APRA Advisor

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Association of Professional Reserve Analysts (APRA) is a nonprofit corporation established in 1995 by principals of America's leading reserve study companies. The purpose of APRA is to provide a forum to establish a common base of knowledge, standards of care and professionalism within the reserve study industry.

The **APRA Advisor** is a bimonthly publication designed to expand the understanding of reserve planning and increase awareness of **Professional Reserve Analysts**.

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Crystal Balling

A fortune teller asked me to gaze into her crystal ball. "I see wear and tear in your building's future. I see a new roof will be needed. I see cracking paint and asphalt in need of repair. I see (gasp!) a depleted reserve fund!"

It doesn't take a fortune teller to predict that common elements are going to wear out and it doesn't take a crystal ball to predict that HOAs are going to need money and a plan to fix them. So why do so many HOAs fail to properly plan for these predictable events and expenses?

The truth is that too many HOA boards are busy putting out this year's financial fires and haven't the time to think about next year and beyond. Remember, "it's hard to remember why to drain the swamp when you're up to your behind in alligators". In other words, it's easy to lose track of long term goals when you get sidetracked by more immediate demands. Putting out fires is what HOAs do, right? The poorly run ones seem to do just that.

HOAs are no different than any other business. Those that are successful engage in long range planning. Those that fail to plan fend off disaster after disaster and board members come and go through a revolving door. No real magic here. To know where you are going, you have to have a destination in mind. In spite of bumper sticker wisdom, those that wander really are lost.

So back to the HOA scenario. When a homeowner association doesn't have the funds to handle a major repairs, they defer those repairs until the funds are available. Of course, money doesn't grow on trees and without a plan to collect more money, band-aiding and deferring become the default reality and slippery slope.

How do you steer your HOA back up to high and stable ground? The first step is to review your reserve study. "What's a reserve study?" you say. A reserve study identifies all common element components that have useful lives between 2 and 30 years like the roof, fences, decks, paint, paving, etc. The average condominium has 15-30 components. The average high rise condo can easily have 100. And HOAs that own golf courses and marinas can have many more. Regardless, a reserve study is customized to the HOA in question.

"But our condominium is small", you say (meaning, "why is a reserve study even necessary in our case?") It's basic math: The more people you have to share the cost, the less the cost per person. Smaller HOAs have a greater need for reserve planning because the cost per person is greater.

After the component list is determined, a current repair or replacement cost must be determined for each as well as the remaining useful life. With this information and the current inflation factor, a funding plan can be made to instruct the board how much money to collect and set aside each year to meet future financial needs.

While there is no state or federal requirement, the reserve study should be performed by a professional since evaluating condition of components and establishing useful lives and current pricing takes special training that few boards have. The professionals carrying the highest credential in the industry, the PRA (Professional Reserve Analyst), belong to the Association of Professional Reserve Analysts. A list of members and contact information can be found at www.apra-usa.com

Rather than crystal ball your future, get a proper reserve study done and follow the funding and schedule recommendations. Leave the crystal balling to Lady Luck. **APRA**

Reducing Financial Liability

It seems that homeowner association boards are being barraged by issues that weren't even considered a few years ago. Construction defect litigation has mushroomed (pun intended) and lawsuits related to financial mismanagement are more frequent. They are at best a nuisance, and at worst very costly and stressful.

Historically, homeowners volunteered to serve on the HOA's board because they had an interest and/or an expertise that were applicable. This approach generally worked well. However, today overall management has improved with the help of professional managers, attorneys, engineers, accountants and other homeowner association specialists. One critical expertise involves planning for future capital repairs with an adequate reserve fund.

Now more than ever, HOAs are using the services of professional reserve study providers. A professional reserve study determines accurate, supportable annual reserve contributions necessary for the repair or replacement of common property as it wears out over the development's life. The goal of a reserve study is to eliminate special assessments through regular and adequate contributions to ensure that sufficient funds will be available when common element components need to be repaired or replaced. Eliminating special assessments offers peace of mind to owners and reduces claims of financial mismanagement.

Homeowners typically view their HOA property as a financial investment with the added element of "my home is my castle". This means they take it very seriously how well the board maintains this investment on their behalf. All real estate wears out and it takes money to keep it at its best. The board that fails to budget for these events is guilty of mismanagement. In response to the widespread problem, regulatory pressure on HOAs from state governments has increased dramatically in recent years.

When it comes to reserve funding, some state statutes call for "reasonable" or "adequate" reserve funds, while others require that the HOA "shall maintain a reserve fund which, at a minimum, shall be equal to 10 percent of the current annual budget." While regulations vary from state to state, there is a strong trend toward more legislation rather than less.

The purpose of this legislation is to protect members and prospective buyers, and to ensure that the HOA is properly managed. Questions of fiduciary responsibility date back at least as far as the early 1980s in California case law with the landmark Raven's Cove decision. The Court of Appeal held that: "...Where owners' association's original directors... failed to exercise their supervisory and managerial responsibilities to assess each condominium unit for an adequate reserve fund ... former directors of the association breached their fiduciary duty and were individually liable to the association for said breach..." For more, see http://davis-stirling.com/ds/cases/ravenscove.htm

And it's not just state statutes. Currently, FHA (Federal Housing Adminstration) underwrites the majority of condominium loans and has a requirement that a condominium loan (purchase or refinance) to qualify, the association must have a current reserve study with a minimum contribution of 10% of the annual budget.

Why should board members be concerned about being sued when covered by Directors & Officers liability insurance? Directors of a homeowner association are responsible for actions or inactions that impact the HOA members' financial well-being. If failure to perform causes litigation, the HOA's insurance premiums would likely escalate. Also, board members can be subpoenaed years after leaving the board to testify against accusations of mismanagement.

Even the American Institute of Certified Public Accounts (AICPA) has guidelines that specifically address homeowner associations and reserve funding. The **AICPA Audits of Common Interest Realty Associations** states that the homeowner association's "primary duty is to maintain and preserve the common property." Further, "Inadequate funding for future major repairs and replacements may adversely affect the ability of owners to sell or refinance their units, because of the concerns of prospective buyers or the banks which can lead to difficulty in obtaining mortgage financing ..."

The AICPA audit guidelines require disclosure in the financial statements about an HOA's funding for future repairs and replacements. If this disclosure is absent or inadequate, the auditor will disclose this in a "qualified" audit. Qualified audits raise questions from prospective buyers and their lenders which are generally not good.

For practical reasons, smart HOA boards are becoming more sophisticated in how they conduct business, particularly in the area of reserve planning. By engaging firms that specialize in reserve studies, the board fulfills its fiduciary responsibility and will reduce the likelihood of financial mismanagement claims.

From an article by John P. Poehlmann **APRA**

eBombs

In the age of instant communication, email often plays an indispensable role in homeowner associations (HOA) operations. Boards, managers, homeowners, attorneys and contractors routinely use email properly and efficiently. Under most circumstances, email is a boon. However, email has some major pitfalls when misused. Here is a list of tips that will keep email an effective communication tool instead of a weapon of mass destruction:

Never assume that only your intended recipient will read your email. Emails can easily be forwarded to others, intentionally or unintentionally. Emails can be intercepted, deleted or easily modified and forwarded. Before sending an email, ask yourself if you would die of embarrassment if the wrong eyes read it. If the answer is yes, don't send it.

Email is not a conversation. An email, while a great form of communication, still amounts to a monologue not a dialogue. Email lacks the dynamics of face to face which includes nuances like sight, sound, tone and body language. Writing effectively is an art form that few master while most communicate pretty well in person.

Forever is a long time. Emails can be archived for years and may later be retrieved, especially in the context of litigation. Your off hand email remarks may incriminate you years later.

Avoid email for complex issues. Lengthy emails often get misinterpreted and when multiple recipients are weighing in, someone is not going to get the whole message. Save complex topics for face to face meetings where everyone is there to hear the same thing at the same time.

Flame off. Avoid the temptation to send flaming emails, even when the recipient deserves it. Angry emails seldom change hearts and minds and often burn bridges.

Safeguard privileged information. In a genuine effort to keep the lines communication open with members, a well-meaning board member may share an email to a non-board member containing advice from legal counsel. This practice, even with good intentions, could effectively waive the attorney-client privilege.

Email can be used for good and evil. But eBombs have a way of doing substantial and lasting damage. Before you fire off an email, make sure you're pointing at the right person and the email is properly loaded. **APRA**

Ignoring the Obvious

Reserve studies recommend project scheduling and funding models to keep building and grounds components like painting, fencing and paving in good repair. These recommendations point out the obvious, a plan to renew common elements and money to do it. Unfortunately, the recommendations are often ignored by the board, or only partially implemented. Ignoring the obvious can have serious consequences. Consider the following:

Point of diminishing returns. As HOAs reach around 20 years old, many of the most expensive repairs come due. HOAs that are not prepared face unpopular and unfair special assessments. The natural consequence of unpopular actions is for boards to dodge and weave, defer and delay. What's a year or two more going to matter? And, by next year, the directors might be able to sell their units and avoid the unpleasantry altogether.

Show me the money. One often overlooked advantage of effective reserve planning is strategic investing of the funds. The funding plan will reveal when funds will be needed and thus allows unused funds to be invested for longer terms and higher yields. An increase of only 1-2% in investment yield can often lead to thousands of dollars in interest earnings over the, usually, 30 year projection period. Every dollar of interest earned is one dollar less of owner contribution.

Neither a borrower or lender be. One option that HOAs consider to finance urgent repairs is bank loans. When HOAs borrow money, it's considered a commercial loan and both the rate and loan fees are considerably higher than home loans. These loans are typically short term (five to ten years) and require monthly payments just like any other. The lenders require much hoop jumping to get them. There are relatively few lenders that will do them at all. There are situations when borrowing money is called for (like unanticipated and hugely expensive urgent repairs) but there's simply no free lunch and this one comes at a premium price. If certain owners lack the cash to fund an urgent special assessment, it's much cheaper to get a home equity loan or even draw on a credit card. Home equity loan interest is deductible for this purpose.

Fixed income blues. For a variety of reasons like disability, divorce, retirement and long term unemployment, some HOA members may not be able to fulfill their financial obligations to the HOA. If a member is unable to afford HOA expenses longterm, it may be time for a lifestyle adjustment. The HOA simply cannot fulfill its financial obligations when it plans around or concedes to the weakest link. While this sounds cruel, remember that there is no government bail-out for HOAs. If some don't pay, the rest must. The board should press for collection, and the sooner the better. Most will make good. For the rest, it may be time for a heart to heart about downsizing.

All things wear out sooner or later. A reserve study analyzes those assets that the HOA is responsible for, projects future costs, current funding needs and a schedule for keeping the assets in good repair. The approach is fair to all owners, now and in the future, and ensures repairs are done when needed. Result: happy members with sustainable home values.

When your HOA is caught in a financial quagmire, it's best to hire a Professional Reserve Analyst (PRA) that can prepare a proper reserve study and make the case for urgency. A PRA doesn't have the political problem that board members do of being neighbors. A PRA can explain the cold hard realities of raising the funds and getting the job done or the dire consequences for failing to do so. A PRA can also recommend material and design upgrade suggestions to reduce future costs plus preventive maintenance that will help maximize the useful lives of components. Ignoring the obvious has obvious pitfalls. Sooner or latter, the inevitable becomes unavoidable. As the saying goes, "If you find yourself in a hole, it's best to stop digging." **APRA**