

Tips for Creating a Successful Reserve Study

By Robert W. Browning, PCAM, RS

ECONOMIC TIMES CONTINUE to challenge everyone, especially homeowner associations. It is difficult serving on a board with dwindling assessment streams and rising costs. It takes individual fortitude by board members and a strong team to pass a budget with an assessment increase. This team of board members, managers, and industry professionals must work together with the best interests of the members in mind. Board members need good information now more than ever to ensure budgets reflect reality. The single largest line item in most budgets is the contribution to reserves, so dealing with reserves, the reserve study and the reserve specialist is critical to creating a budget that will meet the needs of the community.

Let's start at the beginning of the process: bidding the reserve study. It is never too early to take the reserve study out to bid, especially if a site visit is required. Fortunately there have been no new laws related to reserve studies in California the past few years. So for most associations, a reserve study that includes a reasonably competent and diligent visual inspection of the accessible areas of the major components that the association is obligated to repair, replace, restore or maintain is still required every three years.

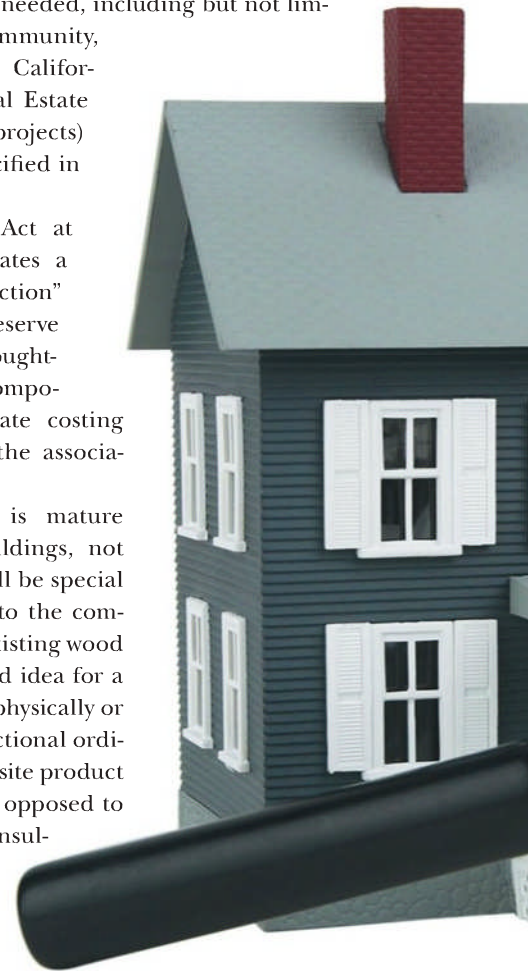
If the association is in one of the two "off" years, meaning an update without site-visit study is needed, having this level of study is a good idea for a couple of reasons. First, the California Assessment and Reserve Funding Disclosure Summary must be executed and included in the budget packet mailing to the members and this form can only be executed properly from a currently updated reserve study.

The second reason to update the study every year is because it makes good business sense, especially within the context of current economic times. This is the true safety net to ensure interest rates, inflation factors, and component-costing projections are updated. The cost for a yearly update is usually nominal and for continuity and pricing reasons, the reserve analyst who performed the site-visit study is usually your best bet for updating the off-year study, both in terms of cost and speed.

So the association has bid the reserve study and selected a qualified reserve analyst. Next, the reserve analyst will need several documents to perform the site-visit study. Just a few of these would include: signed contract, retainer fee, list of reserve expenses since last study, audit or review, budget and current financial statement. If this is a full study, meaning the first time the analyst has worked for the association, then a lot more will be needed, including but not limited to: a map of the community, governing documents, California Department of Real Estate budgets (for newer projects) and other items as specified in the contract.

The Davis-Stirling Act at Civil Code §1365.5 states a "diligent visual inspection" must be part of the reserve study. This means a thoughtful look at the major components including accurate costing for the region where the association is located.

If the association is mature (we're talking the buildings, not the members), there will be special considerations related to the components. Perhaps the existing wood shake roof is not a good idea for a re-roof material either physically or because of local jurisdictional ordinances. Maybe a composite product is better for decking as opposed to wood. The cost for a consultant or construction manager may need to be built in to the reserve component costing.



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The three-year “update with site visit” study provides the perfect opportunity to re-think the staging of related projects. Considering the big picture guarantees components are replaced or maintained in context with each other. For example, how many times have you seen the city dig a trench, to replace a water line, a few months after new asphalt has been installed? Instead of blindly accepting the recommendations of the reserve analyst, carefully look at the work contemplated over the next several years. For example, if the association needs roofing and painting in the next five years, why not engage the services of a color consultant or architect to suggest materials and colors that complement each other. Chocolate brown was a great color back in the 1970s, but may not be the best fit now for exterior paint. Computer illustrations make it easy to see how your community will look post rehab. Some paint manufacturers will do this for free. By thinking big picture, boards are allowing the members to get the most value for their home at their next resale, and also ensuring assessments are set at the proper level. The job of maintaining, enhancing and protecting the value of the community is one of the prime responsibilities of the board of directors.

This is a good time to discuss what a reserve study is NOT.

It is not an engineering study, nor is it an architectural review or a construction management plan.

Wouldn't it be nice if a \$3,000 reserve study scoped out all reserve projects, with different materials, alternative suggestions for environmental concerns and best practices? But all of these services are specialized and require the help of professionals in a variety of fields. Remember: a reserve study is a budget tool, not an engineering exercise. The reserve analyst may be able to contract individually for some of these specialized services; remember this is an add-on to the reserve study.

For some of the more “mature” communities as discussed above, there may be a need to augment the reserve study with professionals who have engineering and/or architectural backgrounds. Often, the reserve analyst is the best person to recommend these skill sets, as they may be needed from time to time.

Once the visual inspection has been completed (for a site visit study), the reserve analyst will work on the funding plan. A quality reserve study will include a funding plan that meets the association's funding objectives. California has no requirements related to funding, other than disclosure to the members.

All too often, when the board receives the first draft of the reserve study, especially if the study includes bad news, board members forget this is the beginning of the budget process, not the end. Stress levels rise. Working with the reserve analyst as outlined here, through collaboration and cooperation, will result in a positive outcome for the board and the members.

Sometimes the board may need to see a few different funding plans in order to adopt one that meets their objectives. If roofing and painting are needed within the next five years as described above, there may be several ways of achieving the same goals. When bidding the reserve study initially, make sure it is stipulated how multiple drafts are dealt with, contract-wise. Some reserve analysts may only give you one bite at the apple while others may charge a fixed fee for each draft. In addition, if you want the reserve analyst to come to a meeting and explain the study, that may be an extra expense as well.

A source of confusion often exists among boards and managers because some reserve studies provide more than one funding plan, at a time, in a single study. This is useful in those situations where the board would like to see the impact of different funding scenarios. However, it is critical that when the board adopts one of the funding plans, or a subsequent hybrid of several optional funding plans, that the association let the reserve analyst know which one was adopted by the board so that the analyst can produce a “final” reserve study with that funding plan.

Adopting one specific funding plan and asking for a final reserve study serves several purposes. It creates a paper trail memorializing steps taken by the board to set the reserve contribution, hence the assessment. This is important, especially if there is a special assessment or other potentially controversial funding mechanism that may result in litigation.

In addition, if the association hires a different reserve study firm next time, it will be perfectly clear what funding plan the



board adopted and it will be easy to provide this information, for continuity's sake to the next reserve study firm, or the next management firm and/or board in those cases where management has changed or there has been rapid board turnover.

An important as well as overlooked next step is communicating the reserve study results to the members. Once the board has adopted the final reserve study, transmitting the results to the members is vitally important. This includes not just the standard disclosures we will talk

about later, but actually communicating the impact the study will have on the reserve fund, with the members.

Communication is key to "selling" the members on the adopted funding plan. This is especially true if the funding plan impacts the budget in a major way. Sometimes the only way to deal with issues facing the association is to recommend a special assessment. This author can guarantee that if the first time the members learn of a proposed special assessment is when they receive the ballot, the measure will most likely fail. On

the other hand, boards have been very successful in getting large special assessments passed utilizing a myriad of tools. The first step in the process is to communicate as soon as the board learns there is a shortfall in reserves. Letters to members, newsletter articles, presentations at annual meetings, neighborhood coffees, association websites, and email are a sampling of techniques available. In smaller associations divide the member list by board member and go old school, one on one. One association had success getting a large special assessment passed by creating a construction binder for each unit showing before and after illustrations of the project, budgets, and construction timelines. Members want information and assurances this is a one-time event.

The board should, prior to drafting a ballot for a proposed special assessment, have a member meeting where the problems and proposed remedies are presented. The reserve analyst may be the best person to help explain the proposed action along with the board members, committees, management, legal counsel, CPA, as well as all of the construction-related trades involved including the construction manager or architect if applicable. Frequently the members will have valuable input for the board related to the special assessment or other funding issue. Sometimes the members just want to feel the board listened to them.

The study is adopted, the members are up to date, and now management has to mail out the annual budget packet to the members, including the required disclosures. We'll save all of the Davis-Stirling required disclosures for another article and only focus here on the reserve-related items.

For approximately six years, it has been the law in California for the association to include in the annual budget mailing the California Assessment and Reserve Funding Disclosure (CARFD). This document (as stated in Civil Code §1365.2.5) has several statements regarding assessments and reserves, and much of the data on the form flows directly from a current reserve study update. It is not possible to execute the CARFD without first updating the reserve study.

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Because I could write an entire article just on disclosures, here I will focus on the part of the disclosure that can slow the entire reserve study preparation process down.

The very first statement on the CARFD disclosure says, "The current regular assessment per ownership interest is \$_____ per ownership interest." Because this statement cannot be executed prior to the reserve study adoption, this has created a three-step dance in the industry that goes something like this:

- Board adopts reserve study and budget,
- Management transmits adopted reserve contribution and next year's assessment to reserve analyst,
- Reserve analyst fills in the assessment amount in the statement and provides updated disclosure to management.

It is important that the association and management build this extra time into the budget process. Not all reserve analysts work seven days a week!

In addition to the CARFD, there are many other reserve-related disclosures that still need to be included in the budget packet. Some include but are not limited to: notice of special assessment, major reserve component summary, current deficiency in reserve funding, percent funded calculation, mechanism by which reserves will be funded, disclosure of loans, statement detailing procedures used for calculation and establishment of reserves, and finally, the reserve funding plan summary with a statement that the full reserve study is available to any member. This sounds like a lot, but reserve analysts in California have been dealing with these requirements for a long time and can be helpful to the association in ensuring the proper disclosures are included with the budget packet.

In closing, asphalt contractors, roofers, painters, and construction management consultants all report that 2011 is sizing up to be the year when the inflation increases we had been dreading are coming true. Increased governmental regulations, unpredictable weather patterns, natural disasters, and emerging worldwide markets are colliding with the reality the local contractors have

trimmed all they can. These contractors have tried everything from getting into the financing business, to laying off non-essential personnel, to having labor work part-time, and they are now left with the one thing they have been avoiding: raising prices.

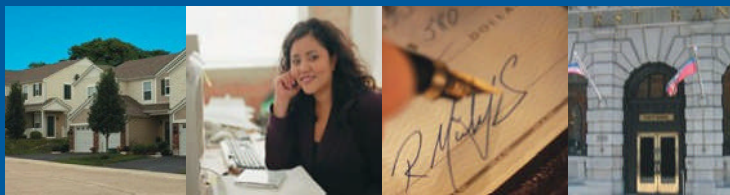
With apologies to Sun Tzu and Machiavelli, "The best defense is a good offense." Hire the reserve analyst early, uncover any surprises quickly, make time for collaboration with your professionals, and communicate the budget/

reserve plan to your members early and often. These simple, yet common sense tips will make your community a much better place for all. And this is an "offer no board should be able to refuse." ■

Robert W. Browning, PCAM, RS is the owner of the Browning Reserve Group. He has served as chair of CLAC, served on the board of trustees of CAI and is a past president of CAI's Foundation for Community Association Research. He may be contacted at (877) 708-0600.

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