

# APRA Advisor

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PUBLISHED BY THE ASSOCIATION OF PROFESSIONAL RESERVE ANALYSTS

MAR-APR 2010

**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**.

## The Great Siding Debate

The primary purpose of a reserve study is to provide a funding and scheduling plan for capital repairs and replacements. Building finishing systems or siding like stucco, wood and vinyl are often excluded from reserve studies under the assumption that they have useful lives longer than the standard 30 year projection period. While properly installed siding should have at least a 50 year life, homeowner associations built in the 1960s and 1970s are now faced with total siding replacements at \$5,000-\$15,000 per unit average.

Siding manufacturers have come a long way in providing an improved product and superior warranties for the materials, which affords some assurance of protection. However, there are many factors that affect the performance and useful life of a siding material or building finishing system.

**Stucco.** Stucco systems rely heavily on the adequacy of the initial installation. An improperly installed system can lead to moisture trapped behind the weather barrier, causing leaks, mold and structural damage. Improper detailing can also cause surface cracking. Careless applications can result in improperly fastening the insulation board or lath, misinstalling

the reinforcement mesh, not installing the proper thickness of material, or by improperly flashing building windows and adjoining building materials. These failures all reduce the useful life of the finishing system.

**Wood Siding.** Wood siding requires continued maintenance or replacement over time. It is important that deteriorated sections of the siding are replaced prior to staining or painting. Some wood siding installations have too much exposure to sun or weather or a very thin thickness. The result is splitting, cupping and failure. Other types of premature failure include fasteners that have rusted, inadequate or missing and voids through knotholes or splitting. These conditions permit water penetration and structural dryrot.

**Vinyl & Aluminum Siding.** As with any material, vinyl or aluminum siding requires periodic maintenance to avoid water infiltration. In addition, periodic cleaning (power washing) should be planned for. Deficient fastening of the siding may cause additional warping in some sections. Periodic inspections of the siding's weathering abilities should be made and compared to the warranty.

Unfortunately, installation defects or material deficiencies are not obvious to most homeowners or lay people. Ideally, a homeowner association should have a thorough building inspection done at developer turnover. Particularly with new construction, developers must warranty the construction for up to ten years although the statute of limitation for such repairs varies from state to state. Once the statute of limitation has run, an HOA is left to execute and pay for such repairs or replacements.

If your HOA is on its own:

- Have the siding system checked by a qualified building inspection service for condition and installation detail.
- Review leak history that is associated with siding and windows.

- Incorporate any recommended repairs into the HOA's preventive maintenance plan. Proper and continued maintenance and repair will prolong the useful life of any system. And,
- Get an estimated remaining useful life assessment. If that number is 30 years or less, siding replacement should be added to your reserve study. Since it is likely to be the most expensive component on the reserve study, the sooner it is planned for, the sooner the funds will be accumulated and available to actually get the work done. **APRA**

## 2010 Symposium

The 2010 APRA Symposium will be held in exciting Las Vegas on May 1<sup>st</sup> at Caesars Palace, the same week and venue as the Community Associations Institute National Conference. Learn cutting edge reserve study techniques and network with peers. All reserve study professionals are invited to attend.

To register, **CLICK HERE** or email [apra@teamwi.com](mailto:apra@teamwi.com)

## Reserves: The Reasons Why

It seems that homeowner association boards are being barraged by issues that weren't even considered a few years ago. Construction defect litigation related to water intrusion has mushroomed (pun intended) and lawsuits related to financial



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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 homeowner associations 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..."

And it's not just state statutes. In December of 2007, Fannie Mae and Freddie Mac, the two home mortgage loan underwriting entities that have accounted for a large percentage of condominium loans, enacted requirements for all condominiums in every state to have a formal reserve study with a minimum contribution of 10% of the annual budget. Failure to comply will cause the loan application to be rejected either for a sale or loan refinancing.

In December 2009, FHA enacted new underwriting requirements for condominium loans. As one of the few alternatives left to buyers looking for low down payment options (less than 20%), FHA has become a major player in the mortgage market. FHA's requirements for condominiums where

it insures loans to include a reserve study no more than 12 months old and evidence that at least 10% of the annual budget is being placed in reserves.

So, where state statutes are lacking, lender requirements have turned up the heat. Condominiums that do not comply severely limit mortgage loan options which have a direct bearing on property values and the ability to sell. Boards that fail to respond to these mandates risk being sued by unit owners who can't sell their units. 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 a homeowner association'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.

Excerpts from an article by John P. Poehlmann of Reserve Advisors. For a list of qualified reserve study professionals, see [www.apra-usa.com](http://www.apra-usa.com)  
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While a reserve study may or may not be required by state law or the HOA's governing documents, no HOA should be without one. Properly maintaining the common elements directly affects the livability and market value of the owners' homes or units.

Each year, the reserve study needs to be reviewed and revised for accuracy. The reserve fund balance, inflation rate and investment rate always change. Any reserve events that actually take place should be amended for price and particulars. Any known cost changes need to be revised. Going through this exercise and reforecasting the 30 year projection ensures that the board always has the best information available and that reserve contributions are keeping pace with costs.

One way of funding reserves is by special assessment. Basically, when money is needed, current members pony up the money. Several complications exist with special assessment funding:

- 1. Owner Vote Might Be Required.** The board may not have the authority to approve a special assessment and must obtain a vote of the members. It is not uncommon for the level of vote needed to be quite high, like 2/3 or 3/4 of all members. This could make getting approval for a special assessment extremely difficult.
- 2. They're Unfair.** A special assessment impacts only current owners, regardless of time in ownership. So owners that have not enjoyed the facilities are forced to pay for those that have benefitted but have sold their property.
- 3. Hard to Collect.** At any given point in time, a certain number of members are unable to pay a special assessment due to divorce, job loss, disability, illness or other valid

## The Cure for Short Term Thinking Syndrome

Maintaining the common elements is a core purpose of every homeowner association (HOA). Those common elements can be as simple as an entry monument or as involved as siding, painting, roofing, landscaping, pools, paving and much more. All of these components wear out at some point and must have substantial repair or replacement. The costs are high and funds must be accumulated to address those costs. All of this needs thoughtful advance planning which is summarized in a Reserve Study.

A reserve study identifies the common elements that the HOA is responsible to maintain, the life expectancy of each component and a current repair or replacement cost. This information, when combined with the current rate of inflation and return on invested funds over a projection period of, normally, 30 years will produce an annual contribution amount adequate to meet those future costs. By collecting reserve contributions monthly (normal for a condominium), costs are fairly distributed among the owners that benefit. Whether an owner is long term or short term, the amount of individual reserve contribution is directly related to the individual benefit received.

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

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reasons. The result is the same: cashflow problems for members mean cashflow problems for the HOA. The HOA can file a lien but that doesn't mean the money comes when needed.

Another challenge to getting a reserve study done or funded is **Short Term Thinking Syndrome (STTS)**. HOAs with large numbers of seniors often have little interest in investing in long range planning. Many members see reserves as paying for a benefit they will not enjoy. The truth is reserves pay for assets as they are being used up. When collected monthly, reserve contributions merely pay for what the current residents got the benefit from. Paying into reserves is like refilling the gas tank of a rental car. You only put back what you used. If your HOA suffers from STTS, point out the reality of what is happening. Most of these folks want to be responsible and will cooperate when the reality is explained.

Reserves in a homeowner association are an absolute must. Having the right amount of funds and a reliable schedule for getting the work done is a fundamental that no HOA board should be without. The **Association of Professional Reserve Analysts** is the nation's leading trade organization for reserve study professionals who carry the coveted PRA (Professional Reserve Analyst) designation that denotes years of experience and expertise. See [www.apra-usa.com](http://www.apra-usa.com) **APRA**

## 2010 APRA Member Recognition

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

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John Kirk **PRA**  
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