

APRA Advisor

Association of Professional Reserve Analysts 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**.

A Case in Point

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.

Maintaining Property Values. The 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 #1 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. What if the Board ignores that charge? HOA Boards are protected by the "Business Judgment Rule", a legal theory 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 Liability insurance. As a wise insurance agent once said, "D&O doesn't defend against stupidity."

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Preserving Legal Options with Contractors.

Many builders lean toward low cost designs and materials that are quick to assemble. Speed of construction can run roughshod over quality of construction by lack of proper detail. Since one facet of construction often conceals another (framing is covered by sheathing which is covered by vapor barrier which is covered by siding which is covered by paint, etc.), 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, siding is recaulked and renailed 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.

IN THIS EDITION

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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. [APRA](#)

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Ask the Reserve Analyst

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 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](#)

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reserves can reduce owner contributions by thousands of dollars over time. While your friendly banker always has some investment options available, the Board should explore other options for higher yielding instruments. (See www.bankrate.com for options in your location.)

Because of fiduciary concerns, the Board should usually only invest in guaranteed and insured investments unless the membership votes to be more aggressive. In either case, there should be a clear and written investment policy for the Board to follow. FDIC Insurance is limited to \$100,000. But some banks catering to homeowner association business have additional private depositor insurance that protects a much larger amount of HOA funds. While this addresses the depositor insurance question, the Board still needs to consider whether the bank offers the best rates.

One of the greatest pitfalls of reserve fund investment is losing track of yield because it's out of sight, out of mind. Interest yields ebb and flow. Currently, savings and money market rates have fallen to historic lows. But that will change at some point so having a reliable investment tracking system is important to ensure that the return on reserves stays as high as possible without risking principal. There are free online investment portfolio trackers available at [Motley Fool \(www.fool.com\)](http://www.fool.com) and [Morningstar \(www.morningstar.com\)](http://www.morningstar.com) for those that like to self manage. Or, if your HOA has been blessed with substantial reserves, hiring a financial advisor to track investments and advise the Board makes sense.

If your homeowner association's reserve fund and investment plan have been out of sight, it time to expose them to the light. Growing reserves mean good stewardship and is one of the Board's highest callings. **APRA**

*Failure to plan is
planning to fail...*

Growing HOA Reserves

In recent years, the importance of accumulating reserves has dawned on many HOA Boards and Managers. Proper reserve planning drives an HOA's ability to adequately care for assets by having both the funds and a maintenance schedule to follow. A well executed reserve study calls for a funding plan that systematically grows reserves to address future repairs and replacements without the need for special assessments.

As a rule of thumb, the average garden variety condominium should have around \$3000-\$6000 per unit in reserves, depending on amenities. There are many HOAs that should have much more than that because of deferred maintenance or extensive common elements. Even the most modest properties should have tens of thousands of dollars socked away in reserves. Larger, more complex properties should accumulate reserves in the millions. To truly know what level of reserves applies, a reserve study should be performed by an experienced and qualified Professional Reserve Analyst. (See www.apra-usa.com for a list.)

As reserve funds grow, it's extremely important that the Board have an investment plan. Wisely investing



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Snapshot in Time

Summer storms and winter winds not only damage communities, they also wreak havoc on the accuracy of an HOA's reserve study. Freezing weather, rain, tornados and hurricanes can accelerate the end of common element useful lives...and sometimes there is no insurance to restore them. Paint may start peeling prematurely, roofs may be missing shingles and fallen tree limbs may have damaged common areas.

Repairing or replacing this kind of unforeseeable damage can quickly alter the outcome of even the best reserve plan. When it happens, the need to update your reserve study is critical so that the impact can be amortized over future years if possible.

A reserve study identifies the HOA's future repair and replacement financial needs as of a specific date. It is a "snapshot in time". From that snapshot, the reserve study predicts a schedule for addressing each component included in the study. Those predictions are based in averages and warranties. For example, in the Pacific Northwest, properly applied paint lasts an average of 6-8 years. The same paint in a dry climate has an average life of 8-12 years. Some



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components, like roof composite shingles, come with material warranties that can be used as useful life guidelines. However, many site conditions can diminish that life expectancy (improper installation, tree cover, moss accumulation, wind, etc.)

Component lives are affected by both the controllable and uncontrollable. Hurricanes are uncontrollable. But regular maintenance is controllable and an HOA's responsibility. Those that perform it well can expect longest component lives, while those that do it poorly will experience premature component failure. The cost of preventive maintenance is a fraction of the cost of premature component failure due to lack of preventive maintenance.

So, for both controllable and uncontrollable reasons, reserve studies need to be reviewed each and every year to ensure that the original assumptions are still valid. If the roof, for example, has not been maintained well, the update may indicate a 20 instead of a 30 year useful life. If the price of oil has gone up 50%, the price of oil based products like roofing and asphalt will too. Adjust accordingly.

Another reason to update the reserve study is the advent of new and improved technology and materials. If a superior replacement is available that

will offer better service and/or lower cost per year, the study should include that information for future planning purposes.

Examining the investment strategy is a critical reason to perform annual updates. Over the 30 year projection period, a difference in investment return of one or two percentage points can amount to *hundreds of thousands of dollars* over the period. Keeping most reserves in higher return investments can have a profound and positive impact on owner contributions.

And don't forget about the effect of inflation. Whether it is small or large, it erodes the buying power of the reserve fund. Even if there was no change in any other aspect of the reserve study, it's absolutely necessary to adjust the contribution level to compensate for the current rate of inflation.

Ideally, all reserve study updates should include a site visit by the reserve study analyst. Visual inspections can tell a lot about the useful life predictions. It may cost a bit more, but in all cases, the cost is well worth it. [APRA](#)

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"Hello and welcome to the Mental Health Hotline."

- ⊗ If you are obsessive-compulsive, press 1 repeatedly.
- ⊗ If you are co-dependent, please ask someone to press 2 for you.
- ⊗ If you have multiple personalities, press 3, 4, 5 and 6.
- ⊗ If you are paranoid, we know who you are and what you want. Stay on the line so we can trace your call.
- ⊗ If you are delusional, press 7 and your call will be transferred to the Mother Ship.
- ⊗ If you are schizophrenic, listen carefully and a small voice will tell you which number to press.
- ⊗ If you are a manic-depressive, it doesn't matter which number you press, no one will answer.
- ⊗ If you are dyslexic, press 6969696

- ⊗ If you have a nervous disorder, please fidget with the # key until a representative comes on the line.
- ⊗ If you have amnesia, press 8 and state your name, address, telephone number, date of birth, social security number, and your mother's maiden name.
- ⊗ If you have bi-polar disorder, please leave a message after the beep, or before the beep, or after the beep. Please wait for the beep.
- ⊗ If you have short-term memory loss, press 9. If you have short-term memory loss, press 9. If you have short-term memory loss, press 9. If you have short-term memory loss, press 9.
- ⊗ If you have low self-esteem, please hang up. All operators are too busy to talk to you. [APRA](#)

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