

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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Reserve Study: The Reason Why

A reserve study is a 30 year plan to deal with homeowner association common element repairs and replacements. The reserve study provides a schedule of events and a funding plan to pay for them. When funds are set aside for the future, they are called "reserves", thus the name of the study. Very few if any single family home owners set aside money for future renovation. Why are reserves for homeowner associations needed at all?

Sharing Common Expenses. In a homeowner association (HOA), common expenses are shared by the owners. It is not uncommon for HOA ownerships to turnover many times during 30 years. So, if each of those owners doesn't pay a proportional share of the expenses, the burden will fall on others to pay. With a properly funded reserve study, money is set aside in proportion to the common elements' deterioration. If, for example, a roof has a 25 year useful life, 1/25th of its replacement cost should be reserved each year to have enough money to pay for the future roof replacement; a fence with a 20 year useful life should have 1/20th of its replacement cost put in reserves each year.

Failure to collect adequate reserves each year places a heavier financial burden on future owners. Collecting adequate money each year from all owners along the 30 year time line fulfills the requirement of the governing documents to allocate expenses according to the benefit received.

Forward Planning. Considering the often large cost and complex execution of future repairs (roof, paint, fences, etc.), the board needs the information a reserve study provides. And size does not matter. This kind of planning is just as important for small HOAs as large ones. As a matter of fact, costs per owner go up the smaller the HOA,

so having and following a good reserve study is even more critical for small HOAs.

Fiduciary Duty. The board of directors has a fiduciary responsibility to the members to operate the HOA using good business judgment. Ignoring or failing to adequately plan for costly repairs is a breach of fiduciary duty and individual directors can be held legally responsible for the results.

Contractual Duty. HOA managers have a contractual responsibility to advise the board about the maintenance and financial matters which a reserve study discloses. As a practical matter, if the board has not collected adequate reserve money, highly unpopular special assessments must be levied which inevitably catch the manager in the crossfire and create much more work sorting out the complaints.

Statutory Duty. A growing number of states have passed legislation requiring homeowner associations to do reserve studies such as Virginia, Ohio, Illinois, California, Florida, Hawaii, Nevada, Oregon, Washington and others. And since HOAs are the "development model" preferred by most municipalities, more states will be developing legislation regarding reserve planning.

Lender Impact. Due to the fall-out of the sub-prime mortgage crisis, FHA, Fannie Mae and Freddie Mac (major underwriters of HOA loans), all require condominiums to have a reserve study current within 12 months. Those that cannot provide this risk having owner and buyer loans rejected.

Simple Logic. When funds are reserved in adequate amounts, common elements will be maintained according to a systematic schedule without special assessments. HOAs that fail to reserve properly and execute renovations on time are simply worth less than those

that do. Simple logic dictates that every HOA must stay competitive or member property values will decline.

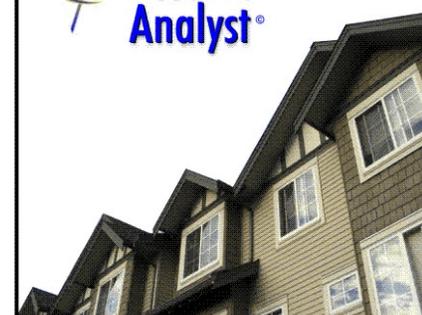
So there are many good, valid, legal and logical reasons why every homeowner association board should have and follow a properly prepared reserve study. Reserve studies are a specialty of Professional Reserve Analyst (PRA) members of the Association of Professional Reserve Analysts. For a list and contact information of PRA members, go to www.apra-usa.com

By Richard Thompson - www.Regensis.net Excerpts from an article by Peter Miller of Miller Dodson. [APRA](#)

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Ask the Professional Reserve Analyst

Q What level of reserve funding should we consider a minimum level? We get conflicting advice that we are trying to sort out.

A Some state statutes require minimum thresholds for reserve funds. But those minimums don't address what is fair. One of the main objectives of performing a reserve study is to determine the current Percent Funded. The Full Funding (100%) model distributes reserve expenses fairly to those that benefit from the assets.

Failing to allocate reserve expenses fairly is contrary to the board's fiduciary duty and exposes board members to

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personal liability for the inevitable results: special assessments.

Q In preparing the annual budget, I noticed several transactions charged to reserves that look like they should have been paid from the operating account, a spa filter and tree pruning. Your thoughts?

A Reserve plans typically deal with any repair or replacement item that has a useful life of 2 to 30 years. Under this definition, both of these items qualify as reserve expenses. However, if the expense is small and the operating budget can support it, paying for it out of the operating account would be okay.

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

A It's wise to include components like "Landscape Renovation" and "Treework" in the Reserve Study. All bushes and trees have a limited life. 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 tree inventory and report of the trees also makes a lot of sense. If each tree is tagged, 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 foot douglas fir will probably get you an 8-12 foot replacement. Based on the coverage available, \$5000 coverage will cover quite a few replacements.

To reduce 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 pest control or remove and replacement them.

Have a Question? APRA is dedicated to providing clear and effective solutions to your reserve planning issues. If you have a question about the process and the benefits, why not email our panel of experts? Selected questions will be included in future editions of the **APRA Advisor**. Email info@apra-usa.com **APRA**



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Deterring Dryrot

While fungi are considered a delicacy when found on your plate, when found in wood, they cause dryrot, a wood “cancer”. And like cancer, it’s best to avoid the conditions that cause it. In the case of structures, the culprits are improper materials, flashing and design.

Dryrot’s name is a misnomer because the rot occurs in wet conditions, not dry. It occurs when water is allowed to penetrate wood in places and in a way where it won’t dry out. Wood destroying fungi require a food source, oxygen and favorable temperature in order to survive. It’s a vicious circle: Moisture promotes fungi which increases wood permeability which allows moisture to penetrate further which encourages more decay, etc. etc.

There are three classes of dryrot:

Brown Rot. Wood decayed by brown rot looks like dry leather and breaks easily into small cubical pieces. Wood strength decreases as the growth spreads. Most of the damage to structures is caused by brown rot.

White Rot. Wood decayed by white rot often assumes a bleached appearance, frequently has black lines through it and feels spongy. Wood strength decreases gradually. If caught soon enough, white rot may be treated by bleach spray and scraped away. It is important to correct the moisture problem that caused the wet wood in the first place.

Soft Rot. This looks like brown rot but the affected wood softens gradually from the surface inward developing cavities (invisible to the naked eye) within the wood cell walls.

Four Principles of Dryrot Prevention

1. Build with properly seasoned wood.
2. Keep wood dry.
3. Break contact of wood and soil.
4. Where soil must contact wood, use properly pressure treated lumber.

The odor of mold and mildew inside the home is a sure sign of condensation and dryrot. Warm weather condensation can be reduced with fans and by decreasing the humidity of crawl spaces with adequate ventilation.

When mold and decay occur, the problem is either water conducting dryrot or dryrot growing on wet wood. Water conducting dryrot feels leathery and can often be peeled off in sheets. The other form of dryrot feels powdery or stringy. The only way to get rid of molds and decay fungi embedded in

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wood is to remove the piece. Frequently extracting a rotted structural piece can be an expensive proposition. Prevention is far cheaper.

A common source of dryrot is wood decks. Wood decks should be constructed of either cedar, redwood, sunwood or pressure treated lumber which all resist dryrot. The deck should have at least a 1/2" air gap between it and the siding that allows water to run down between. The deck should have positive drainage away from the building. The deck door should have proper flashing to prevent water intrusion. Indoor/outdoor carpet should be removed from the deck during the rainy or winter season since it traps moisture and promotes dryrot.

Windows and doors are a prime location for dryrot due to improper flashing and caulking. They all should have drip flashing over the top edge and proper caulking around all edges. Where there is more than a 1/4" gap, backer rod (flexible foam rope) should be laid into the gap and then sealed with a high quality silicon caulk.

Another major source of water intrusion that promotes dryrot is improper "kick-out" flashing. Kick-out flashing is found near the rain gutter where the roof meets a vertical wall. It "kicks out" rain water which runs along the vertical wall that would often miss the gutter and run behind the siding and get trapped in the wall. Missing kick-out flashing can cause huge dryrot damage. Have a competent roofing contractor check your roofs for proper flashing.

Finally, do an annual inspection of all siding, trim and decks to detect dryrot in its early stages. Since it spreads like cancer, the sooner you remove it, the less costly the correction. Deterrent is the best policy when it comes to dryrot. Declare war and never, never, never, never, never, NEVER give up.

By *Richard Thompson* - www.Regenesis.net **APRA**

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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 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 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, resolutions cannot amend or change the meaning of the governing documents, only expand 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 owner 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 enforcement 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 going and why am I in this handbasket?" Safeguard your HOA's appearance *today!*

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Why Not Join APRA?

Membership in [Association of Professional Reserve Analysts](http://www.apra-usa.com) is extended to professional reserve study providers and service providers offering products and services to homeowner associations. Let APRA promote your interests.

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Case for Maintenance

One of a homeowner association's primary charges is maintaining the common elements. When done properly, the members are happier and homes sell for more (also a happy event). Proper maintenance requires consistency, planning and funding and is necessary to:

1. Protect and maintain member property values.
2. Protect the board from personal liability, and
3. Preserve legal options when a contractor fails to perform renovation properly.

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board has direct control over member home values, particularly in condominiums or planned communities with extensive common elements. How well those common elements are maintained directly affects how quickly homes sell as well as for how much. When maintenance slides, buyers (except bargain hunters) *do* take notice. Curb appeal is the number one key to home sales.

Protect from Personal Liability. One of the board's basic duties includes the duty to maintain, repair and replace common elements. HOA boards are protected by the "Business Judgment Rule", designed to protect directors from personal liability for decisions made while on the board. However, the Business Judgment Rule does not protect against failure to "*exercise ordinary and reasonable care.*"

Failure to act is no defense. The board members must act prudently to protect themselves. This issue also directly affects the effectiveness of Directors & Officers (D&O) Liability insurance. As

a wise insurance agent once said, "D&O doesn't defend against stupidity."

Preserving Legal Options with Contractors. Many builders lean toward low cost designs and materials that are quick to assemble. Speed of construction runs roughshod over quality of construction. Since one facet of construction often conceals another (framing is covered by sheeting which is covered by vapor barrier which is covered by siding which is covered by paint), haste generally means sloppy installation that has dire consequences. Most construction defects, however, don't reveal themselves immediately. It may take years.

In the meantime, the HOA is charged with proper, adequate and consistent maintenance. That means that the roof is kept clean and in good repair, the gutters are kept clear so they don't overflow, siding is recaulked and resealed periodically, etc. Failure to do these things can be used by a contractor as a defense for poor construction. If

the HOA is faithful in doing its part, the case for construction defect is easier to prove.

Does your HOA have an adequate maintenance plan in place? If not, make the case today to ratchet up and get moving. There is simply too much riding on failing the charge.

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Beginning in 2011, APRA launched formal education for professional reserve study providers, the first of its kind in the nation. APRA's annual Symposium offers 8 hours professional level education plus networking with peers.

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