fraud and funds transfer fraud, as well as dishonest acts by a managing agent or management company and its employees (if the HOA uses a managing agent or management company).

This bill:

- 1) Provides, for HOA funds deposited by a managing agent into a trust fund account with a specified financial institution, including federally insured credit unions, that the institution may be one that is insured by a guaranty corporation.

- 2) Provides that HOA funds deposited by a managing agent in a trust fund account may only be deposited in accounts that protect the principal, and may not be invested in stocks or high-risk investment options.
- 3) Revises the transfer limit for the amount a managing agent may transfer without prior written approval from the HOA board from the existing threshold of the lesser of \$10,000 or 5% of the association's total combined reserve and operating deposits to:
 - a) The lesser of \$10,000 or greater, or 5% of estimated income in the annual operating budget, for HOAs of 51 or more units.
 - b) The lesser of \$5,000 or greater, or 5% of the estimated income in the annual budget, for HOAs of 50 units or fewer.
- 4) Adds crime insurance and employee dishonesty coverage to the types of insurance an HOA must have for its directors, officers, and employees in an amount that is equal to or more than the combined amount of the reserves of the HOA and its total assessments for three months.
- 5) Requires an HOA's computer fraud and funds transfer insurance to also be in an amount equal to or more than the combined amount of the reserves of the HOA and its total assessments for three months.
- 6) Requires that if an HOA uses a managing agent or management company, its insurance coverage must include coverage for, or otherwise be endorsed to provide coverage for, dishonest acts by the managing agent or company and any of its employees.

COMMENTS:

- 1) *Author's statement.* "AB 1101 will provide clarity on existing requirements for HOAs in California. In past years, HOAs have been a target for fraud from nefarious individuals who work closely with or who are on HOA boards. In 2018, I authored a bill that updated the tools available for HOAs to prevent fraudulent activities and it was signed into law. Two years since its passage, we have heard about the need for specifications on some of the terms that were in the original bill. AB 1101 is a technical cleanup bill that directly responds to implementation concerns from HOAs. This bill will ensure that our efforts to combat fraud are clear so that HOAs can effectively protect their funds."
- 2) *Background: CIDs and HOAs.* A CID is a form of real estate in which each homeowner has an exclusive interest in a unit or lot and a shared or undivided

interest in common-area property. Condominiums, planned unit developments, stock cooperatives, community apartments, and many resident-owned mobilehome parks all fall under the umbrella of CIDs. There are more than 54,000 CIDs in California comprising 5.1 million housing units, or approximately 35% of the state's housing stock. CIDs are governed by HOAs. The Davis-Stirling Common Interest Development Act provides the legal framework under which CIDs are established and operate. In addition to the requirements of the Act, each CID is governed according to the recorded declarations, bylaws, and operating rules of the association, collectively referred to as the governing documents.

- 3) *Protecting HOA resources.* To pay for common expenses, an HOA charges annual assessments to each of its members. While the board is ultimately responsible for how the HOA's money is safeguarded and spent, in practice property managers (e.g., managing agents or management companies) often handle much of the day-to-day financial operations. Collectively, the estimated 54,000 HOAs in California have roughly \$13.3 billion of homeowner assessments on deposit. Perhaps not surprisingly, there have been multiple large-scale fraud and embezzlement schemes involving HOA funds in California.

To address concerns about abuse of HOA resources, AB 2912 (Irwin, 2018) required HOAs to secure additional insurance and review financial documents on a more regular basis. This bill builds upon those reforms, as follows.

- a) *Increased board review.* To help increase financial oversight of HOA finances, AB 2912 required HOA boards to review finances on a monthly, rather than a quarterly, basis.
- b) *Increased oversight of fund transfers.* To help increase oversight of fund transfers, AB 2912 required HOA boards to approve transfers of greater than \$10,000 or 5% of an HOA's total combined reserve and operating account deposits, whichever is lower. This bill revises the requirement to the lesser of 5% of the estimated income in the operating budget or transfers of \$10,000 or more for HOAs of 51 or more units, or \$5,000 or more for HOAs of 50 units or fewer. This provision is intended to help address the varying budget levels between larger and smaller HOAs.
- c) *Mandated fidelity bond coverage.* To help protect HOA members against the costs of fraud and embezzlement, AB 2912 imposed a new requirement on HOAs to procure and maintain fidelity bond coverage to cover their deposits in reserve as well as three months' assessments. This requirement also facilitated tighter controls on HOA finances, since a bonding company is likely to require such controls as a pre-condition for providing coverage.

This bill expands the insurance coverage requirements to include not only the HOA directors, officers, and employees, but to also provide coverage for dishonest acts by a managing agent of the agent's employees. This bill also requires that computer fraud and funds transfer insurance must equal the HOA's reserves plus three months of assessments.

- d) *Deposits of HOA funds.* Although existing law authorizes HOAs to deposit funds in credit unions in California, some credit unions are not federally insured. This bill adds credit unions with alternative guaranty and insurance providers to the financial institutions in which HOAs may deposit funds. This bill also provides that HOA funds can only be deposited into accounts that protect the principal, and may never be invested in stocks or high-risk investment options.

- 4) *Opposition concerns.* The Center for California Homeowner Association Law and the California Alliance for Retired Americans propose a number of amendments:

- a) *Prohibit the creation of accounts in the managing agent's or company's name.* Opponents state that federal law requires accounts to be set in the names of the true owners of the funds. Existing law, which predates AB 2912, allows an HOA account to be in the name of the managing agent as trustee for the HOA.
- b) *Prohibit commingling of funds from multiple HOAs.* Opponents state it is difficult, if not impossible, for an individual HOA board to track its own HOA's finances when funds from multiple HOAs are commingled in a single account. Existing law, which predates AB 2912, prohibits a managing agent from commingling an HOA's funds with the agent's own money or with funds of another HOA unless certain conditions are met, including obtaining a written agreement with the HOA, as specified.
- c) *Establish an enforcement mechanism.* Opponents state that while this bill requires funds to be deposited in financial institutions that are federally insured, and prohibits funds from being invested in stocks or high-risk investment options, it contains no enforcement mechanism. Opponents propose amending this bill to authorize an HOA member to bring a civil action against its HOA for violation of this provision. Existing law, which predates AB 2912, requires HOA funds to be kept in a financial institution that is insured by the federal government, and does not include an enforcement mechanism. As noted above, this bill ensures that HOA funds can also be deposited in credit unions, and adds a new prohibition on stocks or high-risk investments.

The author states that amendments have already been made to this bill to address opposition concerns, particularly in relation to the threshold language on transfers, and that the broader issues with the existing Davis-Stirling Act are beyond the scope of this bill.

5) *Double referral.* This bill was also referred to the Senate Judiciary Committee.

RELATED LEGISLATION:

AB 2912 (Irwin, Chapter 396, Statutes of 2018) — required a CID board of directors to review specified financial documents on a monthly basis and prohibits electronic transfers of funds from HOA accounts without prior board approval.

AB 690 (Quirk-Silva, Chapter 127, Statutes of 2017) — required an HOA manager or management company to disclose certain information before entering a management agreement with an HOA and requires the HOA annual budget to contain specified information relating to charges for certain documents provided by the manager or management company.

FISCAL EFFECT: Appropriation: No Fiscal Com.: No Local: No

POSITIONS: (Communicated to the committee before noon on Friday, June 11, 2021.)

SUPPORT:

California Association of Community Managers (CACM)
Community Associations Institute - California Legislative Action Committee

OPPOSITION:

California Alliance for Retired Americans
Center for California Homeowner Association Law

-- END --