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COMMON INTERESTS

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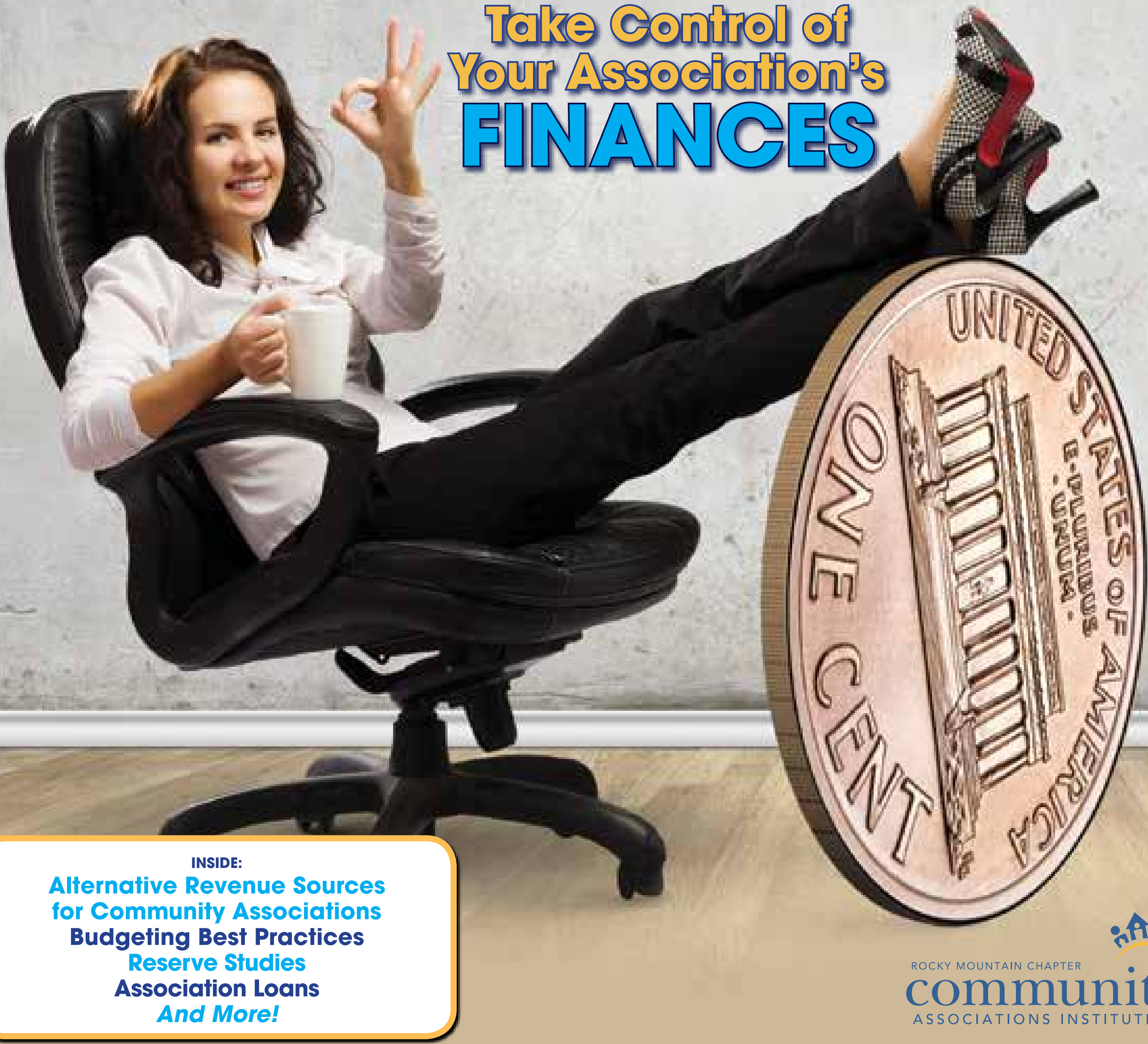

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COMMON INTERESTS is a publication of the Community Associations Institute, Rocky Mountain Chapter.

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Baby Einstein's Creator

Julie Clark

Julie Clark wants to live in a world where work is for fun, cookies are for breakfast and the most frequently heard sound is children laughing. She's a mom, a teacher, the creator of Baby Einstein and the founder of a brand-new company called WeeSchool. Considered one of the first mompreneurs to make it big, Julie has been featured on shows like Oprah and Good Morning America, in print pieces that include People magazine and USA Today, and as a keynote speaker for organizations including the Harvard Business School and Microsoft. Julie is passionate about early childhood education and women in business.

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Special Assessments

What's So Special About Them, Anyway?

Gina C. Botti
Winzenburg, Leff,
Purvis & Payne, LLP

The Colorado Common Interest Ownership Act ("CCIOA") does not define the term "special assessment" or address when or how a special assessment may be levied. So, what is a special assessment and when can a special assessment be levied?

We know common expense assessments are based on a budget adopted no less frequently than annually by the association. Generally speaking, a special assessment is an expenditure or liability, such as a capital improvement, that the association has not budgeted for either in its annual budget or in its reserves. Special assessments allow associations to meet or cover an unanticipated budgetary shortfall.

A good example of this is when the community is devasted by a hail storm and the roofs are damaged. This is not something the association would typically budget for annually, as it's unknown when or if a hail storm will occur. If the association is hit with paying a high insurance deductible and the association does not have the funds in reserves, the association may need to special assess all of the owners to cover the costs for the insurance deductible.

Before doing so, however, the association should look to its declaration and bylaws to determine if the authority to special assess exists; the authority and procedure is always document specific. An association may exercise its powers only in compliance with the authority and procedures outlined in its declaration or bylaws. The association should look at its documents closely as there may be an owner vote requirement to specially assess. If the association's declaration and bylaws are silent, or specifically prohibit the board from levying special assessments, the association may not levy a special assessment and may need to look at other options to pay the costs, such as taking out a loan, or assessing only those owners who benefit from the expense as an individual purpose assessment if the declaration or bylaws allow. The association may also want to consider amending its declaration to provide the authority to specially assess.

The association should also weigh the priority of its maintenance obligations as part of exercising its reasonable business judgment. For example, if the limited common element balconies are in need of painting, but the railings are falling off, the safety concerns of the railings should take precedence over the painting for any special assessment obligation.

The association should also determine if the special assessment will come due all at once, or if an owner will be permitted to pay the assessment in installment payments. If a special assessment is not paid by an owner, the association should follow its collection procedures as it would any other unpaid assessment.

The ability to special assess owners to perform the maintenance obligations under the declaration can save the association the expense of paying interest on a loan and deferring projects that are needed in the community.

If your association does have the ability to special assess, I guess that makes you special!

There is so much more to this conversation than we could write in such a short article. Let's continue the conversation at our forum later this year and on our Latest News tab on our website www.denvercoroofers.com—6145 Broadway Suite 2, Denver, CO., 80216, (720) 309-9722.


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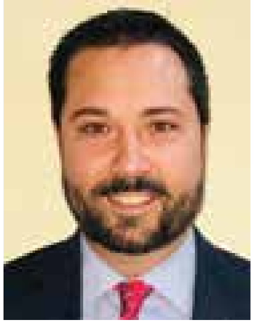
Alternative Revenue for Community Asso



Stephane Dupont
Dupont Law Firm, LLC

Budget season is still far away for most community associations, however, it is never too early to address how an association can improve its ability to meet current and future financial needs. While regular assessment fees account for most of an association's annual revenue, the financial health of an association can be improved if it thinks 'outside of the box' and considers non-traditional means of obtaining additional income to keep annual assessment fees low and ensure that maintenance and improvement projects are completed.

Maximize Current Income

Before considering alternative methods for raising association funds, it is not a bad idea for an association to look at how it can maximize its current income stream. First, an association should ensure that collection of assessments are diligently pursued against delinquent owners. To that extent an association should ask whether it is timely following the process in its collection policy and turning matters over, as necessary, to legal counsel or a collection agency.

Next, if an association has a clubhouse, meeting room or other area that can be utilized by its owners, an association may consider actively promoting the space for rental by its members and their guests for a reasonable charge. A rental agreement should be drawn up so that there is no confusion surrounding the rights, responsibilities, and liabilities of the association and owners.

Sources

ciations

Finally, an association may determine if it can save resources by renegotiating existing vendor contracts. This not only involves locating high quality and reputable, lower cost vendors but also cutting back on services that an association may not be utilizing or realizing much benefit. For example, an association could consider cutting back web hosting services if it rarely updates its website and communicates primarily to owners by newsletter or written correspondence.

Finding New Income Streams

One of the most common ways that a common interest community can generate additional revenue for their membership is through advertisements. An association can start a monthly, electronic or paper newsletter or newspaper that is disseminated to all residents in the community and offer advertisement space for sale to both residents and local businesses. Especially in a larger community, many local businesses are readily enticed to reach out to a wide audience at a fraction of the cost of traditional marketing. If these options sound too time consuming, an association can consider selling ad space on community bulletin boards, common areas, or on its website.

"…the financial health of an association can be improved if it thinks 'outside of the box' and considers non-traditional means of obtaining additional income…"

If a community does not mind the potential eyesore and there is available space, many telecommunication providers demonstrate interest in installing cellular towers in communities. The amount of income generated is contingent on the location of the towers. Typically, a lease agreement is executed with the provider for a specified number of years and an easement may also need to be drafted and provided. Given the potential complexity of the agreement, it is important that it be drafted and/or reviewed by legal counsel. It is also recommended that the proposed lease be first discussed with the membership as health and property value concerns are frequently voiced when this income option is proposed. Most of these concerns can be overcome by pointing out the financial benefit to homeowners and further pointing out the potential improved cellular service in the community.

Some common interest communities may also be fortunate enough to be able to sell or lease oil, gas, mineral, or water rights to generate additional revenue. While it is unlikely that an association is 'sitting on a gold mine,' thousands of dollars can be earned annually from these valuable resources if a proper agreement is put in place.

Finally, an association should consider either hosting or sponsoring events in their community. Many associations host annual barbecues. Consider making the event more attractive for residents to attend by providing live music or activities for children such as a bounce house or face painting. The event can be promoted as a fundraising activity for the community with a reasonable admission fee. Obtaining sponsorships for events can also lead to additional revenue generation in a community. For example, a community located on a golf course could consider hosting a golf tournament and obtaining sponsorships. If you live in a rural community with stocked fishing ponds, how about hosting a fishing tournament? The ideas are endless and limited only by the ingenuity and creativity of an association.

As there may be potential tax implications or insurance related issues with some of the suggestions above, it is a good idea for an association to conduct its due diligence before implementing any potential new income streams.

Stephane Dupont is the managing member of The Dupont Law Firm, LLC and has been practicing community association law since 1999.

BUDGETING

Best Practices

Janet Watts, CMCA, CAM

I have had the pleasure of participating in CAI designation courses, continuous education classes, and have ten plus years of experience as a community association manager (CAM). I introduce myself this way to give you a little of my background when working with Boards of Directors in homeowners' associations. With that said, I have witnessed many strategies upon entering budget season.

In my opinion, there are two primary types of Boards. There are Boards that are intimately involved with every step of the budget planning process and there are Boards that rely on their community manager to draft a proposed budget. Let's dive a little deeper:

Boards that are intimately involved:

The Board will review proposals/bids for budget planning next year's "wish list" projects, analyze the current year financials, review service contracts, research utility rate increases, possibly survey the community for input, and review the governing documents, primarily to confirm any increase "caps" that may be imposed.

Boards that rely on management to draft a proposed budget:

The Board will request a proposed drafted budget from the manager, review the line items, review the service contracts, discuss what goals they may have the community for the coming year, vote to make minor adjustments, elect to raise the dues or not, and approve the budget.

From a community association manager's (CAM) perspective, I have found that the best practice is to help guide the Boards in planning future budgets using a variety of tasks and action items. There are so many tools for a CAM to rely upon such as the HOA's monthly expense reports, reserve studies, reserve fund balances, and investments. We also rely upon any upcoming laws that may affect future expenditures. Industry professionals and contractors are also resources as they provide information about any increases in costs (i.e. insurance policy premiums, green roof requirements, bench marking, etc.)

Monthly Expenses: Monitoring the monthly expenses is a fantastic way to begin the annual forecast for year end expenditures and what to expect for the upcoming year. This also gives you the ability to ensure service contract costs are within line and discuss present trends and future needs for the community with the contractors. This also insures that the costs the HOA is paying is in line with the agreed amounts in the service contracts.

Reserve Studies: When discussing budget planning with your Boards, it is important to review the HOA's reserve study. The study is such a great tool to use in guiding Boards for the purposes of reviewing and assessing the needs of needed major capital repairs, preventative maintenance, and improvements. The reserve study also gives the Board an opportunity to plan goals one, three, and/or five years out when considering major repairs, replacements, and preventative maintenance (i.e. roof replacements, painting, balcony upgrades.)

"While CAMs do not have a crystal ball that can see into the future, utilizing the tools and resources mentioned above will help a CAM guide and direct their Boards with confidence. Remember, a budget is a guide and a tool."

Reserve Fund Balances and Investments: Whether you are managing an aging community or a community that is freshly turned over from the developer, a CAM should ensure the Board is budgeting to contribute to the reserve funds annually. The Board and CAM should work together in vetting the best investment options to help the reserve funds increase. If an HOA has a 60% - 100% funded reserve balance, it is much easier to fund for planned preventative maintenance, repairs, and planned improvements.

Industry Professionals, Contractors, and Utility Service Providers: CAMs and members of the Board should solicit advice from industry professionals on: anticipated service contract rate increases (if applicable), annual consumer price index (CPI), insurance policy premiums, utility rates, etc.

While CAMs do not have a crystal ball that can see into the future, utilizing the tools and resources mentioned above will help a CAM guide and direct their Boards with confidence. Remember, a budget is a guide and a tool. Educate your Boards in anticipating unexpected expenses and plan accordingly. Evaluating past and current performances, as well as identifying successful spending will set a successful budgeting strategy with your associations.

What to Expect When You're Collecting

A Primer on Tools for Your Community Association

Ashley M. Nichols
Cornerstone
Law Firm

Assessments are the cornerstone of an association, and the necessity of an association to collect delinquent assessments is of utmost importance—an association cannot be run without assessments being paid! According to a study conducted by CAI in 2016 (released in October 2017), 5% of owners in community associations were delinquent on their accounts. With 21.3% of the populations residing in community associations (approximately 69 million people), that means that nearly 3.5 million owners are delinquent at any given time.

Leading into summer, many associations could bet on many delinquent owners bringing their accounts current. Why? No cash, no splash. However, as we near the end of our pool days, how can an association ensure that it is efficiently, and effectively, collecting from its delinquent homeowners? Speaking of restricting access to amenities, does your community have a clubhouse, fitness center, or sport court? While it may not bring in as much cash as pool access might, restricting access to other community amenities (if provided for in your governing documents) can be a potential solution to collecting past due assessments once pool season is over.

So, what are some tools that a Board can use to collect from delinquent owners? First, collect early and often. The sooner an association takes action to collect, the more likely it is to be successful. If delinquent accounts are allowed to linger and grow, continuing to incur late fees and interest, it is less likely that owners will be able to resolve the debt without legal action. Ensure that your association has a collection policy in place (it is required by law!) and that it follows the policy. Assess the time frames provided for in your documents. Can they be altered to allow collection on past due accounts sooner?

And speaking of collecting early, acceleration is a great tool to consider when looking at collection options for past due accounts. Acceleration allows a board to call due the entire fiscal year's debt against the owner's account, rather than just the current delinquency. Consider those owners who may be chronically delinquent.

For example, John Doe (it's not his first rodeo) has been consistently delinquent for years. On January 10th, the association turns the account over to its attorney for collections. The current balance due at that time is $1,000. However, the Board, due to the owner's continued delinquency, has reviewed its documents and decided to accelerate Mr. Doe's assessments for the year. At $100 per month, an additional $1,100 would be added to the balance, making the total amount due $2,100. Rather than proceeding to collect on the $1,000, the attorney can now attempt to collect on the $2,100. If it takes six months to collect, once complete, the association will still be paid in full through the end of the fiscal year. You only hope that the owner will pick up paying regular assessments at the start of the next fiscal year!

As we head into the latter part of the year, assess your documents to ensure that your community has the ability to use this tool.

So, what is the process? Every case is different based on its own set of facts and circumstances, but generally, the process goes something like the following: The first thing that must be done once an account is turned over to the attorney for collections is compliance with the Fair Debt Collection Practices Act (FDCPA), both state and federal. A demand letter must be sent to the delinquent owner. If an owner fails to respond to the demand letter, the attorney will generally move the process to the lawsuit stage. Most cases are brought in county court, where the jurisdictional limit for the court is under $15,000. Note that the legislature recently passed a bill that will increase this limit to $25,000 (effective January 1, 2019).

Once an owner is served with the lawsuit, he or she is required to appear in court on the specified date. If the owner fails to appear in court (which happens the majority of the time) and/or file an answer, the association's attorney will request that judgment enter against that owner. Once a judgment is obtained, further collection efforts such as bank and wage garnishments can be pursued.

Bank and wage garnishments are reasonably typical means of collection, and can be very successful. However, if an owner's bank account cannot be located (or the owner banks with a bank that does not have ties to Colorado), or the owner works out of state (with a company that does not have ties to Colorado), you'll often find your community out of luck with those avenues of collection. Receiverships are a great solution in this case. A receivership is a court-ordered appointment of a rental manager for a property. The receiver must be a disinterested person (i.e., not the property manager or management company) and the property must not be owner-occupied. While some county courts do not recognize it as a legal remedy, it is explicitly allowed in the rules of civil procedure, so can always be pursued in district court. Once the court has approved a receivership, the receiver will step into the shoes of the owner in the management of the property. The receiver will collect rents, apply the money to the receiver's fee first, and then to the satisfaction of the debt. Receiverships are effective ways to collect delinquent accounts when the property is not owner-occupied. Additionally, although we are discussing post-judgment collection options here, the remedy of receivership is also available pre-judgment. So, if your association has an owner that cannot be located for service and to obtain a judgment, discuss pursuing receivership with your attorney.

What about settling accounts? George Herbert, a British poet, said: "A lean compromise is better than a fat lawsuit." In order to decrease delinquencies, and when the circumstances warrant, a Board may consider waiving soft costs (such as late fees and interest) to settle an account. When doing so on an individual basis, make sure that your Board is reviewing the facts and circumstances surrounding the request, as well as implementing the policy of waiving fees, in a consistent manner. A Board certainly would not want a claim of selective enforcement brought against it due to the perception of unequal treatment of owners.

As you well know, a few delinquent owners can wreak havoc on an association's budget and potentially affect property values. If the association cannot collect enough to maintain, repair, and replace items in the common areas or items that are its responsibility, conditions of the association may cause property values to decline. Additionally, for a condominium community to be eligible for FHA approval, no more than 15% of units can be delinquent in their assessments more than sixty (60) days. If your community is not FHA approved, the pool of potential buyers into your community will be significantly decreased, thereby leading to declining property values in the community. Board members have a fiduciary duty to maintain property values, and keeping delinquent accounts to a minimum (and taking steps to collect on delinquent accounts) support that goal.

As Board members, facing collection issues can sometimes be challenging. These owners are your neighbors. Collection of community association assessments is not "faceless" like credit card, medical, or student loan debt. These owners live in the community, (maybe) show up to your board meetings, and will (maybe) end up on your board. Be respectful and treat each case as an individual matter, with its own facts and circumstances. As the saying goes, everyone is fighting a battle you know nothing about. Be kind. Always.

Ashley Nichols is the principal and founder of Cornerstone Law Firm, P.C. She has been in the community association industry for ten years, providing associations with debt recovery solutions for their communities. Cornerstone Law Firm represents Colorado communities in all areas of common interest community law. You may find out more at www.yourcornerstoneteam.com.

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I Bought Into an Association in Colorado...

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Pat Wilderotter, CIRMS
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Moving into a community association can be perplexing for new unit owners. What insurance do they need to purchase? Although only a small percentage of people ever read the governing documents (CC&Rs) of the association they are moving into, those declarations will let each owner know what coverage they need to purchase under their personal HO6 policy. The association's insurance responsibility on the interior of each unit can range from bare walls coverage where the association is only responsible to replace the dry wall and sub-floors, to "all in" coverage where the association has to replace the unit as it was at the time of the loss. From that wide range of options, throw in replacement to original construction, add in exclusions/inclusions for items such as floor coverings, appliances, cabinets and countertops, and what's covered can be very confusing. Without reviewing your declarations with your personal insurance agent, you could be found devastated after a property loss with what is and is not your responsibility to insure and what is replaced in your unit.

When you see insurance as part of your monthly assessments, that only means that portion of the community that the association is required to insure according to the declarations. When it comes to personal property, the association cannot insure what it does not own or is legally responsible to cover. Additionally, make sure you have adequate liability coverage. When someone enters your home, you become liable, so a slip and fall on your throw rug can result in a law suit against you personally.

Also, review the association's deductible policy. Some associations can assess the property deductible back to the individual unit owner or owners involved in a property claim. In this case, make sure you have added enough property coverage under your building/property coverage (typically section A) of your HO6 policy to cover this deductible.

In a situation where the entire community is assessed for a deductible, coverage is generally available under the loss assessment portion of the HO6 policy. Confirm with your personal agent that there is not a sub-limit if going to pay for an association's deductible or that the coverage is offered under a special endorsement. This coverage is essential under your personal insurance. Due to the number of hail claims over the past several years, with May 8th of last year coming in as our most severe with over $1.4 billion in damages, we have seen many carriers non-renewing or leaving the habitational marketplace. Those companies remaining are typically going to a percentage deductible, with 5% of the property value becoming the norm although we still have carriers offering 2% or a specific dollar amount. Adding adequate loss assessment coverage is relatively inexpensive under your HO6 policy, so just make sure your limit is adequate to cover your potential assessment. Simply take the building limit times the percentage and divide by the number of units in your community to determine your potential assessment. For example, a $10,000,000 building with a 5% deductible has a $500,000 wind/hail deductible. If you have 50 units in the building, each owner could be assessed $10,000. If you have a 2% deductible, the association has a $200,000 wind/hail deductible and each owner could be assessed $4,000.

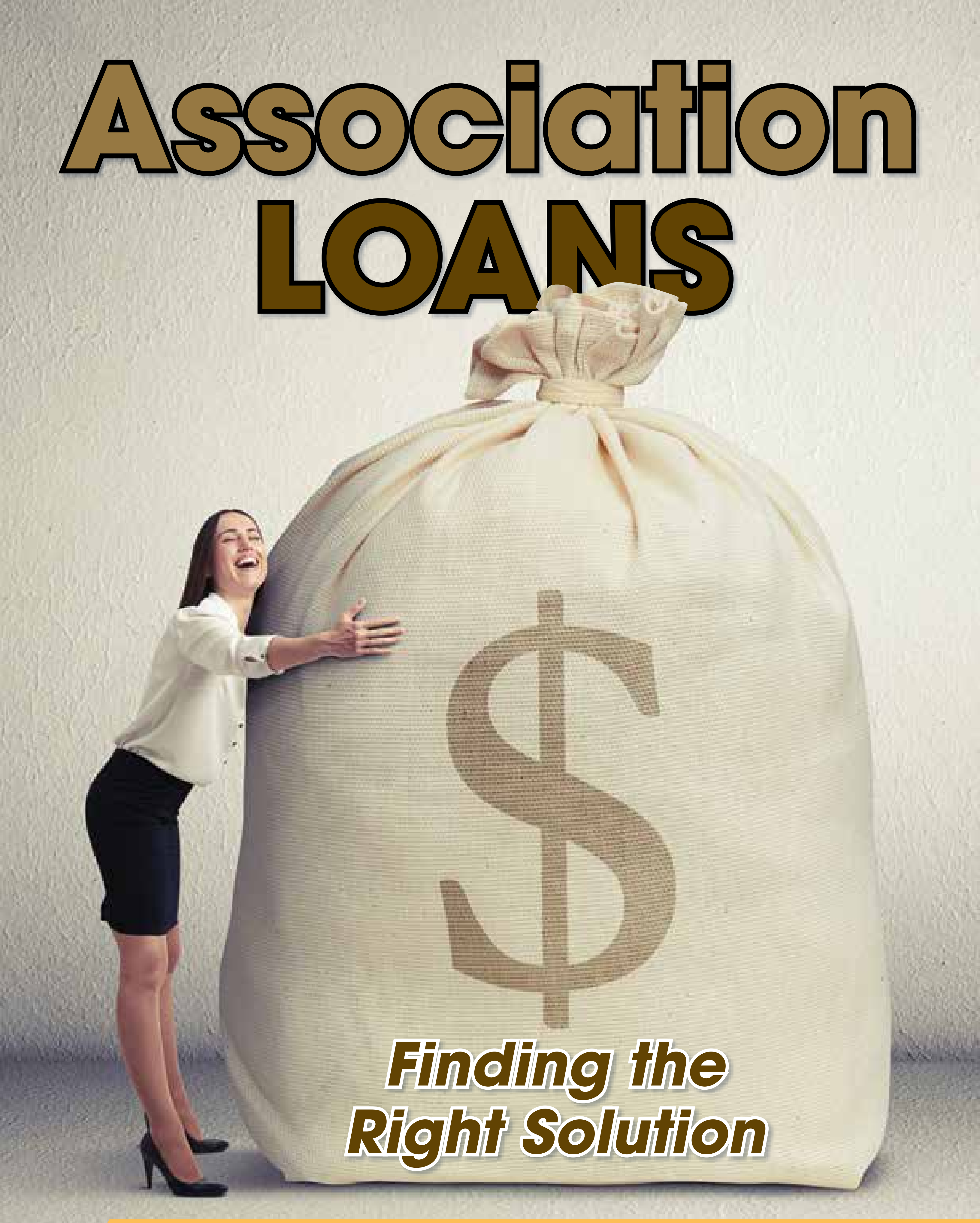
Again, check with your personal agent to make sure there are no sub-limits or special endorsements needed to insure the association's wind/hail deductible.

"Without reviewing your declarations with your personal insurance agent, you could be found devastated after a property loss with what is and is not your responsibility to insure and what is replaced in your unit."

There are some policies, generally through Lloyds of London, that offer a buy down product that will cover the wind/hail deductible down to a deductible like $50,000. These policies however are very expensive, have gone up significantly in cost over the past two years, and often cost as much as the package policy for the association. If the association does not want to have to raise monthly assessments to cover these buy down policies, the Board often wants to make sure each member is informed of the their potential portion of the wind/hail deductible so they can purchase adequate insurance through their HO6.

CCIG is a Denver-Based insurance brokerage firm. Pat Wilderotter, past president of the Rocky Mountain Chapter of CAI and one of approximately one hundred in the country to hold the designation of CIRMS (Community Insurance and Risk Management Specialist) heads their HOA team.

Association LOANS



Finding the Right Solution

Alicia Granados, CMCA, AMS, PCAM
Pacific Premier Bank HOA & Property Banking

"Should my association consider a loan?" There are a number of scenarios where this question comes up, and times when it doesn't but perhaps should.

"We have deferred maintenance and we don't have enough in our operating budget or reserves to make needed repairs… what should we do?"

"Our construction defect litigation settlement was not enough to correct all of our issues… what should we do?"

"We had a catastrophic loss but our insurance coverage has a deductible we can't afford… what should we do?"

"We want to add a new community playground… what should we do?"

In trying to answer these difficult funding questions, Boards often assume that their only option is to special assess each owner for their share of the association's shortfall. Owners are then left with the option of using cash on hand or obtaining individual financing through a second mortgage or other means. This can be difficult for those who may not be good candidates for a loan; some may have poor credit while others rely on fixed monthly incomes. Undoubtedly, large special assessments can place a great burden on members of a community.

For many communities, an association loan is a very attractive solution, allowing the Board to quickly obtain needed funds. In the absence of an adequately funded reserve account, an association can borrow money and often avoid a significant and urgent special assessment against its members.

One of the most common reasons for borrowing is the need to fund deferred maintenance through a large scale repair or renovation project. A loan allows the community to escape the inconvenience and expense related to multi-year phasing of a project, while still allowing the membership to spread payments out over time. Needed work can be performed right away, enhancing the value of the community, while the cost remains more manageable for each owner.

When considering a loan, the following questions often arise about the type of collateral required and the impact on individual owners, as well as the typical terms and structure of an association loan.

What Type of Collateral Does the Bank Require?

Typically, the association will assign the bank its rights to collect future assessments and other accounts receivable. In other words, if the association failed to make its loan payments, the bank would have the right to step in and collect assessments on behalf of the association. Except in the case of a loan made specifically to purchase real estate, an association does not generally pledge its property, such as a pool or clubhouse, against a loan. There is no personal liability for an association loan. Board members are not asked to provide personal guarantees, nor are there liens placed against individual units to secure the loan.

What is the Impact on Individual Owners of the Community?

Individual owners are not directly obligated for an association's loan, therefore homes can be bought and sold regardless of whether there is a loan in place. A loan is also not reported on any member's personal credit report. The most common impact on owners is that the association's assessment income often needs to be increased by some amount in order to support the loan payment. Depending on the governing documents, a vote of the owners may be required to approve the Board's ability to pledge assessments.

How Does an Association Qualify for a Loan and What is the Typical Structure?

An association can expect to be required to meet various qualifications related to the size of the community, delinquency rates, percentage of absentee owners, concentration of ownership and amount of the proposed assessment increase. The structure of the loan will depend on the type and length of the project being funded. Banks may offer either a line of credit or a traditional term loan, typically amortized over ten years or less. It is best to look for a loan with no prepayment penalties so that the loan can be paid off more quickly if funds become available.

"In the absence of an adequately funded reserve account, an association can borrow money and often avoid a significant and urgent special assessment against its members."

A Loan Sounds Like a Great Idea— Now What?

It's never wise to rush into applying for a loan without first consulting your governing documents and the association's legal counsel. It is important to ensure that the documents and applicable state statutes permit the association to borrow funds and also to determine whether a vote of the membership is required. In some cases CCIOA (The Colorado Common Interest Ownership Act) requires that the Declaration provide express authority for the association to assign future income, so a document amendment could be required.

Once the Board believes that a loan is a viable solution, it is best to contact a bank that specializes in lending to community associations. Like other knowledgeable industry partners, banks most familiar with associations will be able to successfully guide the manager and Board through the process, avoiding many obstacles and securing a loan that will best meet the needs of the community.

Alicia Granados, CMCA, AMS, PCAM is an experienced HOA & Property Banker in Colorado. Pacific Premier Bank HOA & Property Banking specializes in lending and innovative banking solutions for the community association industry. Their advanced technology and API integration with industry accounting software packages creates meaningful efficiencies for management companies and community associations across the country.

Reserve Policy & Prudently Building Community Reserve Funds

While a Homeowner's Association Board of Directors has many duties, the proper management of finances is paramount to the responsible administration of and tranquility in any community. Nothing creates bigger headaches and angst for both the Association Manager and Board than a special assessment as a result of poor financial forecasting. Management of funds falls into two categories; short term and long term. Short term funds deal with the daily operations such as keeping the lights on, mowing the grass, trimming shrubs & trees, and heating the pool. It also means paying for these services day in, day out.

Long term fiscal management focuses on the repair or replacement of community assets which depreciate over decades, such as signage, concrete, siding, fencing, elevators, light fixtures, and roofing, etc. These expenses are more difficult to properly manage for numerous reasons. Many Board members know they will not remain in their current roles on the Board and therefore, may not feel that the need for a ten, twenty, or thirty-year budget for their community, especially if they do not plan on living in that community for long. Furthermore, deterioration is often slow and not easy to notice, which does not provide the same sense of urgency. Most long term maintenance requires a level of construction expertise which many Board members simply to do not have. Few Boards have intricate knowledge of electrical, plumbing, asphalt, and drainage necessary to financially plan. Finally, too many directors and homeowners believe that keeping monthly assessments as low as possible is their most important duty and the best indicator of smart decision making. This combination often creates negative outcomes for the Board, Property Managers, and residents.

In addition, the finances required for some of these projects are formidable and beyond the scope of most Board member's experience. The complexity of projects can be great, requiring building code knowledge, permitting, inspection, traffic control, and neighborhood inconvenience, and can create substantial community friction. Often there is an additional layer of peer pressure to not raise monthly assessments, creating a recipe for disaster in the future that is completely unavoidable without proper financial management. Special assessments and loans then become necessary, which undermine a sense of community and ultimately will cost much more than addressing reserve needs proactively. Annually raising monthly assessments allows homeowners to plan, budget, and control the outcome of their communities and respond after disasters, such as the 2014 Colorado floods.

The State of Colorado has the Prudent Investor Rule that covers financial responsibilities when one or more people manage funds on behalf of others. Within the Statute there are several requirements which are common sense to most people, such as using reasonable care, skill, and caution. Further, liquidity, preservation of capital, and appreciation of capital and taxes are important financial considerations. Most of these are very obvious to Board members. One important consideration that is often overlooked is the effect of inflation. Inflation is not tangible, happens slowly, and is difficult to notice, much like deterioration of siding or a roof. This one facet should be placed high on the list to overcome. Commonly, it is not even considered, resulting in decreased purchasing power of reserve funds over time. According to the Bureau of Labor Statistics, in the 40 years ending in 2010, average annual inflation was 4.4%. Thus, the issue becomes, how can we direct Board members to manage funds in a manner compliant with the Colorado Prudent Investor Rule?

There is an important distinction about adding to reserves diligently, including increasing monthly assessments routinely versus loans or special assessments. The former involves foresight, planning, and strong Board communication with the community. The latter is reactive and puts a community on the defensive, causing angst and spreading doubt as to other Board decisions and processes. The advantage of proactive planning, budgeting, and saving is that it creates an opportunity to have the reserve funds work hard for the community, instead of the other way around.

Looking at the difference between short and long term funds we should realize we need two policies in place. For the short term, we should have zero risk. Banks and Credit Unions provide us with funds that are FDIC or NCUSIF insured. We need to make sure the electric, landscape, or insurance bills get paid. Having the bank or credit union of our choosing backed by Uncle Sam is a prudent route.

For the long term, we need to understand the role inflation plays as discussed above. By their very nature, banks and credit unions do not help us keep pace with inflation. While this implies we need to have some level of risk (conservative risk is preferable) to be able to combat inflation, this is where a different type of expertise is needed to help mitigate risks associated with investments. Typically the Board or Association Manager must look to municipal or investment grade bonds or bond funds in order to find better returns. This means we need to take care to retain an expert and ensure our decisions are in the best interests of the community, under the Colorado Prudent Investor Act.

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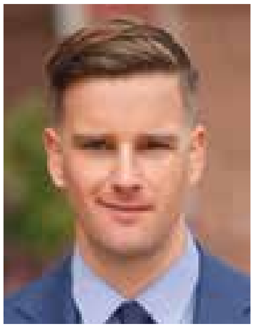
When Should a Reserve Study Be Updated?



Bryan Farley, RS
Association Reserves

On my tenth birthday I was given the greatest gift a kid could ever ask for. That gift, which every adolescent looks forward to, was of course… braces. Not only did I look silly (my grandma affectionately called me 'train-tracks' since my teeth looked like they could support a steam engine), they also required ongoing upkeep and maintenance. One of the daily maintenance tasks was to hook these small rubber bands into the braces to improve my overbite. The problem was that I found the bands to be a nuisance and preferred not to wear them. My thought was that the orthodontist wouldn't notice my lack of discipline. Unfortunately he did notice, but in my infinite wisdom I still thought that it wouldn't make much of a difference whether or not I wore the bands. Finally after a year, the orthodontist told me that the more consistent I was with my daily maintenance, the sooner the braces and bands would come off.

Just as I assumed that my daily maintenance negligence would go unnoticed, many Boards assume their annual Reserve Study maintenance will go unnoticed. A Board may assume that Reserves are something that a future Board may need to think about. Or, the Board may assume that the owners may not notice that the association is lacking proper funding for the upcoming summer projects. The lack of Reserve Study updates is an issue that many Board members fail to realize. Because the physical condition of the association's assets and the size of the Reserve Fund change on an annual basis, Board members need to know how much to budget for their Reserve contributions each year.

The problems that occur when a Board does not update their Reserve Study include; higher special assessment risk, increased dues, deferred maintenance, and cash flow deficiencies:

- **Special Assessments** – Based on a analysis of over 19,111 of our most recently completed Reserve Studies, we found that when clients only updated their Reserve Study every five years, the risk of special assessment increased by 35% when compared to a client that had updated their report every year. If a client updated their Reserve Study every three years, the risk of special assessment increased by 28% when compared to a client that updated their report every year. Why does special assessment risk decrease when the Reserve Study is updated regularly? One factor could be that it is harder for a Board to ignore an upcoming project when the Reserve Study is constantly reminding them each year of their annual fiduciary responsibility.
- **Increased Dues** – Increased special assessment risk will also require higher reserve contributions, which will affect the overall dues assessment. On average, reserve contributions should make up anywhere from 15%-40% of the total annual budget for a well-run association. When an association falls behind in their funding, they will need to increase their contribution rate to catch up with the ongoing deterioration of their property. When a client updates their Reserve Study annually, the year-to-year variation in Reserve contributions will, on average, drop by 9%.
- **Deferred Maintenance** – When an association neglects to update their Reserve Study, scheduled projects tend to be deferred, and deferred maintenance will only become more expensive. For example, suppose an association completed a Reserve Study in early 2013 but the Reserve Study has not yet been updated since. Since 2013 there have been at least two major hailstorms, one catastrophic flood, and countless wind storms. The unexpected surprises may cause an association to defer the expected, inevitable projects such as exterior painting. However, by deferring these projects, the costs of the routine painting maintenance may increase by 50% due to wood rot or other carpentry issues.
- **Cash Flow Deficiencies** – An association that has not updated their Reserve Study will be unprepared for inevitable expenses of expected deterioration. How will a Board know how to set their annual reserve budget unless they know what their annual reserve costs are? It would be like packing for a vacation but not knowing if you are going to Hawaii or Iceland (unless you can handle a bikini in the snow). A budget must be set with the end in mind; what is the projected roof replacement cost, what is the projected asphalt sealing expense? If an association does not know what the inevitable costs will be, the most likely scenario will be that the Board will underfund the reserve account.

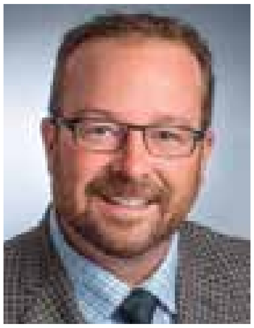
Updating a Reserve Study requires that a Board be disciplined, however this discipline today will bring financial freedom for years to come.

Once I had understood that my daily routing of rubber band wearing would eventually bring me freedom, I became driven to be the best rubber band braces-wearer I could be. At the wise old age of eleven, I had finally realized that positive results require diligent routine and discipline. Similarly, boards that pay attention to their financial situation have demonstrably fewer special assessments and more stability to their budget. They tend to be on-track, setting the right amount aside towards Reserves, with owners all paying their fair share (the true cost of home ownership). The result is their property is significantly more likely to have the necessary Reserve funds on-hand when they are needed to perform those major, predictable common area repair and replacement projects.

Bryan has completed over 1,500 Reserve Studies and earned the Community Associations Institute (CAI) designation of Reserve Specialist (RS #260). His experience includes all types of condominium and homeowners' associations throughout the United States, ranging from international high-rises to historical monuments.

Sweating the Big Stuff

Planning for the Big Five in Res



Justin T. Foy
SBSA, Inc.

National reserve study standards define reserve components according to four criteria. A component must:

1. **Be the responsibility of the association.**
2. **Have a limited useful life.**
3. **Have a predictable remaining life.**
4. **Exceed a minimum cost threshold.**

These four criteria are the building blocks necessary to develop an accurate, reliable, and repeatable list of components necessary for long term community planning purposes. What to do with this list is where many associations find themselves at a crossroads.

A typical community association has 25-35 reserve components. Small communities may have only a couple components, while large communities with amenities such as golf courses, restaurants, and recreation centers may have hundreds. Regardless of community size, the following five items typically have the largest impact on long term financial planning:

- **Roof system**
- **Exterior façade**
- **Decks**
- **Concrete flatwork**
- **Asphalt paving**

erve Studies

Our research of ten randomly selected and recently completed Colorado reserve studies shows how significant these components are. Analyzing the projected expenses of the above five components over the next 30 years shows that they consume about 61% of the necessary reserve funds for the average community.

In analyzing a few of the individual communities, we found the following:

- **Community 1:** A mid-rise community containing 12 units constructed in the mid-2000s. Common components include interior hallways, lobby, and landscaped and irrigated areas. 66-percent of all expenses for the community can be attributed to the five major components.
- **Community 2:** A single family home community constructed in the mid-2000s containing 517 single family homes. Common community components include clubhouse, pool, large fountain, playgrounds, and community fencing. 19-percent of all expenses for the community can be attributed to the five major components.
- **Community 3:** A two-story, four-building community containing 32 units constructed in the early 1980s. Common components include privacy fencing and landscaped and irrigated areas. 77-percent of the community expenses can be attributed to the five major components.
- **Community 4:** A one- and two-story, 11-building community containing 30 units constructed in the mid-1990s. Common components include a clubhouse with gathering rooms, commercial kitchen, fitness area, guest suite, children's room, HVAC equipment for the clubhouse, and landscaped and irrigated areas. 85-percent of the community expenses can be attributed to the five major components.

Errors with future planning for these five items will have a disproportionately significant effect on overall reserve fund needs. To properly "sweat the big stuff," communities should plan for these five major items appropriately by ensuring the accuracy of the quantity and cost estimates assigned to these components.

Associations should ensure the accuracy by soliciting reserve studies from providers who have firsthand knowledge of the local construction environment for the communities they serve. Instead of looking up unit costs in a book or just googling it, a good reserve study provider should constantly be coordinating with general and specialized sub-contractors that provide roof, façade, deck, asphalt, and concrete services. By updating and citing their cost resources in the studies they provide, reserve study providers improve the accuracy of the costs assigned to reserve components.

Reserve study providers should also conduct quantity measurements of the site utilizing appropriate methods. Measurements should be completed first from As-Built drawings, if available. When As-Builts are not available, quantity estimation should still be completed utilizing field measurements and aerial image measurements. Associations should also be cautious of reserve studies that provide measurements of components as "1 unit" with no definition of quantity. These "1 unit" measurements often end up allocating a lump sum price to a component replacement, which can result in either a large surplus or deficit in the community's largest impact items due to inaccuracy. The worst part of the "1 unit" measurement is that it is impossible to verify the true quantity.

Reserve study providers that work with both general contractors and associations understand the effect of accurate measurements and unit costs. Select a reserve study provider who can assist in guiding your community through your reserve planning so you don't have to Sweat the Big Stuff alone.

Justin Foy is a Senior Vice President and Reserve Specialist with SBSA. Justin has over 18 years of experience in engineering management and 15 years of experience providing Reserve Studies. Justin and his team are one portion of SBSA's staff of engineers and architects that work with communities throughout building and component lifecycle.

Welcome New Members

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Issue	Topic	Article Due Date	Ad Due Date
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Palace Construction & Restoration
Pro Disposal & Recycling
RBC Wealth Management
RealManage

ROCKY MOUNTAIN CHAPTER
community
ASSOCIATIONS INSTITUTE

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ASSOCIATIONS INSTITUTE
CAI Rocky Mountain Chapter
11001 W 120th Ave, Suite 400
Broomfield, CO 80021

CAI-RMC EVENT CALENDAR

AUGUST	
16 Thu	**M206** Fort Collins
21 Tue	**Speaker Series**
SEPTEMBER	
11 Tue	**HOA Roundtable** Centennial
13 Thu	**Clay Shooting** Kiowa Creek
17 Mon	**Mountain Conference & Trade Show** Vail
OCTOBER	
11 Thu	**Managers Lunch** Denver
16 Tue	**Speaker Series**
20 Sat	**Board Leadership Development Program**
24 Wed	**M100** Fort Collins

For the latest information on all our programs, visit www.cai-rmc.org!

Don't forget to register for events as prices are significantly higher the day of the event.