COMMUNITY RESOURCE

INSIGHT & EDUCATION FOR COMMUNITY ASSOCIATIONS

JUNE
2019

This Issue

RESERVE STUDIES

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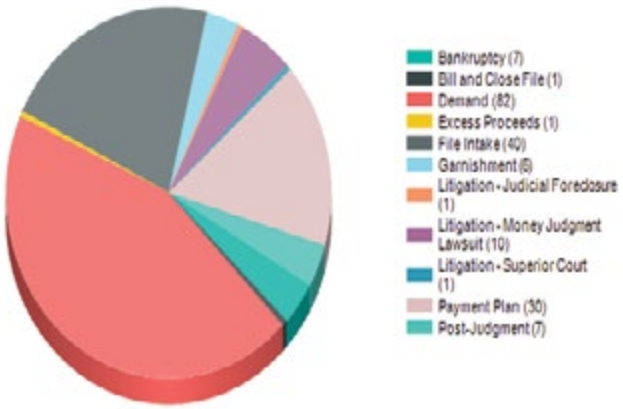

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REGISTRATION & HAPPY HOUR: 4:00 – 5:30 PM

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Message

FROM THE DIRECTOR

KAYTE COMES | EXECUTIVE DIRECTOR
CAI - Central and Southern Arizona Chapters

Welcome Southern Arizona Chapter to our Community Resource magazine. We produce 11 issues throughout the year, excluding December. The magazine has a variety of educational articles and advertising by annual sponsors from both chapters. This magazine is free to all chapter members of both chapters and we hope you find it valuable. All articles are able to be reproduced and if anyone has any specific ideas for an issue, we are open to suggestions. Currently we have published a page on the Central Arizona chapter website www.cai-az.org of the themes for 2019 for each issue. All issues of this magazine dating back to 2010 are also available on this website for all Southern Arizona members.

It is my goal as the executive director of both chapters to provide the best customer service and value your membership can offer, and we encourage all members to call or email any ideas they would like to share. The staff can be reach using the same contact information as before director@soazcai.org, info@soazcai.org and 520.870.7759. Central Arizona members can reach us at info@cai-az.org and 602.388.1159.

On behalf of the Central Arizona Board of Directors and chapter staff we welcome you to our award winning magazine and chapter resources.

All the Best!

Kayte Comes

MBA, MNML

CALENDAR

SOUTHERN CHAPTER
2019 EVENTS

JULY	No Events
AUG 14	**CAI - Southern Arizona Chapter Educational Lunch: How Do We Get Involved?** New Location: Sheraton Tucson Hotel & Suites
14	**Chapter Board Meeting** New Location: Sheraton Tucson Hotel & Suites
22-24	NATIONAL CAI EVENT **PMDP Course M-100 Phoenix** Location: Hilton Phoenix Airport
SEP 27	**CAI - Southern Arizona Chapter Annual Trade Show** Location: Tucson Convention Center

AZ Southern Chapter

FROM THE PRESIDENT

BRIAN GONCALES | CHAPTER PRESIDENT
CAI - Southern Arizona Chapter

The Southern Arizona Chapter has some exciting news! We are now working with the Central Arizona Chapter for daily operations and event planning.

Please understand that they are still two different chapters with two different board of directors. The Central Arizona staff will plan programs and activities based on the Tucson area needs, increase educational classes for continuing education for managers, introduce homeowner leadership classes and offer business partner education. We feel this is a great opportunity for potential membership and increased value for current members.

In addition, their monthly magazine will be produced for our chapter and we are encouraging chapter members to submit articles. The June issue is the first combined issue for both chapters. You will also see in the magazine two different calendar of events, Central chapter president message and an executive director message to all.

The Central and Southern Arizona chapters have always worked closely together through the Legislative Action Committee and several joint events and this seems to be the next logical phase in the working relationship. Please welcome the Central Arizona Chapter of the Community Associations Institute staff in our chapter family.

Best regards!
BRIAN GONCALES

2019 LEGISLA

EYE ON HOMEOWNER ASSOCIATIONS

By Alexis Glascock

Like many states, Arizona homeowners' association (HOA) legislation comprises a lion's share of bills each legislative session. This was a year where Arizona legislators again had an eye on HOA legislation.

The Arizona State Legislature convenes on the second Monday of January, and lawmakers begin debating bills and crafting public policy. This year the bills ranged from making lemonade the state beverage, brought forth by a grade school class studying the legislative process, to the highly important state budget.

This session was complicated with the 2018 mid-term election bringing significant changes to the legislative composition as well as many newly-elected members. The Republican majority in the Senate remained seventeen to thirteen similar to the prior session. However, the House Republicans had a razor thin majority with 31 Republican members and 29 Democratic members winning seats in the 60-member House. Among the new members, approximately a quarter of the House legislators were new to the legislature. While thirteen of the members in the Senate were also newly elected, all but one had previously served in the House. The large number of freshman legislators greatly impacted the session as new members worked to become familiar with the complex legislative process in addition to the House and Senate Rules that are critical to the successful passage of legislation.

In addition to fresh faces, the legislature elected all new leaders to both parties in the House and the Senate. Veteran legislators Karen Fann, from Prescott, was elected Senate President and Rusty Bowers, from Mesa, won as Speaker of the House. This session produced a great deal of important legislation for the state including the historic multi-state Drought Contingency Plan to meet federal deadlines addressing the state's water shortage. Other significant legislation included taxation of on-line out-of-state retail sales, tax conformity to deal with the federal tax changes, and an $11.8 billion budget among other bills.

Legislative sessions have averaged 130 days over the last seventeen years. The 2019 legislative session lasted 134 days and saw a total of 1,318 bill introduced. Among those bills, 331 passed and 280 were signed by the Governor. Seven bills were vetoed by the Governor. For the bills that passed, the General Effective Date is 90 days after the legislature adjourns sine die. This year bills that do not have a Delayed Effective Date take effect on August 26th, 2019.

Among the bills outlined above, the budget was the most contentious part of the legislative session. Some members held their budget votes ransom to ensure a vote on other bills that they felt were critically important, which delayed the session and caused increased political maneuvering. One of the last items to pass was an increase in the legislators' per diem travel payment. The bill passed tripling rural members per diem pay and bringing Maricopa legislators per diem close to that number. The legislators, however, had not had any increase in the per diem payments since 1972.

Similar to past years, Arizona's legislative session included a tremendous number of bills focused on HOA-related issues.

Community Association Institute's (CAI) Legislative Action Committee (LAC) and their lobbying team worked to produce HOA-related legislation that is in accordance with the interests of the Association. CAI's reputation with Majority and Minority Leadership in both legislative chambers increased tremendously this session. In a private meeting with Senate President Karen Fann, she reported to the Legislative Action Committee (LAC) Co-Chair Lynn Krupnik, that CAI was in excellent hands with their new lobbying team creating stronger relationships that will continue to grow at the Capitol. Furthermore, during the stakeholder process on President Fann's top legislative priority, the lobbying team was able to bring CAI's concerns to the forefront. President Fann, at first hesitant to allow CAI into the closed small group of stakeholders that had been meeting for over a year, concluded that Lynn Krupnik's proposed changes were imperative. These changes significantly improved the bill's impact on HOAs.

CAI has set itself apart by working well with legislators to support clear and functional HOA policies. This was personally acknowledged prior to the legislative session by President Fann in a meeting with Lynn Krupnik and CAI's lobbyist when she encouraged CAI to continue assisting legislators with constituent HOA disputes. She stated that the Association is an excellent resource to solve many HOA constituent issues. This practical approach resonates well with legislators who want to avoid legislation

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that micro-manages HOAs, often related to a single HOA constituent issue, or causes unintended consequences for Associations throughout the state.

CAI's strategic approach to HOA policymaking is extremely effective. As always, CAI played a significant role in every HOA bill that was heard by a committee this session. Regarding future sessions, it is vital to educate new members during the legislative interim about how to approach HOA issues, which are among the most complex and numerous at the Capitol. In tandem with that objective, CAI must continue to work with members during the legislative interim to refine their understanding of HOA policy and prepare for the next wave of HOA legislation. In pursuit of that objective, the LAC Co-Chair, Brian Morgan, and the CAI lobbyist recently met with Senator David Farnsworth to discuss the stakeholder meeting that he plans to convene in June to deal with a variety of issues next session. We are laser-focused on having a strong voice in crafting that legislation to advance CAI's objectives.

As we conclude this session, it is important to acknowledge that the success of each session is only possible with the volunteers who serve on the LAC. They dedicate countless hours to crafting legislation that is sensible public policy. These volunteers contribute their time, energy and considerable talent to make sure that the bill revisions, large or small, are productive and successful.

Alexis Glascock is an attorney at Fennemore Craig, P.C. and oversees government relations for the Firm in Arizona. Fennemore Craig provides government relations, public affairs and political consulting services in Arizona and Nevada and is a full-service law firm with three offices in Arizona, two in Nevada and one in Colorado. The firm provides lobbying and consulting services that positively affect legislative, agency, county and municipal policymaking.

coming soon

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RESERVE STUDIES

Understanding Reserve Studies

By Clint Goodman, Esq.

We've all had it happen, whether in our own lives or in an organization: a large, unexpected expense shatters your savings and pushes other necessary, but less immediate expenses further into the periphery, potentially leading to exponentially increased costs in the long run. But, was that large unexpected expense truly unexpected? Probably not. Reserve studies can assist your homeowners' association in making those surprise costs less surprising, while enabling your budget to stay on track.

A reserve study involves a diligent identification and visual inspection of the major components that the association is obligated to repair, replace, restore, or maintain, and an estimate of the remaining useful life and cost of repair, replacement, restoration, or maintenance of the components. Sometimes, typical low-level ongoing maintenance is budgeted and considered separately. The reserve study process is flexible and can be catered to the Association. But, at the heart of the process is the cataloging and inspection of big ticket components like the boiler, roof, leaky plumbing systems--the usual suspects for surprise budget woes.

The reserve study body then calculates how much money is needed and when, and causes that analysis to be considered when budgeting and planning for special assessments, if necessary, to fund the association's reserves. Typically, this financial analysis includes a 20 to 30-year cash flow projection of the reserve fund, with a focus on planning and budgeting for the large-scale repair and replacement of the catalogued components.

Generally, it's a good thing to plan ahead. The reserve study process provides a consistent and regularly reviewable method for ensuring that surprises do not happen--the major components creating large and consistent costs of maintenance and repair have been reviewed, inspected, catalogued, and accounted for, potentially with additional planned infusions to the reserve fund.

And, state HOA policy has caught on to the benefits of reserve studies. They are required in several states, including California, Colorado, Delaware, Hawaii, Nevada, Oregon, Utah, Virginia and Wisconsin. Other states, like Washington and Minnesota, still statutorily encourage associations to have a reserve study performed on a regular basis.

By consistently reviewing the anticipated maintenance and replacements that are expected in the coming year, the Association can plan to have the required work performed before the conditions deteriorate to the point that remedial work is required, or damage is done to other important components, which can cause a substantial increase in both cost and chaos. But, importantly, Association boards have a fiduciary responsibility to unit owners to make sure reserve funds are invested properly. The reserve study process ensures that boards are able to meet that fiduciary duty because adequate funds are being allocated for necessary repairs and money is not being wasted on repairs or replacements that are more sudden--and therefore more costly--than necessary.

Clint Goodman is the managing partner of Goodman Holmgren Law Group, a law firm dedicated to providing legal services to community associations. Clint is heavily involved with Community Associations Institute (CAI), serving on the Legislative Action Committee, and other events.

Can a Reserve Study Help the Budget Process?

By Charlene Cruz, Esq.

With budget season around the corner, community associations typically review expenses for the upcoming year. However, expenses for large capital expenditures or long-term and major projects may be overlooked as part of the annual budget process. Failing to properly fund a reserve account can result in significant "surprise" special assessments or increases in regular assessments.

The reserve budget should take into account all assets within an association, such as elevators, roofs, tennis courts, roadways, streets, and boilers/chillers as well as the current condition, the life expectancy, and cost to regularly maintain these assets.

The following is an example of how a reserve study can be used by an older association to prevent a potential financial disaster. A condominium association located in the historic district of a metropolitan city establishes a budget to maintain the association's day-to-day operating needs, but fails to take into account any unexpected expenses or long-term investments. Many of the unit owners are retired or on a fixed income, and vigorously oppose any special assessments or assessment increases. Having a reserve study done would allow the association to gradually start planning for the eventual replacement of assets.

The condominium has a vintage elevator system, but has never commissioned a reserve study to help plan for an eventual replacement. When the elevator suddenly breaks down, the association is now faced with a substantial and unexpected multi-million dollar expense to replace the outdated elevator system with a new system that meets local permitting and code requirements. If the association had commissioned a reserve study in the prior years, the association could have calculated the elevator breakdown into the overall budget for the condominium. Owners are more likely to accept increased assessments when they can see exactly why the increase is necessary.

The condominium does not have the funds in reserves to pay for the replacement up front, because the association budget never contemplated the replacement expense. After years of financial neglect, the condominium is in such poor financial condition it also does not meet the financial requirements to obtain a bank loan to cover the elevator replacement costs. As previously explained, the majority of the unit owners are unable to pay the required sudden special assessment. The condominium association will run out of money to continue to operate and could be forced into receivership, or worse. A reserve study would have allowed the members to examine their financial situation and plan years in advance for the eventual elevator replacement.

Reserve studies take into account the condition of all assets and determine the replacement costs of each asset along with the year such asset will need to be replaced. Check with a reserve study specialist for guidelines regarding review of each association's specific reserve study, but in our experience 3-5 years is typical. A reserve study and budget puts the association in the position to meet larger financial obligations and ensure that the association is maintaining the correct level of funding. When reviewed on an annual basis in conjunction with the budget, reserve studies help associations maintain a reserve fund level that will allow the members to repair or replace capital assets in a timely manner. Without proper funding, the board could be forced to levy and collect a special assessment or defer the replacement all together.

Reserve studies play a significant part of responsible financial management, improve resale values, and fulfill a board member's duties to act in good faith and in the best interest of the Association. A reserve study provides a valuable roadmap to help guide the budget process over the course of years and prevent sudden financial surprises for the members.

Charlene Cruz is an Associate at Carpenter Hazlewood Delgado & Bolen. She practices in Community Association Law, including collections, general counsel, enforcement, and insurance defense cases. In her spare time, she enjoys trying new restaurants, hiking and spending time with her family.

Facilitating Your

by Stephanie Mueller, RS, PE and Andrew Stoutenburg, RS, PE

As we approach the midpoint of the year, last year's budget season is a fading memory, and we can feel like we have all the time in the world until we start on next year's budget. However, now is as good of a time as ever to dust off your reserve study and get acquainted with it. Not only will it help you identify upcoming large capital projects, but the reserve study can also be used to help create the most accurate, realistic operating budget. Below we'll cover a number of different areas within a reserve study that will assist in the budgeting process.

Reserve Contributions

Let's start with one of the main goals of a reserve study: identifying adequate annual contribution levels for the reserve account. This amount commonly plays a significant role in an association's annual budget. Associations without a current reserve study often set annual contributions to reflect 10% of the total annual budget. However, this approach generally falls short as it does not take into account the anticipated costs of capital repair and replacements. Therefore, it's understandable that an accurate, recent reserve study plays a critical role in facilitating the budget process by providing proper guidance on what might be one of the larger line items of the operating budget.

Additionally, because the magnitude of annual reserve contributions can be significant, this highlights the importance of a qualified reserve study underpinning these contribution amounts. While a number of parameters can be used to qualify a reserve study, for the sake of this article, I suggest the following as a starting point:

- Produced by someone holding either the Reserve Specialist (RS) or Professional Reserve Analyst (PRA) designation
- Based upon the findings of an on-site inspection
- No more than five years old
- Meets the requirements of the National Reserve Study Standards

Capital Projects

The next area where a reserve study assists in the budgeting process requires a deeper look into the findings and results of the study. With a reserve study covering at least 20, and typically 30 years, it's easy to become overwhelmed with the amount of data it contains. However, a great place to start is with the near-term outlook.

First, review what is planned for replacement or capital repair in the year you are budgeting for. Then, take a look at the repair and maintenance line items that relate to these common elements. There is a good chance you'll need to make adjustments to these line items. For example, if there currently exists a repair account specific to the roofs, yet the roofs are scheduled for complete replacement, you may consider zeroing out the budgeted repair amounts for the year of replacement. Additionally, with new roofs, you can also plan to budget a reduced amount in this repair account for the first few years, as compared to what it was leading up to replacement.

Sometimes, when a property is very new, it can be difficult to determine how much to budget for repairs, as no significant historical expenditures are available. One good approach is to think of repairs as a function of the total replacement cost, similar to how we maintain our own cars. Let's use the example of a new car purchased for $20,000. Over the next three years, you're likely to change the tires and brakes as well as have about 12 oil changes. These costs would average approximately $500 on an annual basis. This amounts to approximately 2.5% of the replacement cost of the vehicle. Now, let's assume a condominium has asphalt shingle roofs that will cost $300,000 to replace. Using the 2.5% value, that amounts to $7,500. Obviously, cars and roofs are similar in no ways, but this concept helps to relate maintenance costs as a function of the replacement cost. At times, $7,500 could feel like a large amount of money, but when compared against the total replacement cost, it begins to have more meaning.

Once all near-term projects have been reviewed, take a look at the mid-term, somewhere around 5- to 15-years. Here, the point is somewhat the opposite of what was assessed above, and best explained with an example. Let's assume a community is 5 years of age and has private streets. The asphalt pavement is expected to have a useful life of around 25 years, resulting in a remaining useful life of 20 years (Remaining Useful Life = Useful Life - Age). Because this is a newer community, there quite possibly has been little to no repairs performed on the roadway. Therefore, no repair/maintenance account has been established for this asset. However, upon reviewing the reserve study, you're provided with a clear picture of when these roads are expected to be repaved. Based on that information, you can make an informed decision on whether or not it's prudent to establish a repair account that can facilitate repairs as this asset continues to age.

Now it's best to look a few more years into the future. Once the community is 15 years of age, the roads will have a remaining useful life of 10 years. A great way to leverage the reserve study is to evaluate the cost of replacement against the cost of maintenance. With many assets, as they age, the cost of maintenance continues to climb, sometimes to the point that it makes better sense financially to accelerate the replacement of the asset. To understand this, let's assume the asphalt pavement will cost $100,000 to repave. As stated earlier, we project a useful life of 25 years. Therefore, the annual cost of ownership can be calculated as $4,000 ($100,000 / 25 years). By reviewing the reserve study and determining this value, you can make the decision of whether or not to repave the pavement. Replacement, even if it is ahead of schedule as depicted in the reserve study, will allow the maintenance costs to be reduced significantly, if not all the way to zero for a number of years. Additionally, once replaced, the aesthetics of

Budget Process

the community will be enhanced. By using the information provided in the reserve study, you are able to adjust related budget line items correspondingly.

Maintaining the Common Elements

We've previously covered the relationship between capital projects scheduled in the reserve study and their corresponding repair and maintenance accounts in the operating budget. However, there is additional information within a reserve study that helps provide some guidance for expenses not specifically outlined in the reserve expenditure schedule. Two main sections of a reserve study to review include the list of common elements classified as long-lived along with common elements identified as falling below the cost threshold of the study.

To begin, we must understand why some common elements will be classified as long-lived. An element is considered long-lived if it does not have a predictable remaining useful life or if replacement will occur beyond the 30-year scope of the reserve study. An example may be the interior building plumbing for a new community. While the plumbing is a common element, it is not likely to need systematic replacement in the next 30 years. That being said, it is sensible to review all common elements listed as long-lived to evaluate if regular maintenance costs are likely, and to budget accordingly. While the scope of long-lived elements varies greatly depending on the community type and age, some examples may include:

- Concrete Pavement, Complete Replacement
- Pipes, Interior Building
- Pipes, Subsurface Utilities
- Pool, Structure Replacement
- Walls, Fiber Cement Siding
- Windows and Doors

The other section to review is the list of expenditures which fall below the minimum threshold established for the reserve study. While the specific dollar amount of the threshold varies for each community, the intent of excluding these expenditures is that they are relatively small in nature and their inclusion in the study would not have a significant effect on the outcome. However, it doesn't diminish the importance of these expenditures but rather draws attention to them as needing to be accounted for in the operating budget. Similar to the long-lived list, it will be specific to each community, but an example of expenditures that could fall into this category are included below:

- Asphalt Pavement, Striping
- Irrigation System, Controllers
- Landscape, Maintenance
- Pool Furniture
- Walking Paths, Gravel Replenishment

The reserve study will not identify the estimated costs for these activities, but it provides a great starting point as an annual budget is being put together. Some items contained in this list are easily assumed to be included in the reserve expenditure schedule, and their exclusion from the operating budget as well means when the time comes for replacement, no funds will have been properly allocated. The following is suggested when reviewing this list:

1. Review each item and determine if this is an annual expenditure. If so, then you likely can utilize accurate historical expenses to help forecast future expenditures

2. If the expense is not annual in nature, assess the item and determine if it is likely in need of repair or replacement in the coming year.

3. Some expenses may fall in between these two categories. If so, you'll need to employ a combination of the two approaches.

Let the Reserve Study Guide Your Budget Process

A reserve study is an extremely important tool that communities should have as they prepare their budgets each year as well as when looking into the future for major projects. Reviewed in this article are some ways a reserve study can assist in this budgeting process:

- Identifying the annual contribution amount to the reserve fund
- Refining the amounts set aside in repair and maintenance accounts
- Incorporating repair and maintenance funds for items designated as long-lived or below the dollar amount cutoff

Using the reserve study beyond the scope of simply identifying future expenditures allows the community to achieve the greatest value from their investment in the study. Being an investment, it's wise to ensure this tool is accurate and up to date. As time goes on the projections in the study become less accurate, and with the potential changes discussed in this article (acceleration or deferral of replacement, increased or decreased maintenance costs, and reserve fund contributions above or below expected amounts), an association should look to update the study every 3-to-5 years. Now you're ready to tackle next year's budget; Good luck!

Stephanie Mueller joined Reserve Advisors in 2010 and serves as a Senior Engineer, based in Phoenix, Arizona. Ms. Mueller has received and currently holds her Reserve Specialist (RS) designation along with her Professional Engineering (PE) license in Wisconsin.

Andrew Stoutenburg is Reserve Advisors' West Regional Executive Director. Since joining the company in 2013, Mr. Stoutenburg has received and currently holds his RS designation along with his PE license in Texas, Arizona, and Florida.

Both Stephanie and Andrew have worked with community association managers and board members across 34 states and the District of Columbia, as well as 11 other countries, to prepare more than 1,100 comprehensive reserve studies, which serve as a key part of their associations' long-term planning process.

Impact of Inflation on Reserves

What it is and what we can do about it.

By Darwin Albrecht CMCA AMS

Healthy skepticism has served me well when analyzing statistics. One statistic, in particular, the rate of inflation, is very misunderstood and misleading. I firmly believe that one should never use a statistic to make decisions until one understands the methodology used to calculate the statistic.

What is so misleading about the quoted rate of inflation? Two things: It is very specific to one's spending, and it is adjusted.

The rate of inflation is specific to the spending of an individual or entity. The most widely quoted measure of inflation is the Consumer Price Index-All Urban Consumers (CPI-U). The Bureau of Labor Statistics (BLS) calculates the CPI-U based on a basket of over 80,000 goods and services for the urban consumer. It then determines which of these items the average family purchases, and in what quantities. Your personal rate of inflation can vary greatly, depending on where you live and what you buy. Consider the rate of inflation comparison between health care and televisions. There are very few average families; HOAs are certainly not families. They have very different spending needs than families. Most of the money spent in the reserve fund is more closely represented by construction costs rather the cost of personal items like food or clothing.

The rate of inflation is adjusted. The CPI-U is a statistic that is designed to measure the impact of inflation on macroeconomics, it is not a good measure of spending inflation. CPI-U is not a raw number reflecting price increases but is a downwardly adjusted statistic. It is downwardly adjusted by hedonic price regression, product and outlet substitution ("chicken for beef", "Wal-Mart/ Amazon effect"), and Rent Equivalency Method (housing inflation).

The most significant impact is hedonic price regression. The Greek word hedonics ("pleasure doctrine") has been used as a statistical measure for over seventy years. This technique did not become widely used until the late-1990s. The Boskin Commission was formed in 1996 to analyze the information in detail.

Given the combined effect of the Commission report and the increased number of technological innovations reaching store shelves, the BLS increased the use of price hedonics in calculating the rate of inflation. The idea behind hedonic price calculation is to incorporate quality changes into prices so that inflation calculations use a so-called apples-to-apples comparison. The problem with the adjustment is that it is subject to the personal bias of the statistician and does not reflect spending inflation. Depending on what the experts decide, the overall product receives a new price from the BLS that is different from the market price of the product.

For instance, when you buy a computer with increased memory or other features, the BLS makes a statistical adjustment to the market price. The same is true of safety features on a car, improvements to household appliances, or any other product that you purchase. You get more bang for your buck, and the BLS takes account of that higher value.

The vital thing to note is that the actual price one pays for a product or service may increase despite the adjusted number from the BLS. Accounting for real spending inflation is therefore very important when planning for the financial future of your HOA.

What should one do about the inflation calculation on a reserve study? First, understand that CPI-U is not a good reflection of spending inflation, but rather a macroeconomic statistic. Second, use a more appropriate inflation index reflecting the products associated with HOA reserves. There are several inflation indexes based on construction costs; ENR, Turner, or Marshall and Swift. The rate of inflation has a significant financial impact on a 30-year reserve study. Your decision in choosing a more appropriate inflation index will help your HOA have a better financial future.

Darwin Albrecht CMCA ® AMS ® is the General Manager of Sunland Village, a best value age-privileged community in Mesa, Arizona

Reserve Studies and Property Condition Assessments

Responsibility and Liability for Failure to Maintain and Inspect the Common Area

by Ritchie Lipson, Esq., Senior Counsel, Kasdan LippSmith Weber Turner LLP

What are the Responsibilities and Potential Liabilities for Failure to Maintain and Inspect the Common Area?

The responsibility of the board in making (or not making) decisions related to maintenance, repair and inspection of association common areas is often set forth in the association's governing documents such as the Covenants, Conditions & Restrictions (CC&Rs), Bylaws, etc. Arizona and Courts throughout the country have applied and interpreted these responsibilities in various ways, with potentially significant impact on a board member's role under current law.

Many associations have their reserve study specialist perform these inspections, if inspections are performed at all. Indeed, most reserve study specialists will readily admit that they are not competent to assess building component performance, nor estimate what it would cost a contractor to repair them. Only the repair contractors themselves can do that adequately.

It is well established in Arizona that the specific provisions of an Associations CC&R's must be followed. (See Johnson v. Pointe Communities.) For example, some CC&R's contain a requirement that independent experts inspect the common area annually and issue a report to the members of any required maintenance. If the report is not completed and maintenance is continually deferred which results in excessive special assessments will the business judgment rule protect the Board if a member sues?

In a recent case in Maryland, the Court of Special Appeals in Greenstein v. Council of Unit Owners of Avalon Court Six Condominium, Inc. found that an association can be sued by its unit owner members if it fails to investigate the common area and take timely legal action against a developer for defects.

The court held that the duty to maintain, repair and replace the common elements creates a concomitant obligation on the part of the association to not only inspect and investigate the condition of the common elements, but to also pursue recovery from the developer on behalf of the unit owners for damage to the common elements caused by the developer's negligence, breach of contract, or a violation of any applicable law.

In another recent South Carolina Court of Appeals decision, Fisher v. Shipyard Village of Council of Co-Owners, Inc., the court held the Board has a duty to investigate causes of damage to the common elements and to pursue all responsible parties for the damage.

In Fisher, many windows and balconies in many buildings in the condominium leaked, and repairs were attempted. When the repairs failed many of the unit owners sued.

The court similarly ruled that the Association and the board has a duty to thoroughly investigate the cause of the leaks, and bring appropriate claims for the defects, but also held that there is a presumption that the board acts in good faith.

In Arizona it is clearly established that an Association owes a duty to of reasonable care to maintain the common area in a safe manner and protect owners, tenants and invitees, just like a landlord. It is not much of leap to envision an Arizona court ruling similar to courts in Maryland or South Carolina.

The bottom line is that Boards need to: (1) conduct regular inspections by an independent 3rd party professional (Property Condition Assessment and/or Reserve Study); (2) bring appropriate claims against the developer and general contractor for defects before the statute of limitations and repose expires (8 years from substantial completion): and, (3) do not defer needed maintenance projects.

For the past 19 years, Ritchie Lipson has limited his practice to representation of Homeowners Associations, Residential Property Owners, School Districts, Municipalities, and Commercial Investors to assist in the fair resolution of their claims for defective construction. During that period, he has been involved in over 70 cases, including several Class Action lawsuits, recovering over $123 million for clients.

Reserve Contributions and Budgets

But that's all we can afford!

By DJ Vlaming, RS

So commonly we hear this comment in response to our recommended Reserve contribution rate. But it reveals a basic misunderstanding the role Reserve contributions play in the budget process. It all starts with a board's responsibility to manage the affairs of the association, which includes setting a budget to pay its bills. This means if the association has plentiful grounds, there will be a significant landscape budget. And if there is a pool, there will be a pool service line item. These ongoing expenses "come with the property". In addition, there are some expenses the board has significant influence over, such as securing "full" or "financial only" management, or the size of the insurance deductible. Board decisions in these areas affect the size of the expenditure, and thus the size of homeowner assessments.

Reserve contributions are like the landscape or pool they "come with the property". They are not optional, like securing professional management or hiring a security service. Reserve contributions are not significantly influenced by board decision like which type of management to obtain or the size of the insurance deductible. Reserve expenses are what they are. Wishing them to be smaller doesn't make it so. In addition, ignoring them doesn't make them go away. The roof, asphalt, pool, fence, carpet, etc., will all deteriorate on very predictable schedules, with predictable replacement costs. The roof will fail (on schedule and likely in plain sight over the last 20 years) and require replacement whether the board has set aside adequate funds or not! Properly sized reserve contributions are as required as any other bill the association pays… management, utilities, insurance, etc.

But how much to set aside in Reserve contributions? Based on proposals or the association's monthly expense history, it is generally pretty obvious how much needs to be budgeted to pay the utility bill, insurance, management, or other "operational" expenses. Since the roof doesn't send a "deterioration bill" every month, that's where a Reserve Study comes in. A Reserve Study identifies the cost and timing of the association's major predictable common area repair and replacement projects, calculating a smooth and stable funding plan so the association can offset ongoing deterioration. In this way, the association is prepared to pay those large and infrequent expenses when they occur. Those Reserve contributions are for predictable expenses, not for "guesses" about the future. They are also not for a "rainy day fund". Reserve contributions are for anticipated expenses, no different than a board budgeting to pay for an upcoming insurance premium, management bill, or utility bill.

What if that contribution is more than is perceived "affordable"? You can check with your attorney, asking them which bill to "not pay". But I expect you'll get a response that it's the board's job to budget to pay all its bills. Digging deeper, you'll find that it is the board's job to manage the affairs of the association. It is the job of individual residents to decide if they can afford to live in the association. Boards are outside their scope of responsibility when they begin to presume they know that an individual should enjoy their premium cable or a new car rather than pay their fair share of association bills. The cable company or the automobile company charge what is necessary to sustain their company. The association should also charge what is necessary to sustain the association. Let individuals make their own personal choices on accurately presented costs. The board does nobody a favor in underfunding Reserves, only to have to ask for those same funds (and oftentimes more!) in an emergency special assessment.

So look to your updated Reserve Study for budget guidance regarding how much is necessary to set aside in Reserve contributions to offset ongoing deterioration of the physical elements of the association. You're enjoying them as an owner, you should pay your "fair share" along the way.

DJ Vlaming, RS has led the Association Reserves - Arizona office since 1997, and has personally completed thousands of Reserve Studies for properties ranging from simple developments with minimal assets to complex international resorts. DJ is an active member of multiple CAI chapters.

It's Not Chicken Soup Without Chicken and It's Not a Budget Without a Reserve Study

By John Cligny AMS, Association Consulting Group

The Arizona Condominium Act does not require community association boards of directors to prepare reserve studies or fund reserves. This begs the question of how you create a meaningful budget that includes and provides for the disclosure of "common expenses", defined as including allocations to reserves. The best image for not including the reserve funding plan in budget process is the proverbial "blind man in a dark room looking for a black cat". It is simply nonsense. Furthermore, common area, is defined as all real estate and physical components that the association has the responsibility to maintain, repair and replace. Astute community managers and boards of directors will understand that the reserve study and reserve funding plan will be the key driver of the budget and should be the first line item to be evaluated. Here are some best practices for how the reserve study can help the budget process:

• Update your reserve study annually and early in the budget process. Consult with a qualified reserve specialist to be sure that all common area real estate and physical components are reviewed carefully. Are useful life and remaining life estimates reasonable? Is repair or replacement cost realistic? Are any physical components missing? Have any repairs or replacements completed in the fiscal year been noted and revisions to the reserve study completed as necessary? After making these updates ask your reserve specialist for an updated reserve study draft to be used in developing the budget.

• Take stock of your current reserve account balances. Be sure to include any borrowings from reserves to operating account funds. Helpful hint, sometimes your balance sheet will not agree with your reserve account bank statement. Be honest and only consider cash balances. Calculate different percentage funded scenarios using the schedule for repairs and replacement in the reserve study for the next 12, 24, 36 and 48 months.

• Review your updated reserve study draft and take note of any potential maintenance, repair and replacement items that may be unfunded and discuss what options the association will have to fund them and how? Be sure to ask your reserve specialist if they have included project management cost, permit and engineering costs and mobilization costs if applicable. If not, consider adding these cost estimates to get a truer estimate of cost.

• Based on the reserve study, determine the amount of the allocation to reserves the association needs to make for the fiscal year and create a line item on the budget for the allocation. Helpful hint, once the

budget is approved be sure to make the transfer of the allocation to reserves from the operating account to the reserve account monthly, on the same day each month so that it is easily tracked.

Starting the annual budget process using the association's reserve study is critical to ensure that the association will be ready and able to pay for scheduled and required maintenance, repairs and replacement of real estate and physical components and not fall victim to deferred maintenance and special assessments. A budget that clearly lists the annual allocation to reserve funds also demonstrates to members and potential owners the board of directors priorities in meeting its fiduciary responsibility of duty of care and its commitment to a well-funded, well maintained community, intent on sustaining and improving property values and quality of life for all residents. Remember, an association's budget communicates the expectations of the members and board of directors, where the association is going, how it intends to get there and what the association's values are. Former United States Secretary of the Treasury, Jack Lew comments, "The budget is not just a collection of numbers, but an expression of our values and aspirations".

Arizona may not require reserve studies and reserve funding plans, but they are an indispensable and critical first step to creating a well thought out and meaningful budget for your community association.

John Cligny AMS, is a veteran portfolio manager and community association management executive. As Co-founder of Association Consulting Group, John is a trusted advisor primarily focused on educating community association board members on effective governance to promote positive public opinion of homeowner associations and community management. John is a frequent speaker and panelist on a wide range of community associations.

Plan Ahead for Big Landscape Costs

By Rebecca Herro, Chief Development Officer
DLC Resources, Inc.

As the landscapes in your Communities mature, they will require different care than they did when they were first installed. As your Community changes, make sure your budget strategies grow and change with your landscape; that way you'll be left with plenty of green — not only in your landscape but also in your Community's pocketbook.

Budgeting for Plant Replacement

Plants and trees are living things, and like the rest of us, they have an expiration date. After years of looking great, plants can simply reach the end of their life spans and die off. Things like insects, disease, storms, frost and car accidents can also cause premature plant death.

That's why it's smart to budget each year for plant loss. While there's no set formula, a good rule of thumb is to set aside money to replace about 5-10% of your plant and tree inventory each year. This money should be earmarked strictly for plant replacement and not lumped into a general landscaping fund. That way, other items such as granite replenishment or irrigation repair won't deplete your plant replacement budget.

To determine exactly how much money to set aside each year, you need to take into consideration the type of plants in your Community and what their average replacement costs would be. A tree and plant inventory can be an especially useful resource during this process. If your Community doesn't already have one, it may be a good idea to create an inventory of each species including specific quantities. Then, work with your landscape maintenance contractor to help determine the estimated replacement costs (including installation) for each of the species that make up your landscape.

Another thing to keep in mind is the age of your replacement plants. Purchasing younger trees will be less expensive than older, more mature trees. If your Community would like to save money, younger trees may be a good option. Or does your Community prefer that more mature plants be used? Make sure to consider the overall look your Community desires when budgeting for replacement costs.

Managing a Mature Arbor Asset

As your tree asset grows, so will the amount of money it will require to properly maintain it. A tree that is 20-30 years old will have a considerably larger canopy than a 10-year-old tree, and may cost nearly double for routine maintenance — such as canopy thinning and structural pruning.

When planning for these costs, however, knowing your specific tree species characteristics is crucial. A Sissoo can grow to be 60 or 70 in just 15 years and will cost quite a bit to prune, while a Southern Live Oak may never grow more than 30 feet tall and will cost significantly less for routine pruning. Again, a tree inventory will be an invaluable source for your Community when it comes to determining a long-term tree pruning budget.

Another thing to keep in mind with mature trees is their changing irrigation needs. Many times, older trees don't need dedicated irrigation lines anymore since they get needed water from surrounding turf and shrubs. However, other mature trees may need drip irrigation lines moved out as their root zones grow. This work would come at an additional cost, and is something that should be planned for if it's determined your older trees will still need irrigation.

Work with your arbor management company to assess your Community's trees and create a plan for what work they will need in the next 5, 10 or even 15 years. That way, your Community can begin budgeting or planning for these added expenses now.

Planning for Irrigation Upgrades

As you are well aware, one of the most essential tools for a healthy landscape is an efficient and well-functioning irrigation system. Maintaining that system is imperative, and routine repairs and adjustments are usually budgeted for right alongside water costs.

But what happens when the entire system reaches its expiration date? Technology advances every year, and eventually irrigation system components — like clocks — will one day be obsolete. Hunter ICC is a good example of this.

But most communities' reserve studies don't include funding for irrigation system replacement. That's why it's a good idea double check your reserves and include funding for the replacement of things like pump stations, irrigation controllers and polyethylene drip lines (Poly pipe) if it's not already included.

One way to do that is to determine the average lifespan of your irrigation system components and how much it would cost to replace them when that time comes. Say, for example, that your community has 25 clocks controlled by a central control system, and each clock would cost approximately $4,000 (including labor) to replace. This means your community would need to budget about $100,000.

Another large expense we're seeing a lot of right now is Polyethylene drip lines breaking down and failing, leading to a lot of leaks, breaks, repairs and wasted water. Converting Poly lines to PVC helps restore the functionality of an irrigation system. However, conversion isn't cheap. If you're seeing a lot of cracking and breaking Poly lines in your Community, or if your irrigation system is reaching about 15 years old, it might be a good time to start budgeting for conversion. Your irrigation contractor can help prioritize areas for conversion so that the entire process fits your budget.

Nothing lasts forever. This is especially true in our Community landscapes. When it comes to keeping your landscaping looking great and functioning well for years to come, simply looking ahead, anticipating changing needs and creating a plan can go a long way.

As Chief Development Officer, Rebecca Herro leads DLC Resources' development teams while also serving on the CAI Central Arizona Chapter Board of Directors. She has been a member of the DLC family for the past 10 years, and her team supports the needs of DLC's 32 Community Partners and implements the company's growth strategy for future clients and development of our employees and leaders. Founded in 1989, DLC Resources focuses on the landscape, water and arbor management of communities in the Phoenix metro area and is celebrating their 30th year in business in 2019.

Should I Warranty my Asphalt?

A guide to better understanding warranties in construction and how they can affect your community

By Dave Boon

During recent years, I have often been asked about warranties and how they relate to asphalt pavement maintenance and homeowners associations. It is critical that before you ever agree to pay for a warranty, that you understand the different types of warranties that exist, and what additional protections have already been put in place by the government to protect consumers.

The standard one year "Call Back" Warranty found in most standard contracts today are enforced, and even extended, by the AZ Registrar of Contractors' ability to impose penalties within the first 2 years of a project's completion. In addition, Arizona courts also recognize Implied Warranties, which include good workmanship. Because these types of warranties allow for a reasonable time of discovery, they can offer protection many years beyond the written contract.

Finally, let's look at a type of warranty that may initially appear to benefit the consumer, but very often does very little to protect the owner's interests. These are known as Vendor Warranties and they cover a product that is manufactured and/or distributed by those offering the warranty. These warranties often exclude certain types of problems or failures and are very limited in their scope, which can make collecting on the warranty very difficult, if not impossible. These types of warranties can easily pose a trap for the property manager or board member that is unaware of these exclusions and is expecting a much higher level of protection.

As an example, I recently had a community manager express to me their extreme dissatisfaction with a warranty experience they dealt with. Approximately three years prior, this community had agreed to have a contractor spray apply an asphalt emulsion product on their streets. The product came with the promise of a single product being able to treat a wide array of different pavement conditions, but what made the proposal seem especially appealing, was the inclusion of a full, five-year warranty.

Despite being almost twice the cost of what other licensed contractors had proposed, they went forward with the contract and had the product applied in their community. Their reasoning was simple - the extra cost was justified by the peace of mind they were gaining from the warranty.

Recently, that same property manager requested that the contractor return to the project location to discuss concerns they were having about premature wear of the product. Upon discussion with the contractor about the warranty claim, two major points of conflict quickly became evident. First, the warranty coverage was based on a value for which there is no test that exists to check it. Second was what they had been told was a full five-year warranty, was pro-rated and that the "no charge" portion of the warranty had expired after two years (the same time period determined by ROC guidelines).

This is a trap that can be easy to fall into, as many of us associate the word warranty with the return policy of a big retail store. For instance, I can buy a light fixture from Home Depot, return it a couple months later, and I get the full purchase price back, no questions asked.

Vendor Warranties do not work that way and are aggressively marketed for one primary reason – they make money for those that are selling them. The word "warranty" can have a reassuring effect on someone considering a big purchase. This, along with the fact that only a small percentage of these warranties are ever collected upon, makes these types of warranties valuable revenue streams for the contractors selling them.

Remember, the state of Arizona already has a variety of laws and statutes in place to protect the consumer. By using a licensed contractor, the state is guaranteeing that their warranty obligations will be met. So, beware of Vendor Warranties that promise added value, as they are often filled with disclaimers and are designed to benefit those selling them, not the consumer.

Dave Boon is part of the ownership of SealMaster Arizona and acting General Manager. Dave joined SealMaster in 2001 to become Operations and Plant Manager after eight years of prior commercial construction experience.

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