

# 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 Received Now What?

You paid good money for your reserve study. So why not make the best use of it? Unfortunately, few board members take the time to thoroughly understand their reserve study. The consequences can be disastrous when making long-term fiscal decisions. It is imperative that your board designate one or more members to become familiar with the reserve study--to analyze it, study it, and fully comprehend it.

Here are three steps you should take as soon as you receive your reserve study:

### Step 1: Check for Omissions

The sooner you examine your reserve study, the better. Include the finance committee in the review process, and, if possible, the HOA accountant.

Make sure the information you conveyed to the reserve study preparer was complete and/or correctly incorporated into the analysis. At a minimum, check the following:

- Are all reserve components incorporated in the reserve study?
- Does the estimated useful and remaining life of each reserve component meet the board's expectations?
- Do the estimated costs meet the board's expectations?
- Does the reserve study accurately reflect the HOA's finances (starting reserve balance, interest rate on reserve investments)?
- Do you disagree with any of the assumptions?
- Does the reserve study show your reserve funding requirements for the next year?
- If you are underfunded and will require a special assessment to pay for reserve work, does the study indicate when and in what amount?

A reserve study should be an interactive

process between the board and the reserve study professional. Reserve study preparers typically are willing to revise a reserve study to correct omissions or do some fine tuning. For example, suppose the draft study shows that your HOA is overfunded (Oh happy day!). If the board had been postponing some noncritical expenses, such as building a playground, it could then accelerate the scheduling of such expenditures. The board can incorporate this into the final reserve study, thereby reducing surplus reserves.

Another reason for adjusting the reserve study is that replacement scheduling can be based on useful life. Suppose, for example, the reserve study preparer schedules painting next year. The board, however, may want to postpone the job for one or two more years because the paint is still in good condition. This is perfectly acceptable as long as the paint is closely examined to justify the extension.

### Step 2: Use it as a Planning Tool

Use the reserve study as part of the budget review and to schedule repair or replacement tasks to address in the next year. If funds are inadequate to meet next year's reserve expenses, you will need to levy a special assessment. Your reserve study will help determine the amount of that special assessment.

You should also use the reserve study to schedule investments for reserve funds. By understanding which years the HOA will not spend its reserve funds, informed decisions can be made about how much of the reserves can be invested for longer terms and higher yields. Laddering investments (like allocating reserves between 6 month, 12 month and 18 month Certificates of Deposits) is an excellent way to ensure that funds are available while still earning higher rates of return.

### Step 3: Distribute the Results

Distributing the reserve study to the

members provides supporting evidence for assessment increases or special assessments that may be needed due to insufficiency of regular assessments. Include:

- The estimated reserves needed to fund reserve expenditures.
- The actual amount of cash currently in the reserve fund.
- A statement as to whether a special assessment will be necessary to pay for reserve expenditures in the coming year.
- A statement describing the procedures used for calculating and establishing reserves.

If you don't understand your reserve study, you're unlikely to use it. If you follow these steps, your reserve study will be more meaningful, useful and productive. Evaluate the results, use the results and distribute the results.

*Adapted from an article by Chris Andrews - Stone Mountain Corporation*  
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## **Pernicious Contradiction**

There is a vicious rumor going around. The board is talking about raising the dues again and everyone's up in arms. They raised the dues last year! And the year before! It's time to fire up the tar

and pluck the chicken!

Ever hear this kind of thunder roll through your community? At the core of the storm is a pernicious contradiction. Members want the property taken care of but expect the board to do it on a slumlord's budget. With too little money chasing too many expenses, maintenance suffers, home values slide and livability diminishes. Yet, year after year, the Spend No Money Drum gets beaten. But it wasn't always thus.

In the beginning, when the homes were new and the future bright, members basked in the glow of their own ignorance. The developer kept the dues low and, heck, why shouldn't they be? It doesn't cost anything to maintain something that's new. Let's worry about that when the time comes. Well, the time is now, the cash register is empty, the assets worn out and recriminations abound. A special assessment! Who's responsible for this? Why wasn't money being socked away years ago? I can't pay it! I won't pay it! Where's my lawyer?

It's at times like these that outside professionals are called for. The board is authorized to hire the expertise it needs to run HOA business. HOA consultants like managers, lawyers, architects and engineers can assist the board in making its case to the members. In the case of deferred maintenance and inadequate reserves, the board should hire a Professional Reserve Analyst (PRA) to perform a reserve study. PRAs are credentialed professionals with years of experience who follow national standards developed by the Association of Professional Reserve Analysts [www.apra-usa.com](http://www.apra-usa.com) They specialize in doing reserve studies. A reserve study will consider all the repair and replacement issues, not just the urgent ones. A reserve study looks, typically, thirty years down the road and charts a course to proactively deal with these issues. The reserve study identifies priorities which the board can further prioritize according to funding.

Hiring a knowledgeable consultant to supervise each large project is a real bonus. For example, roofing projects should have a roofing consultant who can detail the scope of work, draft a

contract, gather proposals from qualified contractors, ensure that the project is done to proper specifications and get lien waivers executed. Consultant oversight ensures that the material warranty is not voided because of faulty installation. The cost of a consultant is typically only a small percentage of the total project cost. Clearly, this is an investment worth making. The same principle applies to other major projects like structural repairs, painting and landscape renovation.

Playing catch up on major repairs costs a lot of money over a short time period. In an effort to soften the blow to the members, the tendency may be to piecemeal the repairs over a number of years and break large costs into more manageable chunks. For example, instead of reroofing all twenty buildings at the same time, the board does four a year for five years. But, piecemealing causes the costs to go up significantly! When it comes to best pricing, the bigger the project, the cheaper the cost. Piecemealing renovation also creates an imbalance in member home values. If Building A gets new paint this year, those units are more attractive and valuable from a buyer's perspective than those in Building D that was painted four years ago. This inequity leads to resentment among the members that didn't get the benefit of the repairs.

To avoid these costly traps, the board should perform complete projects whenever possible. If repairs must be split up by years, do them by type, not location. If painting is to be done, do all buildings at the same time. Same for roofing. Do it all at once, minimize disruption, get it over with and save a bundle.

If your HOA is suffering from deferred maintenance, consider raising the money to do multiple projects the same year. For example, if siding needs to be replaced, those energy inefficient windows should be replaced as well. The improved livability and value increase usually far exceeds the cost so this is one of the best investments the members can make. And just consider the advantages to ending the bickering, debate and back-biting. The sooner completed, the sooner the community chest will swell with pride and past

resentment forgotten. So, recognize your HOA's pernicious contradiction when it raises its ugly head. This is one monster that's best dealt with directly and quickly. The harmony of your HOA hangs in the balance. **APRA**

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## Project Planning Protocol

Winter is the time of year that the board should be arranging and reviewing proposals for fair weather renovation projects. Painting, siding, fencing, pool replastering and roofing are but a few of the major items that fit the profile. There are several practical reasons for starting the process early:

**Contractors Are More Available.** Winter is a slow time for many contractors. This means they have the time to consider your work and produce a good proposal.

**Better Pricing.** When work is slow, many contractors are willing to offer better pricing to "seal the deal". Sometimes the work you want done can be performed during the winter months. If you agree to start the project now, you just may save a significant amount of money.

**Scheduling Preference.** If you accept a contractor's proposal now, you can often get preferred scheduling. Set the date early. If you wait you may not make the schedule at all.

**Arrange for Funds.** If you haven't accumulated enough reserve funds, you will need several months to discuss, approve and collect a special assessment.

**Coordinate with Residents.** If the project is extensive and disruptive, you will want to warn residents well in advance. This will give them the opportunity to work around or even plan vacations strategically.

**Verify License, Bonding & Insurance.** Most states require building contractors to be licensed and to show their state license number on proposals, website and business cards. Where licensing is required, a bond is often required as well as well as certain kinds of insurance like liability and workers compensation if the contractor has employees. Insist on evidence of this.

**Get References.** Only use contractors that have a proven track record. Make sure the references are for work that is comparable in size and complexity to yours. It is not uncommon for small contractors to get in over their head. Require evidence that they have performed similar work for other homeowner associations.

**Get Named as Additional Insureds.** Insist on getting a current copy of the contractor's liability insurance coverage directly from the insurance agent. If you accept the proposal, require that the HOA be included on this insurance as an "additional insured" and get an appropriate and current insurance certificate from the contractor's insurance agent to prove it.

**Make Progress Payments.** Do not make advance payments on the project work unless there are custom materials involved. If there are custom materials, pay the material provider directly and have them delivered directly to the site. A contractor that insists on up front payment is often a red flag of a contractor that may be using your money to pay for some other job's labor or supply bills. You could be left high and dry with uncompleted work. Instead, use progress payments that pay for work actually completed. Be sure to inspect the work to verify completion.

**Consider Paying for a Performance Bond.** For large and expensive projects, requiring a Performance Bond provides assurance that the contractor will perform, or, another contractor can be hired to finish the job. It costs extra but is often worth it.

**Get Lien Waivers.** When making payments, have the contractor provide a Lien Waiver for the amount tendered. A Lien Waiver is the contractor's promise that he has paid for all labor, material and supply bills related to the work to date. Keep in mind that if your contractor "forgets" to pay his suppliers or subcontractors and material suppliers, those folks have the right to place a mechanic's lien on the property to secure their debt. It's a good policy to require copies of all paid supply, material and labor bills be attached to and referenced in the signed Lien Waiver.

For substantial projects, it's important to involve an attorney who can draft or review the contract. There's a lot riding on what the board is obligating the HOA to. There is much planning involved in rolling out a successful renovation project. Forget the leap of faith on this one. The safety net just may not be there when you land. Get a jump on your renovation projects and get a quality job done on schedule and at the best price. **APRA**



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## Creating a Nest Egg

Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac) and Federal Housing Administration (FHA) underwrite most of the residential mortgage loans lenders make and set the standards those loans must

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meet. Underwriting guidelines enacted in recent years require lenders to verify every condominium loan made that the HOA contributes at least 10% of its annual budget to reserves.

In HOAs that don't comply, owners may have trouble refinancing or selling their unit. To ensure that this doesn't happen, boards that have avoided the reserve fund question in the past now have to address it. The elephant in the room is about to take a seat at the table.

Here are some best practices:

**You Need a Plan.** Homeowner associations need a plan for funding and managing their reserves, and the first step is to commission a reserve study. A reserve study will identify all the major common element components, estimate their useful life, and project the cost of repairing or replacing those components when the time comes. The goal is to make sure that when it's time to replace the roof or the HVAC system, you will be able to pay for it out of reserves rather than obtaining a bank loan or levying a special assessment on owners.

But keep in mind that even the best

reserve study has its limitations. While it predicts likely useful life spans and replacement costs, it can't guarantee either one. A reserve study is based on assumptions that change over time. The climate, weather, soil conditions, maintenance, design and construction quality play a role in the aging process, causing some components to age differently than expected. The financial climate is also variable. Investment earnings and the inflation changes from day to day. To keep the reserve study accurate, industry experts recommend (and state statutes often require) that the reserve study be updated annually.

**How Much Do You Need?** The reserve study will estimate how much money is needed for future projects and when the funds will be needed. Fannie Mae and Freddie Mac want to see a minimum of 10% designated for reserves in the budget. But that formula will produce different results in different homeowner associations since common elements vary. For the typical garden style condominium, it is necessary to reserve at least 25-35% of the annual budget to meet future needs. So, while 10% is better than nothing, you should follow the funding

recommendations of the reserve study which will likely be much higher.

**Communicate with Owners.** For HOAs that are not currently contributing enough to reserves, the solution is to start contributing more by increasing the monthly fees. The board can easily justify the increase by pointing out the new mortgage lending requirements. In other words, there is no choice. Owners must fund the reserves because it will be difficult to buy, sell, or refinance a unit if they don't. Once the reserve study is completed, provide owners with a copy and encourage them to read it. Hold a special meeting and invite the reserve study provider to explain it. Make sure owners understand the reserve funding schedule and emphasize the relationship between the reserve level and property values. It is not just lenders that will be scrutinizing the HOA's finances. Increasingly savvy buyers will be scrutinizing them as well.

**Don't Commingle Funds.** Reserves should not be used to pay for ongoing maintenance and repairs. Those should be paid out of the operating budget. Reserve funds should be kept in an

APRA offers the Professional Reserve Analyst (PRA)<sup>™</sup> credential to members that qualify by related education, years of experience and client references.

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

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# APRA

Association of Professional Reserve Analysts

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account separate from operating funds. Typically, the portion of HOA fees earmarked for reserves is swept each month into a separate account. Only reserve related expenses should be paid for out of this special account.

**Borrow Reserves Funds Prudently.** Only borrow from reserves in an emergency or because of seasonal high expenses (like the insurance premium comes due early in the year and not enough fees have accumulated yet to pay it). If you must borrow, document the board vote approving that decision, establish a reasonable repayment plan and stick to the plan.

**Develop a Reserve Investment Plan.** Reserve funds are typically placed in FDIC insured savings accounts, money market accounts and Certificates of Deposit. Most state laws don't have specific reserve investment standards for homeowner associations. The governing documents usually give the board investment discretion. Boards should develop a written investment policy that defines the investment goals, establishes the objectives against which the investment performance will be measured, and identifies the boundaries within which investment selections will be made.

The investment policy should include:

- Keep the reserves safe (don't risk the principal).
- Preserving earning power (choosing investments that at least match the inflation rate).
- Ensure that the funds are available when they are needed.

Other issues to consider include:

- Consider working with an investment professional.
- Remember that this is OPM (Other Peoples' Money). Tread carefully.
- Document the investment decisions in meeting minutes.
- Diversify the investments (savings, CDs, etc.)
- Focus on liquidity. Industry experts recommend holding 5%

of reserves in cash for emergencies, another 10-15% in short term (six months or less) securities and the rest spread among varied investments with varied maturities.

- Don't overlook the earnings potential of your operating funds. If they aren't in an interest-earning checking account, they should be.
- Review your investment strategies annually to make sure they still match near and long term goals. Don't let cyclical changes in the market alter the investment strategy which should remain long term.

Some boards may perceive the new lender requirements as an unwelcome burden. But maintaining adequate reserves has always been part of the board's fiduciary duty to preserve the investment owners have made. The new rules haven't created that obligation, but they force boards that haven't done so to make reserve funding a priority.

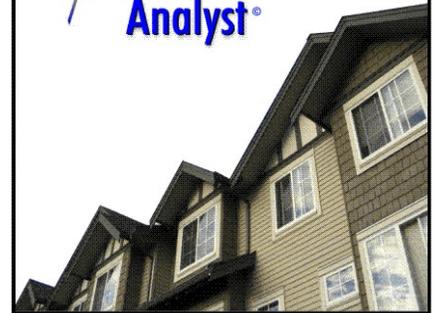
*Excerpts from an article by Nena Groskind of CondoMedia*  
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### APRA Institute Webinar Series

APRA proudly offers its 2012 Webinar Series to those holding the PRA credential for continuing education credit, other reserve professionals, HOA boards and managers. Each webinar is 90 minutes and features cutting edge information presented by nationally recognized experts. This year's webinars include:

**The Word of HVAC.** Russell Keeler PE reviews typical

high rise heating and cooling systems, their life expectancies, costs and maintenance protocols.

**APRA Standards Review.** Association of Professional Reserve Analysts adopted national standards for reserve studies in 1995. Rob Forney PRA presents APRA's recently adopted Standards of Practice which expand on APRA's original concept. This is a must for reserve study professionals.

**Deck Design, Materials & Red Flags.** The Deck Expert Bill Leys discusses the good, the bad and the ugly about decks.

**Seeing Beyond the Glare of Eco-bling.** Green building architect Peter Pfeiffer discusses ways to improve energy efficiency and reduce energy consumption.

For dates, times and registration details, go to [www.apra-usa.com](http://www.apra-usa.com) and click on APRA Webinars. Special discounts apply for APRA Members. **APRA**

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## Beautiful Barriers

Robert Frost's poem Mending Wall explores how people with different temperaments and territorial natures are able to cooperate and work together. He sums it up with "Good fences make good neighbors". In common wall homeowner associations, this observation resonates loudly. HOA barriers abound in a plethora of options including chainlink, brick, stone, wood, stucco, vinyl, concrete and siding.

Besides the visual differences of these barriers comes practical considerations. In common wall communities like condominiums, the HOA is responsible for the maintenance, repair and replacement of such structures. Materials like chainlink are inexpensive, have a long life and low maintenance, but aren't very attractive and don't afford privacy. Sided walls are expensive to build and maintain and are subject to dryrot in wet climates.

There is a great alternative which is attractive, low maintenance and long lived called the "Good Neighbor Fence" (Frost would be proud). This fence is built of redwood or cedar and pressure treated wood (all rot resistant) with alternating boards on each side so that the fence looks the same on both sides. The open weave design blocks views but allows air to pass through for ventilation. This design also reduces the effects of high wind that could damage or blow the fence down.

Leaving the fence unpainted has a number of advantages since painted fences peel and need frequent touchup and repainting. Also, painted wood fences do not last as long as an unpainted Good Neighbor Fence. Cedar or redwood will last 15 to 25 years when properly built and left unpainted. Clear sealer can be applied to help retain the wood color but this does nothing to extend its life. As with any wood fence, the fence boards should have at least 6" clearance from the dirt.

The Good Neighbor Fence looks great, is ideal for replacing other types of fences and costs \$25-30 a linear foot. Based on looks, price and durability, this is a seriously beautiful barrier.

**APRA**

## Riding a Dead Horse

Indian tribal wisdom says that when you discover you are riding a dead horse, the best strategy is to dismount. However, in modern organizations, new "improved" strategies have been developed:

- Buy a stronger whip
- Change riders
- Say "This is the way we always have ridden this horse"
- Appoint a committee to the study the horse
- Arrange to visit other sites to see how they ride dead horses
- Modify the standards to include riding dead horses
- Create training sessions to improve riding ability
- Compare the state of dead horses in today's environment
- Pass a resolution declaring: "This horse is not dead"
- Blame the horses' ancestry
- Harness several dead horses for improved performance
- Declare that "No horse is too dead to beat"
- Provide funding to increase the horse's performance
- Do a study to see if a contractor can ride it cheaper
- Declare the horse is better, faster and cheaper dead
- Form a committee to find uses for dead horses
- Revisit the performance requirements for dead horses
- Elect the dead horse to Board President

*From an anonymous but very wise source. **APRA***

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