

Result of Discussion Meeting with HOA Attorney & CPA

(For claims made in Feb 2014 RHA General Meeting, HOA management company inputs, and subsequent Board of Director questions)

1. Tax claim: Monies collected over and above actual annual expenditures, by Washington law, had to be declared as “profit” and taxes paid on the excess income.

Attorney Input: Attorney says he sees no issues with copies of RHA tax return provided him. Suggests we get CPA confirmation as well.

CPA Input: CPA confirmation pending. The RHA tax forms reflect adherence to current tax laws filed using form 1120H for HOA’s. Specifically, income received from assessments is non-taxable, as long as (1) It comprises at least 60% of the HOA’s income, and (2) qualified expenses comprise 90% of all expenses. Non-exempt income—such as interest on bank accounts—is taxable, and the return reflects such. However, such income must be over \$100 in order to be taxed which is not the case for the RHA, so no taxes are typically due.

2. Tax Claim: Monies collected over and above actual expenditures in any calendar year, by Washington law, had to be reimbursed to property owners or carried forward as a possible reduction in future assessments.

Attorney Input: There is no law stating income in excess of expense had to be reimbursed to property owners. Doing so, in fact, would have the effect of penalizing good money management by the Board (spending less than authorized). In his experience, HOA’s typically carry forward any excess to help manage unforeseen or excessive expenses in subsequent periods. It could, however, be applied as a credit toward future assessments if the Board so approves, and general membership agrees during the next budget cycle.

3. Budget claim: The use of the word “Reserves” to identify possible expenses for items like “dangerous tree removal” in the community greenbelt, or “legal fees for liens”, requires a Reserve study. Furthermore, a reserve account can only be used for replacement and/or upkeep costs of community owned capital items and cannot be used for items like dangerous tree removal. Also, reserves must be held in a separate banking account from other funds.

Attorney Input #1: The use of the word reserves can apply to maintenance items for commonly owned property (greenbelt) as well as capital items. Therefore, expense for possible tree removal could be held under “reserves”.

Attorney Input #2: The RHA does not require a reserve study. We are too small and, therefore, exempt by state law.

Attorney Input #3: Although he didn't cite a specific regulatory requirement, he suggested it was a good idea to keep reserve funds separate. Note: If the original claim refers to law RCW 64.38.045 (4), it says, "The funds of the association shall be kept in accounts in the name of the association and shall not be *commingled with the accounts of any other association*, nor with the funds of any manager of the association or any other person responsible for the custody of such funds," which does not specifically say the funds within the association had to be kept separate.

4. HOA Management group suggestion: The RHA should change the biennium assessment cycle to a one-year cycle because the State of Washington requires an annual process, and it is required by the RHA covenants as well.

Attorney Input: While no law prescribes one-year as the mandatory assessment cycle, the attorney recommends going to an annual assessment since (1) it is the common practice, (2) the language in our documents refers to annual, and (3) it keeps budget and financial reporting more easily understood. It is, however, up to the RHA.

CPA Input: CPA input pending. Estimate of changing to an annual assessment cycle would raise our current costs for service from \$450 per year to \$500 per year.

5. BOD Question: Does our current budget format and process meet legal criteria? If not, what changes would be recommended?

Attorney Input: The attorney sees no issues with the format of the budget sheet.

6. BOD Question: Does the RHA "fiscal year" have to be the calendar year?

Attorney Input: No. HOA's he represents have both. At least one-half don't coincide with the calendar year.

7. BOD Question: Is the RHA required by law to mail out the statement of income and expenses for each year to each lot holder, or is reviewing the information in a general meeting, with due notice given to lot holders, sufficient?

Attorney Input: The state statute (RCW 64.38.025 items 3 and 4) spell out exactly how and when the budget information and the financial condition of the HOA should be disseminated to the membership. We should follow those. In general, both the proposed budget and statement of prior period income and expenses should

be sent to each member at least fourteen days, but not more than 60 days, ahead of the general meeting where the proposed budget is to be voted on.

8. BOD Question: We initiate a lien on a property when the assessment is past due, and in the past it has been successful. However, a recent delinquency on a foreclosed property resulted in the new homeowners not being held responsible for the lien. What option does the RHA have available to collect the money owed in such a situation?

Attorney Input: A foreclosure does protect the new owner from the liability of paying a prior assessment, and he suggested we not initiate a lien on a known foreclosed property. However, the HOA has the right to pursue the owner of record when the assessment was due via lawsuit if a lien is placed. Current law states the owner of record is also liable for all costs and penalties when this avenue is taken (which could run to a couple thousand dollars). Also, his wages could be garnished if necessary. The usual procedure is (1) the HOA notifies the prior owner of their intention to pursue and that legal proceedings will be undertaken if not resolved, then (2) A follow up letter from the HOA attorney if funds not received under number one, and then (3) HOA files suit in court against the prior owner.

9. BOD Question: Is there a legal definition of how much money an HOA can have in a contingency or reserve fund?

Attorney Input: Amounts in reserves or contingency funds are based on agreements reached in budget meetings adopted by the particular HOA. There is no legal definition of how much it should be as each HOA's needs are different.

10. Question put to BOD: We have a lot of Board members for the size of our HOA. What would it take to reduce the number?

Attorney Input: It would require changing the by-laws and that requires a meeting of the general membership and an agreement of a quorum of those attending to make the change. Those changes should be recorded with the Secretary of State. The attorney recommended that given our small size, we drop to not more than seven, and perhaps five was the right number.

11. HOA Management Group suggestion: To look at doing away with CPA services to save money. Suggested that certain banks (Alliance Association Bank) could be helpful.

Attorney Input: Totally up to the HOA. He understood our current set-up was to take money handling and access to accounts out of any individual's hands (checkbook resides with CPA) which he supported, that the CPA handles all assessment billing, collection, and banking for us, and that they also serve as a professional face to the outside world and front office, all of which he thought valuable.

12. HOA Management Group input: That our taxes are filed using 1120H, that billing for assessments are sent out 30 days prior to due date, that no interest can be charged on assessment delinquencies until after 30 days from due date, that interest on HOA accounts over \$100 is taxable.

BOD Input: All of the above are currently done as listed.

13. Question put to BOD: Are all Board members insured and are duties defined?

BOD Input: All Board members are insured through American Family Insurance. The powers bestowed on board members are defined in the by-laws under Article VII. Officer duties are defined in Article VIII.

14. Question put to BOD: Is there anything the RHA can do about disrepair of abandoned properties?

Attorney Input: Under Article VII of our by-laws, if a homeowner fails to maintain property in a manner satisfactory to the BOD, the RHA (upon agreement by 2/3rds of the board) has the right to enter the property and restore the lot to standard and then charge the cost of the effort to the homeowner on his next assessment. The attorney said that this effort should be done by first notifying the owner, then taking it into court. He also said that most associations have rules and standards that impose fines for non-compliance. He suggested the RHA may want to consider such. Side note: A previous attorney said this typically requires an enforcement process, which would mean members of the association would have to act as a policing and enforcement agent. The police and courts won't do that for the association.

15. Question put to BOD: If the RHA has not enforced a rule in the covenants or by-laws, does that prohibit the RHA from ever enforcing it?

Attorney Input: Our covenants say explicitly under Article VII General Provisions, Section 1, Enforcement, that "failure by the association or by any owner to enforce any covenant or restriction herein contained shall in no event be deemed

a waiver of the right to do so thereafter.” The attorney did say, however, that if there had been multiple occurrences of violation over significant time without enforcement, the court would typically judge the rule to be “unenforceable”, but that each instance would have to be judged on its own merit.

16. Question put to BOD: Is it okay for more than one person from a lot to be on the Board of Directors at the same time?

Attorney Input: The RHA by-laws state that a member of the Board can be anyone elected, that the person(s), in fact, don't even have to be a member of the association. The same is true of Board officers. Even so, the attorney said the court usually frowns on such an arrangement because it can result in unequal voting power, and he therefore recommends the board generally not have more than one member per lot on the board.

17. Question put to BOD: Can the HOA be dissolved?

Attorney Input: It is forbidden under state law RCW 64.38.025 (2) for any director to take any action that terminates the association. That would include even answering the question. He said the board members cannot act individually against the board, the actions of the board, or in any manner denigrate the board to the membership while they hold office. He said he knows of board members who have been sued by association members for acting in such a manner.

18. Question put to BOD: Can the covenants be changed to limit the number of rentals allowed in the plat?

Attorney Input: Under the covenants, they can be changed by a 75% approval of the owners (note: A previous RHA attorney once said in order not to have future problems, it needs to be 100%). The attorney said specifics of limiting rentals is problematic, and the court is currently considering a similar case right now. He does not have any idea what the outcome might be. Certainly, any proposed covenant change must not violate existing laws protecting property holder's rights and must be recorded.

—End of list—