

APRA Advisor

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**.

Reserve Studies: Why the Confusion?

When the homeowner association industry was conceived, it was impossible to foresee the problems that might arise. It was a simple concept: Create affordable housing with shared amenities. Instead of buying a house and paying all related expenses (trash, water, gas, electric, landscaping, exterior maintenance and amenities), buy a condominium with tennis court, pool, park, etc. and pay only a small share of the cost.

Prior to the 1970s, there were only a few thousand HOAs compared to over 350,000 today in the USA alone. How would these HOAs operate? Over time, statutes and guidelines have been established for the developers.

Financially, an HOA has two distinct parts:

1. Operating expenses like utilities, maintenance, landscape contractor, etc., and
- 2) Reserve expenses (long term repairs and replacements) like roofing, fencing, painting, etc.

Budgeting for current operations is a straight forward process because bills must be paid now. But budgeting for reserves is a hotly debated topic since those costs are years in the future. The

different approaches for producing a reserve study often leaves the board of directors and homeowners confused.

Why all the confusion? State legislation has been the first problem. Individual states have legislated their own guidelines. California was one of the earliest states to adopt reserve study legislation but that legislation has been changed many times.

The second issue is that the three reserve study funding plans produce very different results:

- 1. Full Funding Plan.** Maintain a reserve fund balance equal to the deteriorated value of the reserve items
- 2. Baseline Funding Plan.** Maintain a reserve fund balance that never falls below zero
- 3. Threshold Funding Plan.** Maintain a reserve fund balance that never falls below a pre-determined amount

Cash Flow Projection. While funding plans have different objectives and results, all use the same calculation structure called a cash flow projection. A cash flow projection includes a reserve fund beginning balance, annual reserve contribution, interest earned of reserve funds, taxes paid on interest earned and a current inflation factor which impacts future values.

Percent Funded. The concept of Percent Funded is based on the amount of reserve funds which must be available for any given year for the Reserve Fund to be 100% Funded. For example, if a reserve component costs \$10,000, has an estimated useful life of 10 years and has been in service four years, then \$4,000 should be reserved for this component to be 100% Funded.

The American Institute of Certified Public Accountants (AICPA) does not take a position on what kind of funding method should be used but does advise:

- A means of assuring that funds for major repairs and replacements will

be available when needed;

- An equitable method of charging current rather than the future owners with the cost of the current use of assets;
- A means of preserving the market value of individual units."

Their Common Interest Realty Association (CIRA) Guide goes on to say that a CIRA should disclose information in its financial statements about its funding for future major repairs and replacements which should include disclosures like:

1. Requirements, if any, in statutes or the CIRA's documents to accumulate funds for future major repairs and replacement and the CIRA's compliance or lack of compliance with them;
2. A description of the CIRA's funding policy, if any, and compliance with that policy;
3. A statement that funds, if any, are being accumulated based on estimated future (or current) costs, that actual expenditures may vary from these estimates, and that the variations may be material;
4. Amounts assessed for major repairs and replacements in the current period, if any;
5. A statement indicating whether a study was conducted to estimate the remaining useful lives and the costs of future major repairs and replacements
6. CIRAs that fund future major repairs and replacements by special assessments or borrowing when needs occur should disclose that information."

A homeowner association that does not have sufficient funds has three choices to raise the money: 1) special assessment, 2) borrow from a financial institution, or 3) a combination of both.

Financial institutions lend based on a business plan that provides for the use

of the funds borrowed and how those funds will be repaid. When making loans to HOAs, lenders look at the maintenance fee delinquencies, owner occupancy rates, the market value of the properties. These kinds of loans are considered commercial loans and carry higher fees, higher interest rates and shorter terms than residential loans.

So far, there are no reserve police to assure that boards are doing proper reserve planning. However, the current housing and financial crisis has had a significant impact on reserve planning. The Federal Housing Administration (FHA), Freddie Mac (FHLMC) and Fannie Mae (FNMA) all have reserve study requirements for condominium loans they underwrite. Since they underwrite most of the loans and those regulations apply to all 50 states, these regulations will significantly impact how HOAs reserve in the future.

Regardless of that future, reserve plans do not have to be confusing. They should be updated annually with a large dose of common sense and simplicity.

By Bill Chaffee of PRA Systems [APRA](#)



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Ask the PRA

Q When the limited common elements attached to each unit (like driveways and decks) vary significantly in size and

replacement cost, how are they handled in reserves? Does each individual owner pay into reserves based on his own limited common area?

A Unless the governing documents assign costs for limited common areas to the owner, reserves for them are funded the same way as any other common area component.

Q Can the board decide to replace unit dishwashers and assess the owners?

A A condominium unit belongs to its owner and the board cannot take on this kind of expense unless *every* owner agrees to it. It often makes financial sense, however, for the HOA to arrange group buying for owners. For example, in some states, exterior windows are a unit owner's responsibility to replace. If the building has old, single pane aluminum windows, it makes enormous sense for the HOA to coordinate a full window replacement project because individual owners could save up to 50% of the cost. Similarly, having the HOA purchase many dishwashers at once will doubtless save owners a lot of money. However, the HOA cannot force an owner to participate and some members might opt out for any reason.

Q Should we include landscape items in our Reserve Study plan? How about insuring trees?

A It's wise to include "Landscape Renovation" and "Treework" in the Reserve Study. All bushes and trees have a limited life. Bushes die and outgrow their location. While trees usually have a long life, they require corrective pruning that should be done every 3 - 5 years and it's expensive. Hiring an arborist to do a comprehensive inventory and report of the trees also makes a lot of sense. If each tree is tagged and referenced in the report, maintenance can be easily tracked. Consistent corrective pruning will extend the lives of the trees and keep them looking good.

Insurance for non-income producing trees provides limited coverage for claims related to fire, lightning, explosion, riot, aircraft, vehicles, vandalism and theft. Most of the claims

are related to vehicle damage. Wind, freezing and pest claims are not honored. And the insurance does not actually insure the trees for value but provides replacement in standard nursery sizes. In other words, that wind fallen 80' oak will probably get you an 8-12' replacement. Based on the usual \$5000 insurance coverage, it will cover quite a few replacements.

To avoid the possibility of insect infestation, use native trees that are hardy and pest resistant. If you already have those prone to insects, consult with an arborist for the proper preventive maintenance or cut them down and replacement them.

Q In years past, the board has either sanctioned or failed to stop illegal additions by owners to their units such as expanded decks, fences, awnings and patio enclosures. The unwritten understanding has been that the unit owners that install these things are responsible for all repairs and replacements. Over time, however, new owners have acquired some of the units and are now demanding that the HOA pay for the work since it's located in the common area. What now?

A The board has no authority to expand an owner's use of the common area. Any redefinition or reconfiguration of common

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area must be approved by an appropriate majority of owners which may be 100% depending on how your governing documents read. However, what is done is done. If the policy has been that the owners that have installed the additions pay for all maintenance and repair, that should be the policy now and the current Board should take inventory of all owner additions and advise those unit owners of their maintenance responsibilities.

To avoid misunderstandings, any unit that is so affected should have a document prepared by a knowledgeable HOA attorney and recorded against the unit title which describe the addition and the owner's maintenance responsibility. This same principle applies to future modification approvals by the board. [APRA](#)

A reserve study is a fundamental planning tool that every homeowner association needs to function properly.

APRA members carry the Professional Reserve Analyst (PRA)[™] credential which requires extensive education, years of experience and client references.

APRA members provide high quality reserve study service throughout the United States, Canada and Australia.

APRA

ASSOCIATION OF
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For contact & membership information:
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Appearances Do Count

One of the advantages of a homeowner association is being able to enforce appearance standards which are designed to protect property values. Research has shown that if all homes follow the same basic theme, the average buyer is willing to pay more.

Most subdivisions have appearance standards, but, in truth, only a lawsuit (or a Mafia hitman) can stop someone determined to violate them. Since most neighbors hate confrontation, appearance standards usually go by the wayside opening the door to the things like RVs parked along side the house, tarped "classic" cars, hubcap sculptures and eye wincing paint colors. Thus, the need for appearance standards and the enforcement thereof.

The governing documents usually outline the appearance standards when they are very strict but often say little when they're not. They may define the standards but not the enforcement method, leaving the Board in an awkward position when confronted with multiple appearance "challenges".

This is a great topic for the Resolution Process. Resolutions

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are board policies that deal with complex issues like collection of money, pets, parking and appearance standards. Resolutions provide a framework to deal with them effectively. By the way, board resolutions *cannot* amend or change the meaning of the governing documents, only clarify on the authority. Amending the governing documents requires an appropriate vote of the owners.

After your Appearance Standards Resolution is drafted, ask your attorney to review it for compliance with state statutes and your governing documents. Then, allow the other owners to participate in the outcome. Once drafted, it should be circulated to all the owners for a 30 day review and comment period. The approval process shouldn't be rushed. Change is difficult for some.

A good way to broach the subject with the membership is to send out a newsletter discussing the main reason why they are necessary: to preserve property values. Consistent appearance standards are in all owners' best interests. Describe how, for example, junk vehicles, unkempt lawns, collapsing fences and peeling or hot pink paint drag property values down (without pointing fingers or naming names). Encourage attendance to a special meeting to discuss the Appearance Standards Resolution.

After the new Appearance Standard Resolution is cussed, discussed, amended and approved, it's time to start enforcement. Select the closest equivalent you have to Henry Kissinger and a Mafia Hitman. If you have none of these,

after appropriate written notifications, make good use of your attorney to turn up the heat. Never be guilty of selective enforcement. Treat everyone the same.

Appearances do count and it's up to the board to watch dog what happens in the community. Don't wake up one day and ask "Where am I and why am I in this handbasket?" Safeguard your HOA's appearance **today!** [APRA](#)

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Right Roofing

There are a number of things to consider when selecting the right roof for your association. Cost and durability head the list, but aesthetics are important too. The right roof for your home is the one that balances all of these considerations.

Asphalt/Composite Shingles hold an overwhelming share of the U.S. roofing market. Most asphalt shingles are fiberglass reinforced which consist of a fiberglass mat with a top and bottom layer of asphalt and mineral granules. Zinc or copper granules can be integrated into asphalt shingles to retard algae growth.

While 3 Tab style shingles have been very popular, "Architectural" style (mimics a wood shake look) has become increasingly popular. Asphalt

shingles are available in 25-50 year warranties depending on the thickness. Most roofing materials are categorized as UL Class A, B, or C, A being the most fire resistant followed by B and C. Most fiberglass shingles have a Class A fire rating.

Cedar Shingles and Shakes. Shingles are machine-sawn; shakes are hand cut and rougher looking. Their natural look is popular in California, Northwest and Midwest. Things to consider: they have a UL fire rating of Class B, C or none at all, and they should be treated with a preservative every three to five years to prevent decay. They are high maintenance, burn easily, cost double that of asphalt shingles and have a 15-20 year life.

Clay or Concrete Tile is a durable but fairly expensive roofing material. "Mission-style" and "Spanish" round-topped tiles are widely used in the Southwest and Florida, and flat styles also are available to create French and English looks. Tile is available in a variety of colors and finishes. Note: Tile is heavy so if you are replacing a lighter roofing with tile, you will need to verify that the structure will support the load.

Slate is quarried in Vermont, New York, Pennsylvania, Virginia, and Canada. It comes in different colors and grades, depending on its origin. While extremely durable, it is more expensive than other roofing materials and its application requires skill and experience. Many old homes in the Northeast still are protected by this long-lasting roofing material.

Metal Roofing is material that works in some residential settings. Some metal shingles are constructed to simulate traditional roofs like wood shakes, shingles and tile. To circumvent warranty loopholes, use an installer that is certified by the manufacturer. This way, no matter what the problem, you're covered.

Choose the right roofing by weighing look, cost, durability, warranty and maintenance. Avoid residents singing "Raindrops Are Fallin' on My Head".

2010 PRA

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We honor our latest **Professional Reserve Analyst™** members to the organization:

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- ⊗ If you are delusional, press 7 and your call will be transferred to the Mother Ship.
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- ⊗ If you have low self-esteem, please hang up. All operators are too busy to talk to you. [APRA](#)