

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 study.

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? Most homeowners view their home as a financial investment. Therefore, 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. State regulation has increased dramatically in recent years regarding the fiduciary obligations of boards and managers. 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 require periodic Reserve Studies.

Florida Statute 718 requires reserves for roof replacement, building painting, pavement resurfacing and, "any other item for which the deferred maintenance expense or replacement cost exceeds \$10,000." {FS 718.112(2)(f)} While regulations vary for homeowners associations (FS 720) and cooperatives (FS 719) 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 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 Really 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.

Matthew Kuisle P.E. RS, PRA is the Director of Florida Client Services for Reserve Advisors, Inc. For more information on this subject, contact Matt at (800) 980-9881 or matt@reserveadvisors.com.