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COMMON INTERESTS

Finance

**Hidden Figures – Financial Lifelines
in Receivership**

**Community Association
Best Practices - Finances**

Passing the Buck Can Cause Collapse

**Construction Contracts and
Holding Costs**

**Basics of an Association's
Investment Policy**

New Monuments

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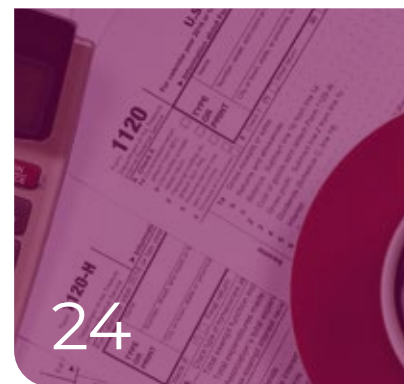
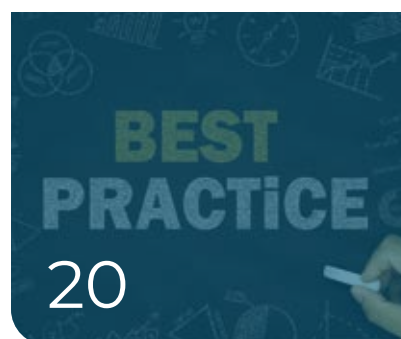
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President's Letter



MELANIE PECK
Chapter President
CAI-RMC

What an incredible year so far! The resiliency of our CAI Rocky Mountain membership has been an incredible journey to watch and be a part of!

Our Chapter over the last four to five years has really set out to focus on our members. We have challenged our leadership to really dive into our strategic plan and focus on key goals and actions that benefit all membership classes - Homeowner Leaders, Managers, and Business Partners.

The summer was filled with great programs and engagement for our membership! Golf, our "Spring Forward" Conference, Peak Series - Financial, Board Leadership Certificate Program, Community Association Workshop and our Annual Strategic Planning Session. The energy and enthusiasm that each of these events generated was contagious!

The Rocky Mountain Chapter has also taken on a Mental Health Initiative this year. We have been working to provide resources, recharge zones, and opportunities to create awareness amongst our peers. We all have personal stories, and anything we can do as a group or as individuals to raise awareness for mental health is a significant contribution. To destigmatize mental health issues and to start to have dialogue is so important - so we invite you to not only take time for your own mental health, but get involved, spread messages of hope, take time to really sit and listen to your peers and those you love.

As we dive into fall, budgets and annual meetings, my hope is that we continue on this positive momentum that we have had as a Rocky Mountain Chapter family. Let's continue to laugh, support one another, elevate ourselves, and elevate others! **HERE IS MY CHALLENGE** - take a moment and just choose one thing, one positive step you have taken, one positive experience, and share it with someone that is NOT in your every day circle. Grab the CAI-RMC Directory and pick up the phone or email someone and let them know how they have had a positive impact directly or indirectly on you. Let us continue to open the dialogue, to communicate, to educate, to share!

TOGETHER we make a difference! 🏠



2021 Editorial Calendar

Issue	Topic	Article Due Date	Ad Due Date
October	Tech / Modernization	August 15	September 1
December	Planning Ahead / Goals / Community Vision	October 15	November 1

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Deadline: First of each month for the following month's issue.
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Product Cost Increases

*& how to
plan for them*



G. MICHAEL KELSEN

Aspen Reserve
Specialists

**IF YOU THINK THE COSTS ARE
HIGH NOW, WAIT JUST ONE
DAY AND THEY WILL
BE MORE.**

I am sure you have heard the expression, “If you don’t like the weather, wait ten minutes and it will change.” As scary as it may sound, we in the Reserve Study and Construction businesses have had a similar expression lately: “If you think the costs are high now, wait just one day and they will be more.” Yes, one day may be an exaggeration, but while we have seen product increases exponentially from last year, we have seen some costs increase month to month.

According to various publications, the current inflation rate for construction labor and goods is running between 5% - 6% in the Rocky Mountain region. From what we have seen with contracts, we think the actual number is closer to 7% - 8%. The national core inflation rate, which does not include volatile oil prices, is running about 3.8% over the past 12 months. As of the writing of this article, even though wood prices have seen a decrease over the past week, a slight change in production or product availability will cause those prices to increase again.

As long as I have been in this business, there have always been outside forces that impact product costs. Believe it or not, a natural disaster in another part of the country will affect replacement costs here in Colorado. Why? Because those building materials are needed where the disaster occurred. Also, sub-contractors and labor tend to go where the work is. As the cost of precious metals soars, so do costs of assembling mechanical equipment. After fires raged in the Pacific Northwest and Canada, in forests where we get our wood for construction, the results were less product, higher demand, and (the basic principle of Economics 101): higher costs. Let's not forget that with the increase of hourly wages, fuel costs, insurance premiums, commercial rent, etc., those additional costs to run a business will get passed down to the consumer. Bottom line, no matter how you look at it, things are only getting more expensive, and will continue to get more expensive in the coming years.

So how do we plan for these increases? In my 30 years of industry experience, I have never seen expenses decrease, and rarely have I seen them stay stagnant from the previous year. This is why if association assessments are not increased annually, then the financial strength of the association is ultimately falling behind and digging themselves a hole. We in the Reserve Study business see this all the time: budgets are established, and rather than following the recommendation of your professional and increasing the reserve contribution, the budgeted reserve contribution is actually decreased to prevent the board from having to raise the dues.

With a healthy reserve balance, associations are able to have some wiggle room in their funds for projects that increased more than anticipated, or for additional labor caused by deferred maintenance. Take wood fence replacement for example: A few years ago, we were seeing replacement of a privacy fence cost around \$30 per LF, depending on total area, location, and types of posts being installed. If you take the average inflation rate of 5% for construction related projects, the cost to replace the fence would be around \$35 per LF today. However, because of factors beyond our control, the actual cost of a fence today is about \$45 - \$50 per LF. When an association follows the advice of their professionals and adequately contributes to the reserve fund, then typically there are sufficient funds available to address the shortage.

Some associations also believe that spreading out an expense, or "phasing" a project as we refer to it, will save them money. In


reality, phasing a project is actually costing you more money for several reasons.

First off, the average interest earned on a reserve account is ranging anywhere from 0.1% to 1.0% if you are lucky. As mentioned above, inflation rates are averaging about 7%. Therefore, for every year a project is deferred, it becomes more expensive. Another way to think of this is that your reserve dollars are literally losing value while sitting in the bank.

Secondly, for projects that are phased over a period of time, the cost of that project will continue to increase for the duration of the phase period. So, rather than spending \$150,000 in year one to address the entire project, the same project could cost about \$161,000 by the time the project is completed three years down the road.

While we realize raising assessments is never a popular topic, it is a necessity in today's world. If an association does not increase their annual assessments by at least 3% - 4% every year, then the financial strength of the association will surely fall behind. As a result, it will only get more difficult to get caught up and be able to address major projects when they need to be performed. ⬆

G. Michael Kelsen is celebrating 30 years of preparing Reserve Studies in 2021, as well as acknowledging the 20th anniversary of Aspen Reserve Specialties being in business. Personally being accountable for completing over 5,600 Reserve Studies, Michael has had his fair share of experience with condominium associations, large scale communities, townhome properties, high-rises, commercial properties, private schools, and worship centers throughout the United States.




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Community Association Civility Pledge

A commitment to fostering a climate of open discussion and debate, mutual respect, and tolerance between all who live in, work in, and visit our community.

1. We expect each individual, whether a resident, guest, board or committee member, community association manager, staff member, business partner, or contractor, to be accountable for his or her own actions and words.

2. We believe all interactions in the community should be civil despite any differences of opinion on a particular issue. We believe in finding common ground and engaging in civil discussion about community issues important to each of us.

3. We vow to respect all points of view and will strive to provide a reasonable opportunity for all to express their views openly—without attacks and antagonization. We agree to keep our discussions focused on the business issues at hand, as well as on the ideas and desired outcomes.

4. We urge all residents to be engaged and informed. Get to know your neighbors, your board members, and your community manager. Attend meetings, join a committee, or serve on the board. Understand the community's rules, regulations, and covenants, and the value they add. Ask questions, share your opinions, and vote.

5. We also encourage all residents to review Community Associations Institute's (CAI) Rights and Responsibilities for Better Communities. The principles laid out in the document can serve as important guideposts for all those involved in our community: residents, guests, board and committee members, community association managers, staff members, business partners, and contractors. Read more at www.caionline.org/RightsandResponsibilities.

6. We believe these commitments to civility, as well as engaged and informed residents, are a vital part of our shared goal of being a vibrant, thriving community.

These commitments are guiding principles. They are not governing documents or legally enforceable and do not give rise to penalties if they are not followed.

If you agree with these commitments to civility, please sign and return the document.

COMMUNITY ASSOCIATION NAME

ADOPTION DATE

By the creation and adoption of the CAI Civility Pledge, the College of Community Association Lawyers (CCAL) recognizes the importance of civility in community association governance. Complete and email your civility pledge to government@caionline.org. For questions, call (888) 224-4321.



talk. listen. respect.

Community Association Commitment to Civility



HOW CAN YOU MAKE IT HAPPEN? Adopting the Civility Pledge Starts with YOU!

1. Distribute the document throughout your community, announcing and publicizing where and when the adoption will be considered.
2. Explain why this is important to your community and the benefits it can create.
3. Review and discuss the merits of the principles at an open meeting of your board of directors.
4. Solicit input from homeowners.
5. Hold a board vote to adopt a resolution endorsing the Community Association Civility Pledge.
6. Share the news of adopting the Community Association Civility Pledge throughout your community regularly. Post on your website, social media, and on every community association meeting agenda.
7. Tell CAI that you've adopted the Community Association Civility Pledge so we can share the information on our website.
8. Once your community association board of directors has adopted the Community Association Civility Pledge, share the good news with CAI by completing and submitting the following information.

DATE OF ADOPTION

COMMUNITY ASSOCIATION NAME & WEBSITE

PRIMARY CONTACT NAME

PRIMARY CONTACT INFORMATION (ADDRESS, PHONE, & EMAIL ADDRESS)

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TIME TO *Borrow*





CRAIG HUNTINGTON
Alliance Association
Bank

A few days ago several of my community manager colleagues and I were talking about how several of their associations had a great deal of deferred maintenance and were concerned about the cost to have it completed. We started talking about borrowing the money for the repairs. One of the managers was the on-site manager of a large adult community and his board

was dead set against borrowing money for the repairs. This got me to thinking about how low the cost of borrowing was right now and how quickly the cost of items, like lumber and oil that is used for asphalt and roof shingles, is going up.

The Bureau of Labor Statistics, part of the Department of Labor in Washington, DC maintains records of costs of products over time. These records are called the Producer Price Index (PPI). It is important to understand the difference between the Consumer Price Index (CPI) and the PPI. The difference between them is that the CPI gauges only four very specific "baskets" of prices: 1. Food Cost; 2. Fuel Cost; 3. Electricity Cost; and 4. Rent. The PPI gauges the costs of finished goods in manufacturing and construction. In February of 2003, the PPI for lumber was 170.5, in 2008 it was 161.9 and this year it is 195.6. The PPI for oil was 114, 199 and 214 respectively.

We all know the cost of labor always goes up. With the economy turning around and Congress talking more about additional taxes, etc. on small businesses, we can safely assume that the cost of labor for any major repair is going to be more in the future.

Let's talk about a \$400,000 paving project. For this example we are going to project \$300,000 for material and \$100,000 for labor. All things being equal, the material will cost us 87.7% more or \$563,157

in ten years; or 7.5% more or \$322,613 in 5 years. For this example we will say labor will remain the same (we all know that is not the case).

If you were to borrow the money for this project, an average interest cost over a five-year period would be \$52,891.40, and over a ten-year period it would be \$109,114.40. Without any additional labor cost, if we did the project today and borrowed the money over five years, the work would cost an additional \$30,278.40, and over ten years we would save \$154,042.60.

Of course, both these examples are only estimates. While we all know costs of items like lumber and oil are going up and labor seems to always go up, at the same time the cost of borrowing money is the lowest it has been in decades. Today, many loans to homeowner associations are in the 5% interest rate range. ⬆

So do the math—not only will you be saving money by borrowing and doing those repairs today, you will be increasing the value of your property.

Isn't THAT what this it is all about?

Craig Huntington is President Emeritus of Alliance Association Bank (AAB), overseeing all aspects of service to homeowner associations and community management companies. Since 2008, Mr. Huntington has worked with the AAB team to provide superior service as well as the banking tools and innovative solutions that meet the needs of the community management industry.

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HIDDEN FIGURES

FINANCIAL LIFELINES IN RECEIVERSHIP



RYAN GULICK

The Receiver Group, LLC



HEATHER NAGLE

The Receiver Group, LLC

The financial aspects and workings of receiverships can be difficult to explain, let alone fully grasp if you are not dabbling with receiverships day-in and day-out. More so, you can almost guarantee each receivership matter you come across will differ from the previous one. That said, below is a short synopsis of how receiverships work through their financial hardships.

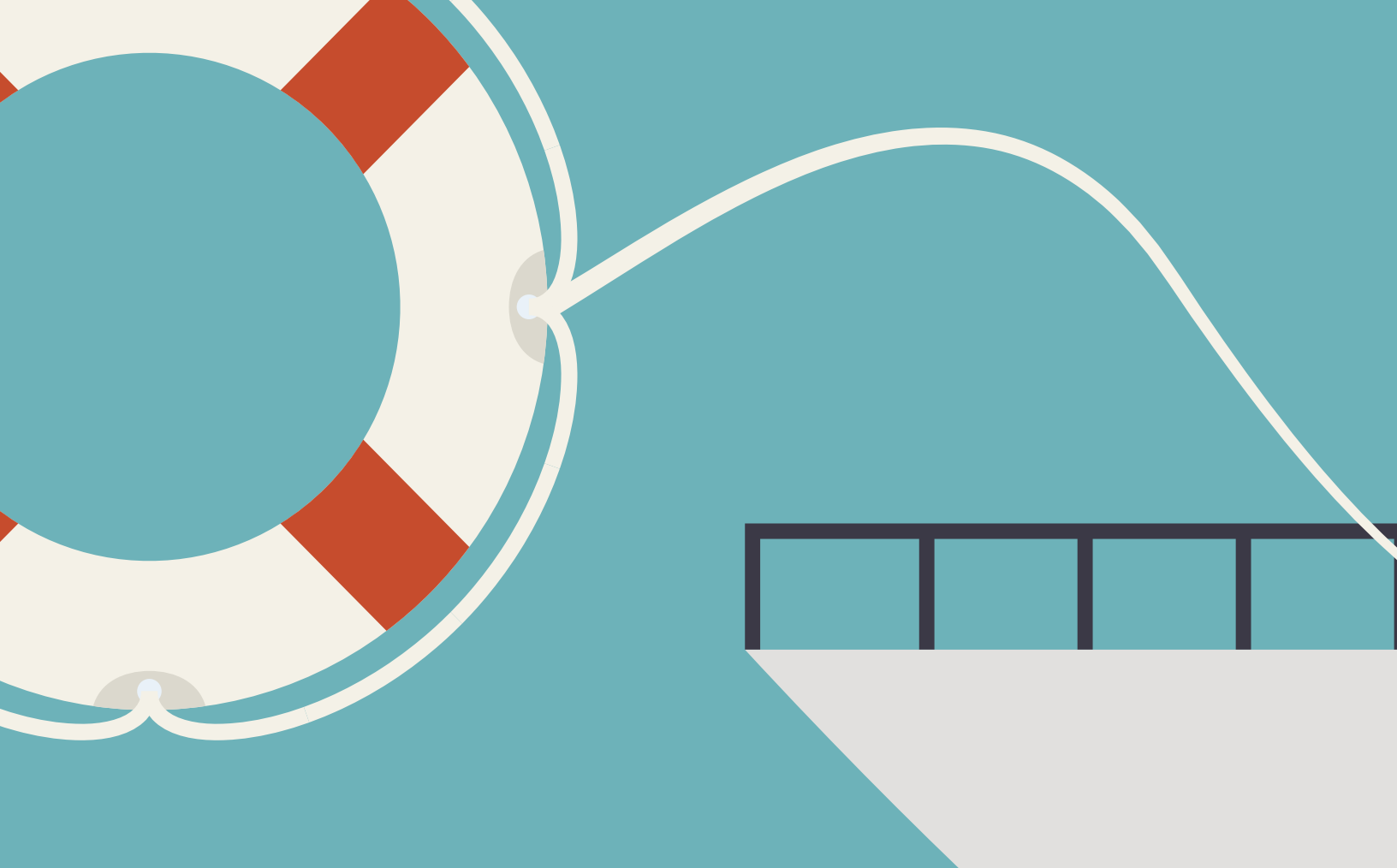
ASSOCIATIONS OFTEN UTILIZE RECEIVERSHIP AS A FORM OF RELIEF TO COLLECT FROM DELINQUENT AND NON-RESPONSIVE HOMEOWNERS WHEN OTHER COLLECTION EFFORTS HAVE FAILED.

To obtain a receiver, the association's attorney files a lawsuit against the property and homeowner pursuant to CRS 38-33.3-316, The Colorado Common Interest Ownership Act (CCIOA). The homeowner's property becomes the asset of the "receivership estate" and is used to produce income while it is in the custody of the court. In a perfect world, the property's rental income is used to pay the debt owed to the association and the case is closed. But when costs arise that need to be covered, such as clean-up of a vacant

property or repairs, the financial aspects of the receivership are often misunderstood, especially in instances where money is not available from the property. Here are the basics:

A receiver has an enormous fiduciary responsibility while administering the receivership estate. They must track the estate's income and expenses and are accountable to the court and parties involved. Receivers first use income generated from a property to pay for hard costs but may need the association's help when deficiencies exist. This is key when a property is vacant and needs some work. In these instances, the association must understand that they are the "bank" for the estate and may need to loan money to the Receiver (but are not required to) for the matter to proceed. Receivers can borrow money anywhere, but since the association has a vested interest and must approve the request, this is most common.

Upon approval, the association loans funds and increases the property's debt balance to correspond with the loan; it also earns interest until paid back. Repairs are made, and the property is either rented or continues to produce income, which is in turn is paid over to the association to repay costs, including the attorney fees and receiver fees. Additionally, in some cases, there are other costs that



must be paid for the receivership to proceed, i.e., delinquent water bills, property tax liens, and in rare occasions, evictions costs. In all these instances, a good receiver will work with the association for the best solution so that these costs are funded and collections efforts can continue.

Receivers remain transparent throughout the process and will keep the association updated on the estate's financials and any progresses made towards the debt balance. Once the debt balance is satisfied, all accounting and financial statements are submitted to the court for approval. Afterwards, the property can then be turned back over to the homeowner and the receivership estate closed. 🏠

The Receiver Group is an equitable solutions-focused firm that specializes in all types of receivership appointments regarding equity disputes, real property preservation (foreclosure, rents & profits), asset liquidation and post-judgment collection matters

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Construction Contracts and Holding Costs



JOEL MASSEY
NexGen Roofing

Lumber. Insulation. Steel. Gas.

Unfortunately, current rising material prices, tariffs, and disruptions in supply chain could mean your project just got a lot more expensive! But what does this mean if price escalation occurs and your community is already under contract for a large construction project?

Most construction contracts include provisions to protect the company from circumstances outside of their control. These circumstances include: labor strikes, weather events, acts of God or acts of war, and material price escalation. Material price increases in the construction industry are very common and materials can increase in price, on average 5-7% each year. For the smaller and more frequent price increases, contractors plan the material price increases ahead of time and figure the additional costs into their estimate based on start date and potential completion time. However, if the project start date is delayed by the community, then the community may be liable for additional fees or surcharges. These surcharges and fees can range from 1-2% of the contract price for each month the project is delayed, so it's important to understand that "time is of the essence," adhere to project start dates, and avoid these additional fees and surcharges.

In rare cases of extreme price escalation, most contractors have a provision in their contract to protect themselves if material prices increase beyond a certain pre-budgeted margin. For example, the price of lumber has increased 288% percent in 2021. Prices for oriented strand board (OSB) are selling for roughly \$65-80 per sheet. If the contract was executed prior to lumber inflation, the dramatic price increase would allow the contractor to terminate the contract without liability; however, the contractor must meet certain conditions to justify terminating the contract. For example,

if the contractor had ample time to purchase materials prior to the price escalation, then the contractor could still be liable and pay out of pocket for the increase. Timeline clauses work both ways for the customer, and the contractor deadlines are equally important for the contractor to ensure their scope of work and pricing is met.

If your project is related to an insurance claim, insurance carriers may update their price lists to current market conditions and pricing. Waiting on approval from the insurance carrier is half the battle when it comes to insurance restoration work. Sometimes these price escalations can happen when waiting for approval on additional construction items related to the claim. If this is the case, then your carrier understands the market conditions and will typically allow the approval of the price increase; however, this also depends on following reconstruction timelines set forth by your carrier. If you wait a year or two to start the work after the claim, and supplement items have been approved, there is a chance your insurance company may deny the additional benefits. We recommend contacting your insurance carrier to review your policy and guidelines regarding material price increases, and its timeline to file and complete a claim.

Material price escalations are also very hard on contractors. These unforeseen increases in pricing put contractors in a tough position understandably, not only the value of maintaining a relationship, but also honoring the price set forth at the time the contract was executed. We understand the potential burden it may have on a community who set an expected budget and now may be subject to additional costs or change orders. Having and maintaining an open conversation with your contractor is the best way to resolve any of these dramatic material price escalations. Understand the terms and conditions up front in order to protect your community from additional fees, change orders, or potential cancellation. ⬆

Joel Massey is the Co-Owner of NexGen Roofing, specializing in multi-family and commercial roof replacement in Denver and the surrounding areas. NexGen has been operating since 2014 and is listed on the Inc. 5,000 fastest growing companies in the United States.

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UNDERSTANDING THE

Board Treasurer Role

AND BEST PRACTICES



APRIL AHRENSEN
CIT

The board treasurer manages the association's finances and must exercise prudent judgment with investments, evaluate the maintenance costs, and ensure that association funds are always protected. It is a crucial role that comes with large responsibility. While there are several nuanced aspects of the board treasurer position, the following can provide a foundational understanding of the role.

April Lynn Ahrendsen is a vice president and regional account executive for CIT's Community Association Banking business, supporting community management companies and homeowner associations in Colorado, Idaho, Montana, and Wyoming. The views and opinions expressed in this article are those of the author and do not necessarily reflect the views CIT.

Tools of the Trade

The board treasurer has a wealth (pun intended) of information at their disposal to assist them with keeping the community's finances on track. This includes budgets, bank statements, balance sheets and delinquency reports. These pieces of information provide a holistic overview of the financial health of the community. Balance sheets help determine association liquidity and cash flow. Budgets keep a running tally of any overages or shortfalls. Bank statements give a detailed account of where association funds are being spent, and delinquency reports offer an excellent overall picture of the financial health of the community. Notice a sharp increase in unpaid assessments? The delinquency report allows boards and management to proactively work with homeowners to keep them from sliding further into arrears.

Choosing Where to Place Reserve Funds

A healthy association reserve balance can contain more money than many people will see in a lifetime. Volunteer board members, some who may be financial novices, are often tasked with the security and placement of dollars that can number into the millions. When choosing where to place these funds, three key considerations are safety, liquidity, and return:

- Safety is a top priority as most association investment policy statements require that reserves be placed in FDIC-insured, principal-protected accounts, such as Certificates of Deposit or Money Market accounts.
- Liquidity must also be evaluated, as capital improvement or deferred maintenance costs require cash on hand to complete the work.
- In terms of return, no association will become rich from the interest earned from principle-protected accounts. However, they are low risk/low yield financial instruments, designed to emphasize safety over the potential greater yields (and greater losses) of more high-risk vehicles.


A Reserve Study is Your Buddy

While the reserve study is a great resource for all board members, it plays an enhanced role for the treasurer. As the treasurer is tasked with maintaining community finances, it's important to know what lies ahead to effectively deploy funds for investment.

For example, if the reserve study indicates the association's roofs are one year away from the end of their useful life, it wouldn't be prudent for the treasurer to recommend placing all of the HOA's funds into a three-year investment. While not an absolutely accurate barometer of the community's financial future, the reserve study provides an excellent roadmap for the major shared components of the HOA and allows for more concise forecasting, budgeting and investing.

Healthy Finances Equal Healthy HOAs

The role of board treasurer is vital to the overall health of an association. The care and deployment of community funds can mean the difference between an HOA that thrives and one that languishes. Board treasurers should consult with their financial partners in the community association space, such as CPAs, HOA partner banks and reserve analysts to educate themselves and ensure that they are consistently acting in the best financial interests of the community. 🏠



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RUSSELL MUNZ
Community
Financials, Inc.

I like to say that the best practices are born out of the trials and tribulations of the worst practices. If you are a board member or community manager of homeowners associations and condominium communities, the way to learn these best practices without suffering yourself is to learn from the mistakes of others. Over the last three years I have researched over twenty case studies of fraud and embezzlement perpetrated by board members, onsite staff, portfolio managers and management companies around the country. In this article we'll discuss the resulting best practices, as well as cover some good housekeeping items.

Financial Reports:

One embezzlement scheme where the management company controller stole over \$2.3M from numerous communities was from doctoring the financial reports. The report package did not include a bank reconciliation report which proves what is on the reports matches what is on the bank statements. Besides fraud, getting reports more frequently will help you spot irregularities faster. Use the comparative income and expense report that shows the actual expenses versus budgeted expenses and the variance for the month and year to date. Look at the variances and then ask questions.

Best Practice

Get financial reports monthly and make sure they include a bank reconciliation report.

Bank Information:

In the case mentioned above, the controller also did not include bank statements with the report package, so the boards couldn't verify the funds in the bank compared to what was shown on the reports.

Best Practice

At a minimum get bank statements as part of the boards' financial report package. An even better practice is for boards (more than 1 person) to have online access to view bank accounts so it can spot irregularities faster and for greater checks and balances.

Old Bank Accounts:

In some cases, board members changed and an old bank account was not reported on the financial reports and a former board member was spending money from this account. Even when there is no fraud, I've dealt with boards where the original signers on the account moved or died and the new board could not access its money until then it filled out a lot of paperwork and had to go through numerous phone calls and meetings with the bank for over nine months! Plus, fewer bank accounts make the financial reports easier to read and will cost you less to have someone prepare.

Best Practice

Close old bank accounts.

Checks and Balances:

Another embezzlement case involved a board president who had the community checkbook and wrote out checks, forged a second board member's signature, and pocketed the money. Even having two signers required for checks did not work.

Best Practice

Systematize the association's accounts payable. We use an online system where the manager and/or two board members have unique logins to review and approve bills before a payment gets processed. This also increases the board's control over expenses and reduces surprises when reviewing the monthly financial reports.

Debit & Credit Cards and Petty Cash:

One onsite manager in Colorado had a debit card and withdrew money from the ATM at the Black Hawk Casino! The Board did not have access to the bank information and this went unnoticed for several years.

Best Practice

For debit cards the best practice is to set up a separate account and then limit the amount of money in that account to say \$1,000. Otherwise, someone could withdraw the daily limit every day and that can add up. Credit cards are better as you can put a cap on them but make sure you have a process in place to track the credit cards when board members or staff change. Petty cash is just a bad idea. We recommend not accepting cash as payment as it can easily "get lost." The best way to avoid all of these scenarios is to use a supply house that will invoice the association or if the purchases are infrequent for a board member to make the purchase and then submit reimbursement through an online approval system as mentioned above.

Payroll:

A community had onsite staff and chose to "save money" having that staff use Quicken to run payroll. The person doing payroll ended up giving themselves extra pay checks as well as additional bonus checks! Additionally, if withholding rates change and you don't change the rates in your software you may incur a shortfall. Depending on how quick the state is to notice this, the association could be liable to pay the shortfall as well as stiff penalties.

Best Practice

Use an outside payroll company to reduce risk.

Good Housekeeping**Separate Operating Funds from Reserve Funds:**

Many communities use only one bank account. We recommend that your association have a second bank account for its reserve funds. This will help you track these more clearly on the balance sheet monthly to see exactly how much you have put aside for capital replacement projects.

Operating Expenses Paid from Reserve Account:

I've seen where communities use the reserve account as a slush fund for operating account shortfalls. If you have to use these funds, we recommend borrowing them for a short term and then replenishing with a special assessment. Levy the special assessment quickly after the cause of the budget shortfall so it is fresh in owners' minds - think more snow than anticipated in a year assessed while it's still cold instead of during mid-summer.

Collections:

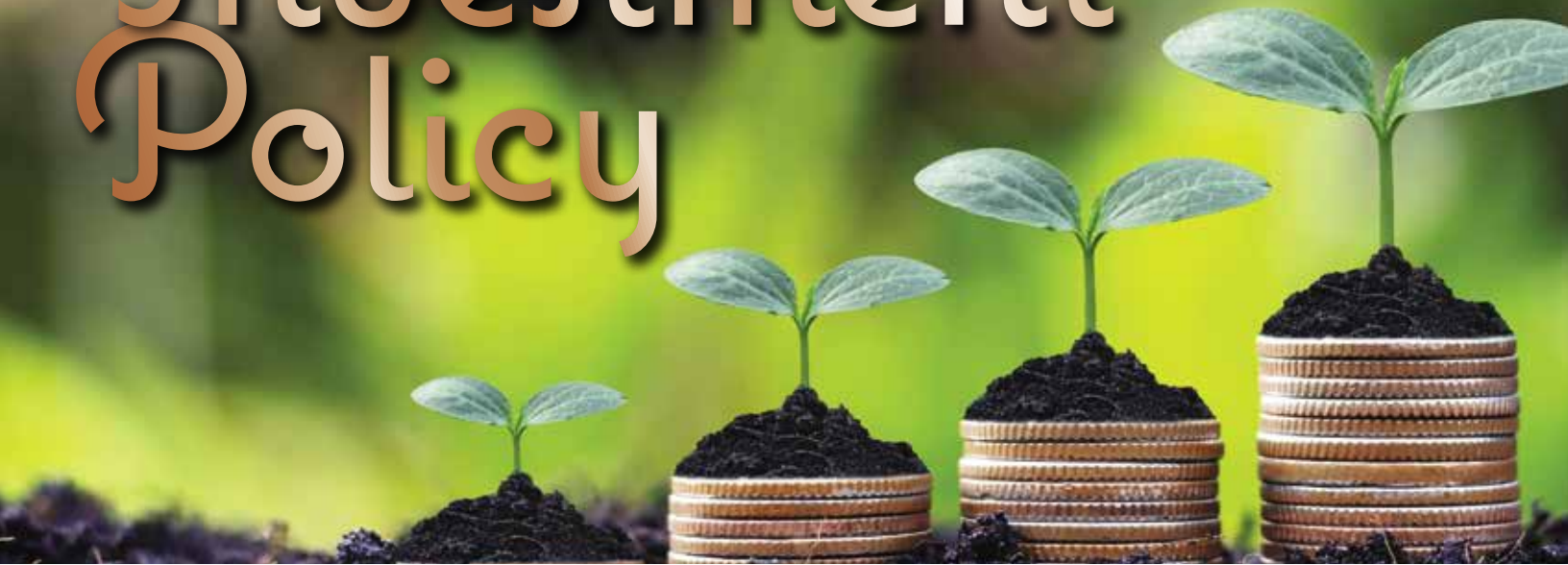
If your community doesn't have a collection policy that outlines what will be done at what time and the associated fees owners will pay (and you should have this policy, because it is required!) put that on your to-do list. This will help the board, management, accounting staff and homeowners get clear guidance on the association's process. Additionally, a best practice for home loans, car loans and credit cards are reporting delinquent payers to the credit rating agencies and now this is available for community associations. This lights a fire under owners to put their association dues bill on the top of stack of bills to pay and not the bottom.

I hope this opens up some discussion at your community or your management company. 🏠

Russell Munz is a Licensed / Certified CAM in 7 states and Founder and President of Community Financials, Inc. a nationwide financial management company that provides monthly accounting services to Community Associations based in Boulder, CO. For more financial best practices and to see the actual embezzlement case studies check out our blog at www.CommunityFinancials.com.

BASICS OF AN ASSOCIATION'S

Investment Policy



NICOLE BAILEY
RBC Wealth Management

Boards of directors and community managers rely on policies and procedures to guide community operations. The governing documents serve as the law of the land and the policies provide the roadmap. Each area of community operations likely has a corresponding policy to see that the board can make decisions fairly and efficiently. Just as covenant enforcement and assessment collections processes are guided by their respective policies, investment decisions are guided by the investment policy.

The use of investment policies is not specific to community associations. Many other entities use policies to guide their decisions. Some examples include college endowment funds, pension funds, and charitable organizations. All of these organizations have one thing in common: they are responsible for other people's money. The board of directors of a community association is elected by the homeowners to make decisions in the best interest of the association. With this responsibility, each director assumes a fiduciary duty of the association – not unlike those that govern the entities listed above.

In order for a policy to be valid and enforceable, the policy must be consistent with the governing documents and within the board's rule

making authority. The board's rule making authority is specifically outlined within the governing documents and should be cited within the policy. The policy should also state the purpose or objective and any restrictions. Confirming that essential components are contained in each policy reduces ambiguity and provides for fair and consistent processes.

The goal of the investment strategy should be detailed in the policy so that all parties subject to the policy (the board, the finance committee, and the investment advisor) are able to work towards a shared objective. Sometimes the investment objective is to preserve principal. This means that the priority of the investment strategy is to preserve the original investment. Another example of an investment objective could be moderate growth. In this situation, assuming a level of risk to the original investment may be necessary in order to achieve a moderate level of growth in the account. Clarifying the purpose of the investments informs the other considerations within the investment policy.

When defining the investment objective, it is important to consider the types of risk and how risk is defined. Most define risk as the potential for loss of principal. Loss of principal can be a result of market fluctuations; however it can also be a result of the loss of purchasing power due to inflation. If the investment objective is preservation of principal, the advisor and the board need to discuss the difference between market risk and inflation risk. If the objective

is moderate growth, a level of market risk might be required in order to achieve that objective. Discussing the potential impact of each type of risk is critical to establishing a risk profile. The risk profile for an association is often established in a conversation with the board and an investment professional who specializes in community association investment strategies.

Just as the objective guides the determination of the risk profile, the risk profile can guide the investment selections. By establishing the level and type of risk the association is willing to expose the funds to, the investment professional can provide recommendations that are in accordance with the objective and the risk tolerance of the association.

AN IMPORTANT CONSIDERATION WHEN INVESTING COMMUNITY ASSOCIATION FUNDS IS THE TIMEFRAME IN WHICH THE FUNDS WILL BE SPENT.

Whether the funds are earmarked for reserve expenses or repairs resulting from an insurance claim event, the schedule of spending and the liquidity needs will impact the investment strategy. Some policies outline provisions for short term funds and long term funds.

Doing so can help provide adequate liquidity while also targeting better returns on the funds that won't be spent for several years.

When creating guidelines around investment decisions, boards should also be aware of market conditions. With record low interest rates at play, what impact does this have on an association's earnings? Strategies that were proven effective in the 1980's may no longer generate the same results on an account. Because of the dynamic nature of investment circumstances, policies should be reviewed regularly so that necessary changes can be made in order to achieve the stated objective.



Considering the board's fiduciary duty to the association, establishing a comprehensive investment policy encourages a proactive and thoughtful approach to community association financial management. ⬆

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Nicole brings a broad background in community management in the Atlanta and Denver areas to her role on the West Wealth Management team. She actively volunteers with the Rocky Mountain Chapter of Community Associations Institute on the Marketing and Membership Committee.

Colorado Community Associations facts & figures

- » Approximately **2,300,000** Coloradans live in **920,000** homes in more than **10,000** community associations.
- » These residents pay **\$4.2 billion** a year to maintain their communities. These costs would otherwise fall to the local government.
- » **78,000** Coloradans serve as volunteer leaders in their community associations each year, providing over **\$79 million** in service.
- » The median home value in Colorado is **\$313,600**. Homes in community associations are generally valued at least **4%*** more than other homes.
- » By **2040** the community association housing model is expected to become the most common form of housing.





TAXES and Your Homeowner Association

Kim Hitchcock is a CPA in Lakewood, Colorado and the managing partner of the public accounting firm McNurlin, Hitchcock & Associates, P.C. Kim is also a member of her residential HOA and is involved with the HOA of her family's vacation rental. She has more than 26 years of experience in public accounting in the tax, audit, and accounting fields working specifically with CIRAs and small businesses. To find out more about Kim and the team at McNurlin, Hitchcock & Associates, P.C. visit www.mcnurlin CPA.com.



KIM HITCHCOCK
McNurlin, Hitchcock &
Associates, P.C.

Today's homeowner is savvy and aware of the tax implications of homeownership. Deductions for mortgage interest and real estate taxes are common topics of conversation, however, taxes paid by the HOA are often left out of the discussion. It is easy to assume that HOAs are tax exempt, but the IRS disagrees. The HOA could be subject to tax on income from vending machines, laundry machines, clubhouse rentals, easement proceeds, roof rent, etc. This is true, even if the HOA is registered as a nonprofit corporation.

If, after reading this article, you are uncertain how these rules apply to you, or your HOA, be sure to enlist the support of a qualified CPA Firm.

Homeowner Associations can pay taxes?!

Homeowner associations (also called HOAs, CIRAs or Associations) have a distinctive taxing structure that is complicated by multiple taxing options. To start, we will first define the HOA.

What is a Homeowner Association?

According to the IRS, the HOA is an entity that provides a benefit to the community. It can be a condominium association designed to care for property in a specific condominium project, a residential real estate association designed to care for properties in an area or a timeshare association. The important factor is that the HOA is created as an entity designed to act on behalf of individual owners or members for the good of the overall community.

For that reason, the HOA is not often taxed on dues and assessments which are collected from members for the purpose of maintaining the property, even when the dues collected are greater than the current year expenses.

My HOA is a Colorado non-profit. Why do we pay taxes?

The State of Colorado recognizes the HOA as a nonprofit corporation. It is important to note that a nonprofit corporation in Colorado is not tax exempt under the Internal Revenue Code (IRC). To become tax exempt, the requesting organization must file complicated paperwork and report their mission to the IRS.

What tax form does the HOA file?

The HOA is a legal entity and a corporation. It is required to have a tax ID number (FEIN) and file annual tax returns with the IRS and possibly with the State as well. The good news is that the HOA can often elect to take advantage of the tax benefits provided by IRC §528 by filing the shorter Form 1120-H instead of the longer Form 1120 unless the HOA is primarily commercial, not residential, or if the HOA is primarily funded by non-exempt sources.

Form 1120-H; U.S. Income Tax Return for Homeowners Associations

HOAs that elect to file form 1120-H will start the process by designating each item of revenue as "exempt" or "nonexempt." "Exempt" revenue would include member dues, assessments, and anything that is charged to members based on their ownership percentage. Everything else, such as investment income, rental income, resort fees, and vending income is "non-exempt." This is an important designation because the "exempt" income is also the "tax free" income.

Non-exempt income, less all associated expenses and a \$100 statutory deduction, is subject to the 1120-H tax at a federal rate of 30% (plus State).

Form 1120, U.S. Income Tax Return for Corporations

Associations that do not elect to file form 1120-H will file the full form 1120, but the HOA will still benefit from special rules for membership organizations. HOAs that file form 1120 will start the process by designating each item of revenue as received either by a member or by a nonmember. Income received from a member is "tax free" if it is used to pay for member/community expenses.

If the HOA collects member income, dues, or assessments that exceed community expenses, the HOA will have something called "excess membership income." This excess must be applied to the following year budget or refunded to the members. Choosing which option, either budget adjustment or refund, is addressed through a resolution at the HOA annual meeting.

Income from nonmembers, less all associated expenses, is subject to federal tax on Form 1120 at a federal rate of 21% (plus State).

As you can see, the complexity of the tax return really depends on the activities of the HOA and the availability to file the shorter Form 1120-H vs the longer Form 1120. Talk to your tax professional if you are seeking more guidance on this subject. 🏠

MEMBER SPOTLIGHT

WHAT IS THE HISTORY OF WINTRUST COMMUNITY ADVANTAGE?

Wintrust Community Advantage was created in 1999 when we realized there was a need for banking solutions geared toward community associations that other banks weren't filling. We cater to the needs of associations, their boards, and the management companies that serve them.

WHAT SERVICES DO YOU OFFER COMMUNITY ASSOCIATIONS?

As one of the Midwest's leading providers of financial services to condominium, townhouse, and homeowner associations, we offer everything you need to manage your finances.

Our full suite of financial solutions and services includes solutions to manage cash and operations, a variety of lending options, reserve investments, disbursement services, and account management services.

HOW DOES YOUR BANK DIFFER FROM OTHER BANKS?

The senior management team has more than 100 years of combined expertise in banking. Wintrust Community Advantage only services the community association and property management industry. Our solutions are built specifically for this industry and tailored to each association.

With our level of knowledge and niche focus, we're able to offer the customer service that you'd expect from a community bank, paired with the backing of our parent company Wintrust, a well capitalized, multi-billion-dollar financial services company. This gives us the strength and stability so sought after in today's economy.

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UNDERSTANDING THE IMPORTANCE OF ASSESSMENT INCREASES

RYAN MORITA
5150 Community
Management

Any community management professional understands that one of the biggest questions raised year after year by board members and homeowners alike is “Why do we need to increase our assessments this year?” An educated manager that comes ready to answer that question is going to be able to both service the community, and at the same time, fight off the negativity that often surrounds assessment increases. There are many valid responses that can be used to communicate to communities the reasons why their specific communities need to raise their assessments.

Ryan Morita is the Director of Accounting Services at 5150 Community Management.

Let's review some of those responses now.

The Association Needs to Keep Up with Rising Costs

Inflation and rising costs are often the biggest factors in the need for a community association to increase their assessments. Year after year, the value of a dollar decreases while costs of many goods and services increase in correlation with this inflation. A responsible community association will foresee these increases in cost and communicate to the membership that the assessments for the association will need to increase as well. If this is not planned strategically and with foresight, the association risks having an operating shortfall and having to resort to drastic measures in order to just maintain the day-to-day operation of the association. These measures could include a substantial increase in assessments that far exceeds the inflation rate. For example, an association that does not increase assessments for several years in order to artificially maintain a “low dues association” could possibly find that it cannot afford a service that is required by the declaration and must increase assessments 20-30% in order to just maintain the standard that is required by the governing documents.

The Association Needs to Plan for the Future

One of the most important aspects of operating a community association is the maintenance and replacement of the physical assets of the community association. Often, this aspect of community management can be overlooked, both by focusing too much on the short-term needs of the membership and by focusing too little on the long-term financial requirements of the community. Every asset that the community owns will inevitably need to be replaced. It is the duty of the board of directors to plan for that replacement and to maintain a reserve fund in order to pay for it. The most important steps in this process are understanding what the association owns, how much it will cost to replace each item, and how long the association has until those items need to be replaced. A reserve study should often be the go-to tool for community association boards and managers, as it provides a guideline for all three of those factors and allows the association to come up with a realistic plan and expectation of maintaining and replacing their physical assets. With an informed plan in place, the odds of the association needing to implement a special assessment or worse, deferring maintenance, will decrease significantly.

The Association Needs to Defend Itself Against Stagnation

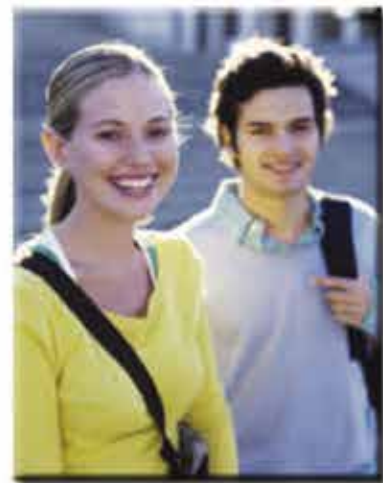
This response is often the simplest to explain, the easiest to implement, and yet the most overlooked by community association boards and managers. If an association begins to expect that dues will not increase, then even a small and reasonable increase could be seen as having a negative impact on the individual members. If the community association is going to be able to keep up with cost increases and save for the future, then assessments will need to be increased by a small amount every year in order to operate. The expectation should be set that a small increase is required and is beneficial to the individual members and the entire association. If the homeowners expect a small increase each year for this reason, then it is unlikely that they will ever be surprised by an increase. Also, if an association expects a small increase each year, it will inevitably avoid the pitfalls of an artificially low assessment level. Often, there is a false association with low assessment levels to being “good” while high assessments are considered “bad,” when there really are only “correct” and “incorrect” assessments. Correct assessments are going to be set at a level specific to the community, that funds for operating expenses, saves for the future, and has the flexibility to allow for fluctuations in cost year after year.

Equipped with these three responses, a community manager will have everything they need in order to communicate to the board and membership the importance of increasing dues annually. It can be a difficult task at times for managers to maintain the balance between satisfying the membership and adequately funding their communities, but a well-informed manager will have all the tools that they need to communicate the importance of increasing dues on an annual basis and avoiding the many traps associated with under-funding a community. ⬆

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What Community Associations Need to Know about Reserve Laws

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PHOEBE E. NESETH, ESQ.

Following last month's devastating partial collapse of the Champlain Tower South condominium in Surfside, Fla., many community association managers, boards, and residents are eager to understand state laws and regulations around reserve studies and reserve funding.

A reserve study is a budget planning tool—consisting of both a physical and financial analysis—that identifies the components an association must maintain or replace, the current status of the reserve fund, and a stable and equitable funding plan to offset anticipated major common area expenditures, according to the Foundation for Community Association Research's Best Practices report on reserve studies and reserves management.

CAI's Government and Public Affairs Committee recently convened a special meeting with experts representing attorneys, builders, reserve specialists, and insurance professionals to discuss best practices, standards, and public policies related to the tragedy in Surfside. Three working groups have convened to establish guidance and model language for CAI's state legislative action committees as well as considerations for state legislators and best practices for community association board members, managers, and other professionals.

The three working groups are:

- Building inspections and maintenance.
- Reserve study planning and funding.
- Insurance and risk management.

CAI advocates for developers to transition communities with a current reserve study and a budget that includes both operational funds and reserves, as well as initial funding of reserves for future maintenance, repair, and replacement of facilities and equipment.

Many states have legislation pertaining to community association reserves and operating funds to protect owners from fiscal concerns and financial hardship. Below is a summary of state reserve fund laws.

Reserve studies or a reserve schedule for condominium associations are required in **California, Colorado, Delaware, Hawaii, Nevada, Oregon, Utah, Virginia, and Washington** state. Washington statutorily encourages associations to have a reserve study performed every three years unless doing so would impose an unreasonable hardship. Florida statute does not require a reserve study but requires a reserve schedule for repair and replacement of major components.

Reserve funding for condominium associations is required in **Connecticut, Delaware, Florida, Hawaii, Illinois, Massachusetts, Michigan, Minnesota, Nevada, Ohio, and Oregon**.

Budget disclosure of reserve planning is required for condominium associations in **Alabama, Alaska, Arizona, California, Connecticut, Delaware, the District of Columbia, Florida, Georgia, Hawaii, Illinois, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Missouri, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, Oregon, Pennsylvania, Rhode Island, Texas, Utah, Vermont, Virginia, Washington, West Virginia, and Wisconsin**.

Resale disclosures are required for condominium associations in **Alabama, Arizona, California, Connecticut, Delaware, the District of Columbia, Florida, Georgia, Hawaii, Illinois, Louisiana, Maine, Maryland, Minnesota, Missouri, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, Pennsylvania, Rhode Island, South Carolina, Texas, Utah, Vermont, Virginia, Washington, West Virginia, and Wisconsin**.

CAI is uniquely positioned to lead the conversation on these standards, best practices, and policy changes to benefit our more than 42,000 members, the 73.5 million Americans living in community associations, and the millions more living in community associations around the world. We will continue to engage in conversations with members, experts, and stakeholders in the community association housing model to strengthen existing standards and public policy in these areas.

If you have comments, opinions, or expertise in any of these areas and would like to contribute to the conversation, please email government@caionline.org.

Access additional CAI resources on reserve requirements and funding at www.caionline.org/Advocacy/Priorities/ReserveStudy/Pages.

Please remember that community associations are governed by state law, which can vary widely from state to state. This information is intended for general educational and informational purposes only; it may not reflect the most recent developments, and it may contain errors or omissions. The publisher does not warrant or guarantee that the information contained here complies with applicable law in any given state. It is not intended to be a substitute for advice from a lawyer, community manager, accountant, insurance agent, reserve professional, lender, or any other professional.

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LEE FREEDMAN
PWF Legal

It began about 40 years ago when the Champlain Towers South condominiums, the Surfside, Florida condominium complex that became a news story in June, was first developed. Internal documents apparently contend that the driveway on the top of the building's garage had "very poor drainage (design flaws) which exposed the garage to water intrusion for 40 years."

The Champlain Towers South community association grappled with what many Colorado community associations grapple with - members fighting over deferred maintenance, increases of assessments, and the levying of a special assessment. At least since 2018, the members were advised of the need to remediate the poor drainage, which was likely to cost approximately \$7 million, which started infighting among the members and the Board.

What many members in community associations fail to acknowledge is that assessments are the lifeblood of community associations. This is why Colorado law, along with statutes in many other jurisdictions, provide that members must pay assessments and may not withhold such payments just because they have a dispute against their association. The levying of general assessments, whether monthly, quarterly, or annually, is a necessity for community associations to raise sufficient capital in which to operate. Assessments are used to pay for the general expenses of community associations and to provide sufficient funds in reserve accounts in order to help pay for deferred or emergency maintenance.

However, assessments are often used as political fodder for those running for director positions on the executive board, whether it is argued that the current board is levying too much in assessments, which is harming the members financially, or is charging too little which is causing harm to the components of the common elements and the values in the community.

Those boards that fall in the "board is charging too much" category tend to care about appeasing the members by keeping assessments low. Many times, these types of boards will refuse to increase assessments for many years and argue that is what the membership wants as it continues to re-elect the same board members.

However, failing to increase assessments, especially for a lengthy period of time, can impact an association in several very troubling ways including not having sufficient funds to provide additional benefits to members such as community events, to pay for the expenses related to the provision of recreational facilities, to perform necessary or recommended maintenance on components for which the association has the responsibility, or to provide sufficient reserves to cover expenses for future anticipated reserves.

THESE BOARDS GENERALLY PREFER TO PUSH THE MAINTENANCE RESPONSIBILITY OR COSTS UPON FUTURE BOARDS – BASICALLY TAKING THE POSITION THAT “IT IS THEIR PROBLEM, NOT OURS.”

They tend to look at the immediate financial benefit of the community, while ignoring the future consequences of their reckless financial decisions, disregarding contractors’ or reserve specialists’ recommendations, and ignoring their own potential legal liability for such future consequences.

Ultimately, such decisions may have serious, and even devastating, consequences. The lack of maintenance can result in the early failure of components or worsening damage of the components, which can also result in damage to persons or other property. These board decisions can invalidate insurance coverage for such injury or damage. If there are not sufficient reserves to cover the repairs, in whole or in substantial part, the association could end up having to immediately come up with thousands, to hundreds of thousands, to even, as in the Champlain Towers South community situation, millions of dollars to perform the requisite repairs. This can result in the Board having to propose a special assessment. However, since many declarations require owner or member approval of the levying of a special assessment, there is not any guarantee that the association can raise the funds quickly or in a reasonable period of

time, which can result in continued deterioration or threat of further injury and damage.

Basically, one board’s decision to not raise assessments can create a slippery slope which can put persons and property at serious risk of harm. The Surfside, Florida condominium garage collapse, resulting in the destruction of at least 55 condominiums and counting, is an extreme example of what could happen in a common interest community should the board fail to levy reasonable assessments or stay on top of necessary or recommended maintenance. It is a strong lesson to all voluntary board members of the consequences of poor association maintenance.

Board members and community managers must take the financial needs of their communities seriously when determining budgets and the amount of general assessments to levy and learn from the mistakes of others.⬆️

Lee Freedman has been practicing HOA Community Law for over 20 years. Lee is an active volunteer in CAI and the Colorado Legislative Action Committee. His passion for education and productive community governance is a driving force in his firm.



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Community Association Governance

Assessment Increases and

Mental Health

CAI-RMC Editorial Committee

This year, the CAI-RMC board decided to focus on the mental health and well-being of the members of our industry – our homeowner leaders, community managers, business partners, and the owners in each of our communities. The past 18 months have taken a toll on everyone and caused stress in the lives of many in different ways than had ever been experienced. We've also seen our community rise and deal with what sometimes felt like insurmountable change in incredible ways. Our current board and leadership have been looking, and will continue to do so, at ways that we, as an industry and as individuals, can take care of ourselves and our members, to create the best communities we can, while making ourselves the best versions of ourselves.

This edition of the magazine has many topics that people may find stressful – assessments, reserves, investments, personal finances, etc. And as we all know, money is one of the most significant stressors. Several studies have shown a link between financial worries and mental health issues, such as depression, anxiety, and substance abuse.

Experiencing mental health issues can easily cause problems at both work and at home. The incomes of many homeowners (inevitably in our communities) may have been significantly reduced and/or eliminated. If they have been able to remain employed, even discussing an assessment increase in “normal” times can cause hardship. But, as many articles in this edition state, assessments are the lifeblood of an association. They are necessary for an association to be run responsibly (and preserve, protect, and enhance the property values in the community).

At the same time, Boards should consider hardships faced by their residents and be willing to work with them to ensure

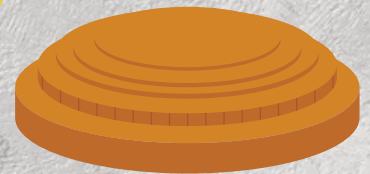
that our homeowners and our associations are both able to meet the needs to support their families and communities. What does this mean? It may mean agreeing to a waiver of late fees/interest if requested from owners on delinquent accounts. It may also mean allowing a more extended payment plan than is required or generally allowed (if it makes sense for your association's financial position).

It certainly means that your board will have to educate its members as to why assessment increases and/or special assessments, at times, are necessary. Now more than ever, with the tragic example of the Champlain Towers South collapse, our communities need to be looking at whether or not they have been deferring maintenance to appease membership and keep assessments low. Having an open dialogue about the association's financial position and maintenance obligations regularly and with owners in the community can help membership understand and hopefully accept additional financial burdens now to potentially save money later.

In summary, we have to remember that many people are having (and sometimes often have) to make hard choices on which bills to pay. We also have to remember that associations are non-profit corporations with boards that have a fiduciary duty to protect, preserve, and enhance the property values in the community. Part of that is ensuring that the governing documents for the association are followed, determining on specific case-by-case basis waivers for members of your community, and ensuring that your board is taking the necessary steps to preserve, protect, and enhance the property values in the community – which includes education on why it is likely that assessments in your community will always be on the rise! ⬆



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Mrs. Tina Harrison, CMCA, AMS, PCAM	Denver	Executive Management Group	PCAM	06/16/2021
Mr. George Skrbín, CMCA, AMS	Aurora		AMS	07/14/2021
Ms. Virginia M. Johnson, CMCA, AMS, PCAM	Aurora	Colorado Property Management Group	PCAM	06/18/2021
Mr. Matt Szmyd, CMCA, AMS, PCAM	Edwards		PCAM	06/18/2021
Ms. Tressa Bishop, CIRMS	Colorado Springs	USI Insurance Services	CIRMS	06/02/2021
Mr. Brandon Perko, CMCA, AMS, PCAM	Littleton		PCAM	06/18/2021
Ms. Amber Wood-Jensen, CMCA	Castle Rock	TMMC Property Management	CMCA	05/20/2021
Ms. Wendy Klein, CMCA	Denver	CAP Management	CMCA	05/18/2021

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Diane Davies–Genesee Foundation

Jeff Bowman–Heritage Greens at Legacy Ridge Homeowners Association, Inc.

Suzie Reinhardt–Innsbruck In Aurora Homeowners Association

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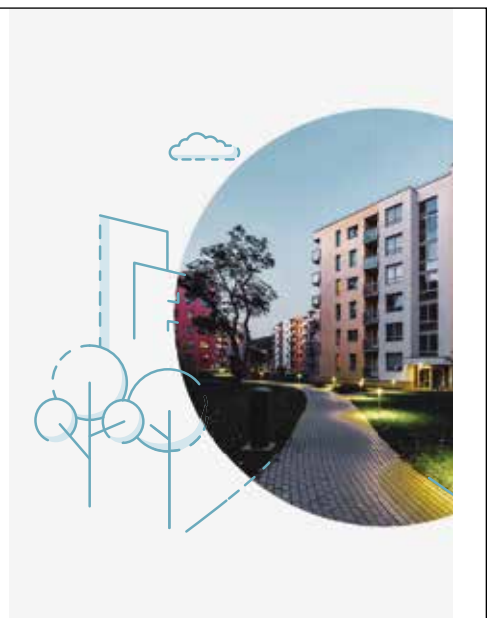
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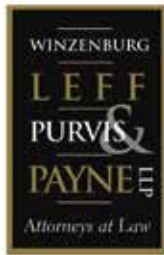
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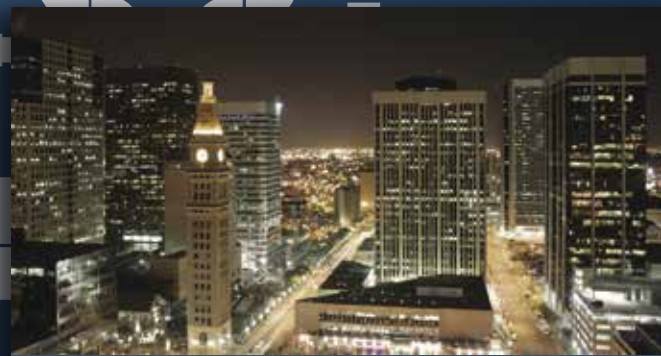


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3	Fri	Business Partner Forum
7	Tue	Peak 2 - Financials Fort Collins
14	Tue	Train the Trainer - Part 2
16	Thu	Annual Clay Shoot
27	Mon	Mountain Conference & Annual Meeting

October

12	Tue	Community Association Workshop
26	Tue	CEO Forum
27	Wed	Orientation Outreach

November

2	Tue	Peak 3 - Insurance
15	Mon	2022 Sponsorship Sales Q&A
30	Tue	Manager / PCAM Forum

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