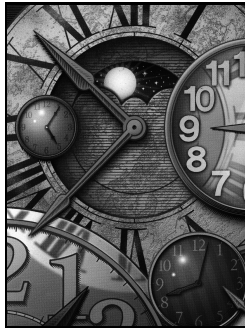


Reserve Studies Minimize Liability

These days it seems that boards are being barraged by many issues that weren't even considered only a few years ago. Lawsuits and claims of financial mismanagement are taking



place on a daily basis. They are at best a nuisance, and at worst very costly and stressful. Over the years,

homeowners volunteered to serve on the board because they had expertise and skills from professional careers that were applicable to the association. Examples include attorneys, accountants, and engineers.

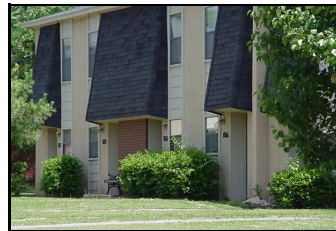
Boards comprise people with these skills as well as other owners who are simply concerned about protecting their most important investment - their home. This approach generally worked well in the early years of the association industry. Today, however, community associations are being managed more like a business with the help of outside consultants such as attorneys, engineers, and accountants who specialize in community association property. One example is planning for future capital repairs with an adequate reserve fund.

Now more than ever, associations are using the services of independent engineering firms that specialize in 30-year Reserve Studies. A professional Reserve Study determines accurate, supportable annual reserve contributions necessary for the repair or replacement of common property as it wears out over the development's life.

Professional Reserve Studies are designed to eliminate special assessments by ensuring that sufficient funds are available when property components need to be repaired or replaced. Elimination of special assessments offers peace of mind to owners and reduces claims of financial mismanagement.

Why are community associations being managed like businesses?

Homeowners view their home as a financial investment that they expect to appreciate in value. More important, associations are



increasingly emulating business management because of the fiduciary nature and responsibility of association boards.

Lawsuits and claims of financial mismanagement have driven state governments to protect citizens who are a part of community living. Regulatory pressure from state governments has increased dramatically in recent years regarding the fiduciary obligations of boards and managers.

Examples include licensing and certification of property managers and more state legislation. These laws are designed to ensure that associations are reserving appropriate levels of funding for common element replacement. Some state statutes call for "reasonable" or "adequate" reserve funds, while others such as Michigan require that the association "shall maintain a reserve

fund which, at a minimum, shall be equal to 10% of the association's current annual budget on a noncumulative basis." While regulations vary from state to state, there is a strong trend toward more legislation rather than less.

The purpose of condominium related legislation is to protect current association members and prospective buyers, and to ensure that the association is properly managed. Questions of fiduciary responsibility date back at least as far as the early 1980s in California case law with the landmark **Raven's Cove** decision, which discussed the fiduciary responsibilities of directors of a nonprofit organization, namely, the association. On January 20, 1981, The Court of Appeal, Taylor, P.J., held that: "...Where owners' association's original directors... failed to exercise their supervisory and managerial responsibilities to assess each condominium unit for an adequate reserve fund ... Former directors of the association breached their fiduciary duty and were individually liable to the association for said breach..." Thus, important case law came into being which affects the individual liability of condominium directors and officers. One may wonder what his "fiduciary duties" are or "why should I be concerned if I am covered by D&O liability insurance?" As a director of a community association, your actions (or inactions) have an impact on your and the members' financial well-being now and in the future. Your association's insurance premiums could escalate as a result of D & O litigation.

Also, board members can be subpoenaed in litigious situations

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years after leaving the board to testify against accusations of mismanagement. Even the American Institute of Certified Public Accounts (AICPA) has guidelines that specifically address community associations and the funding of reserves.

The AICPA *Audits of Common Interest Realty Associations* clearly states that the association's "primary duties are to maintain and preserve the common property." "Inadequate funding for future major repairs and replacements may adversely affect the ability of owners to sell or refinance their units, because of the concerns of prospective buyers or the banks which can lead to difficulty in obtaining mortgage financing.

The AICPA audit guidelines require disclosure in the financial statements about an association's funding for future repairs and replacements. If

the disclosure about an association's funding for major repairs or replacements is inadequate, the auditor will modify his or her report. In other words, the association will receive a qualified audit. Qualified audits raise many questions on the part of prospective buyers, and particularly, their lenders.

Association boards are becoming more sophisticated in the way they conduct association business. Sound business decisions for the future cannot be made without a reliable snapshot of where the organization is now, as well as where it's planning to go.

Boards and management companies alike look to firms specializing in reserve studies for an independent, accurate projection of future capital repair costs. The reserve study becomes the blueprint that the

current and future boards will rely on with complete confidence to fulfill their fiduciary responsibility. They'll be assured fewer claims of financial mismanagement because they invested in independent, expert advice.

Article by John P. Poehlmann, RS.

John is a principal of Reserve Advisors, which specializes in Reserve Studies throughout the United States and Canada. He is co-founder of the *Reserve Professionals Committee* of the Community Associations Institute (CAI) which developed national standards and Reserve Specialist designation for Reserve Study providers. He also serves on the national board of trustees for CAI. John can be reached at **800-221-9882** or **reserveadvisors.com**



Reserve Advisors, Inc. is the leading provider of **Reserve Studies**, **Transition Studies** (defect analysis at developer turnover), and **Property Insurance Advisory Services** in over 40 states and Canada since 1991.

Clients benefit with a customized, thorough analysis that's based on our noninvasive, visual inspection and is easy to use. Understanding the needs and issues that are specific to client objectives helps ensure satisfaction.

Clients comply with national standards because many of our engineers and architects hold the Reserve Specialist (RS) and Professional Reserve Analyst (PRA) designations from the *Community Associations Institute* and *Association of Professional Reserve Analysts*.



John Poehlmann, RS

Our principals are at the forefront of education and professional standards. Theodore Salgado, P.E., PRA, serves as President of the *Association of Professional Reserve Analysts (APRA)*. John Poehlmann, RS, serves on the *Community Associations Institute (CAI)* national Board of Trustees. Both are founders of CAI's *Reserve Professionals Committee*, which developed national standards for Reserve Study providers.

Our focus is to help clients preserve and maintain their property in excellent condition.