

## RESERVES AND D&O INSURANCE: WEBINAR OUTLINE

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[www.reservestudy.com](http://www.reservestudy.com)  
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Miss the webinar? Watch it [here](#).

**It is our job to guide boards and associations effectively towards an improved future, and that improved future comes from making wise decisions in general. In this webinar, Kevin and Robert share insights from their decades of experience about the benefits of effective D&O insurance and the benefits of having adequate Reserves. Achieving those objectives results in peaceful, productive communities with minimized unnecessary expenses and maximized home values.**

### 1. What is D&O Insurance?

D&O is “peace of mind” insurance. Not-For-Profit Board members make decisions, and problems arise when unit owners, other Board members, renters, contractors, or management don’t like a decision you made and files a claim against you. D&O insurance funds the defense of directors and officers of the association in the event there is a claim against them for a wrongful act in their role in managing the affairs of the association.

### 2. What is a “Wrongful Act”?

A wrongful act is any act, error, or omission the insured can be held liable for. Often this comes from conflicts of interest, failure to abide by the Governing Documents, failure to properly handle elections, failure to enforce rules (or enforcing them unfairly), or failure to properly manage association finances.

### 3. Are there different types of D&O Insurance?

Yes. There is no such thing as a “standard” D&O policy, although they generally fall into two categories, which affect coverage. Bundled (packaged) D&O insurance is additional coverage provided by the property insurance company. Stand-Alone D&O insurance is specialty coverage just for this type of risk. Most bundled policies are lower cost and exclude many of the coverages desired by Board members. Stand-Alone policies can cover volunteers, committee-members, managers, (anyone making decisions on behalf of the association) and even former Board members.

#### 4. What types of decisions are covered by D&O insurance?

All decisions made by those responsible for running the affairs of the association are covered by D&O insurance. A common category of decision being challenged is “Breach of Fiduciary Duty”, a broad category describing when a Board does not make decisions in the best interests of the association. A claim, or lawsuit, is lodged by the offended party demanding monetary or non-monetary relief (they want something done like an election recount or they want to challenge a rule). A Board member can be sued for any reason, but they minimize their chances of being sued when they run the association without favoritism, in the best interests of the association. Board members should measure their decision-making considering the following illustration:



**WISE**

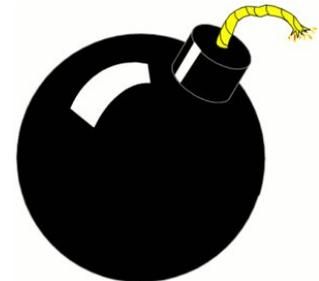
**CASUAL/ARBITRARY**

**FOOLISH**

Wise decisions are rarely challenged, and when they are, they are easily defended and quickly resolved, bringing peace back to the board members and the association. Foolish decisions invite trouble and litigation, take longer to defend, and leave the association and the Board members who are being sued in turmoil for an extended period of time.

#### 5. Are all types of decisions defended?

No. If a judge decides the Board member’s actions were intentional acts contrary to their job as a board member (written guidelines like the law or the association’s Governing Documents) or inconsistent with their job to protect, maintain, and enhance the assets of the association, the D&O carrier may stop paying for that defense, and may actually make a claim against the Board member to recover expenses already paid for that defense. Insurance is for accidents, not intentional or reckless acts.



Board members are always best served keeping their decisions towards the “wise” end of the scale, staying away from the “foolish” end (where in some cases a judge may rule that decision was intentional or out of line).

#### 6. What are some of the strategies to stay at the “wise” end of the scale?

Get qualified, professional counsel, especially in decisions that invite scrutiny (where significant amounts of money are involved) and where the Board lacks specific expertise. With most associations needing in the range of 15% - 40% of their budget going to Reserves to adequately offset ongoing deterioration, Reserve decisions regularly attract scrutiny and (foolish) decisions to underfund become patently obvious at the time of a special assessment. Fortunately, Reserve Studies are written documents, clearly disclosing the scope and schedule of projected Reserve

projects, the strength of the Reserve Fund (Percent Funded), and the recommended Reserve Contribution Rate. This makes a “paper trail” documenting a wise decision very clear.

### **7. What happens if a Board fails to update their Reserve Study?**

The association’s physical and financial assets are in a constant state of change, so it is foolish to decide about a significant financial decision like the size of Reserve contributions without a plan (an updated Reserve Study). Failure to update a Reserve Study in a state where such an update is required is an illegal act, which means it is unlikely such a decision would be defended by D&O insurance. Failure to budget for adequate Reserves, if required by the association’s Governing Documents, would also not likely be defended.

### **8. Informed or not, what happens if a Board chooses to under-Reserve (make contributions less than required by the association)?**

Problems with under-Reserving often reveal themselves years after the decisions were made. For this reason, current owners and Boards may sue former Board members for failure to adequately fund Reserves. It is foolish to make a short term decision to unfairly benefit current owners (keeping the dues low), failing to pay the “deterioration bill” and forcing that expense on future owners. If a temporary cash flow situation exists, the board should make a well researched and documented business decision to move forward incrementally, perhaps implementing a multi-yr plan, to reach a point where Reserves are being adequately funded.

If a Reserve Study exists and the Board feels the Reserve Study is incorrect, they should get it corrected. Most Reserve providers perform a revision for free. If the Board goes against clear, sound advice in the Reserve Study and budgets less than recommended, not only do they not save the association any money, a judge may rule that decision as a willful decision outside of the Board’s responsibility to care for the needs of the association. Such a decision may cause that defense to not be covered by D&O insurance.

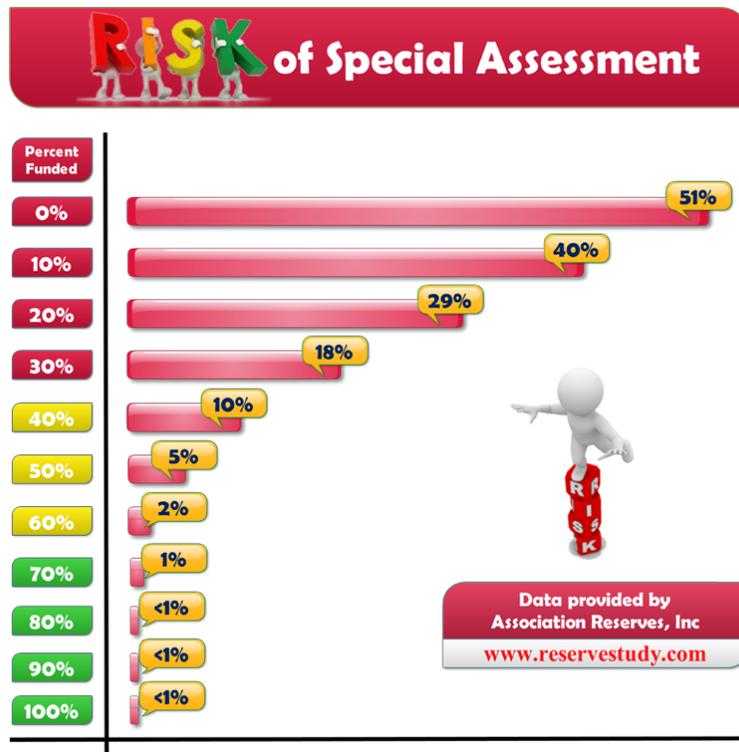
### **9. How much “wobble room” does a Board have when considering their Reserve Contribution recommendation?**

Typically not much. Even the lowest Reserve Funding Plan (“Baseline Funding”) crafts a plan to provide sufficient Reserves for the timely repair or replacement of the association’s Reserve projects without reliance on future special assessments. It takes a significant amount of Reserve contributions just to plan to accomplish all Reserve projects on time. Conservative Reserve Funding Plans designed to offset ongoing deterioration with Reserve cash (“Full Funding”), yield higher average Reserve Fund Balances. But the difference between providing for anticipated Reserve expenses and having a little margin on top of “just being able to pay for those expenses” is relatively small. Cutting your Reserve contributions more than just a few percentage points means the Board is choosing to unfairly burden future owners with more than their fair share of the costs of deterioration. This increases the chance that future owners

will get hit with a special assessment to pay for deterioration that occurred before they owned a unit at the association.

**10. How does a board gauge their exposure to special assessments? Can they measure Reserve Fund strength and effectively see one approaching?**

[National Reserve Study Standards](#) (formed in 1998) defined a term called Percent Funded to measure the relative strength of the Reserve Fund. Percent Funded is the ratio of the current Reserve Balance to the current deteriorated value of Reserve components. Percent Funded reports if the cash in Reserves are “keeping pace” with Reserve deterioration. Associations with a Percent Funded in the 70-130% range enjoy a relative absence of special assessments and deferred maintenance. Those same Reserve cash flow problems are common among associations with a weak Reserve fund, in the 0-30% range. An association can track their Percent Funded from year to year to see if they are gradually strengthening their Reserves, or gradually weakening their Reserves. Special assessments are a measurable risk based on an association’s Percent Funded, as shown in the following chart.



**11. Is it wise to update your own Reserve Study?**

Once a professional has laid the foundation of an appropriate Reserve Component List, future updates are a much simpler process. Many associations make a “business judgment decision” to keep their Reserve Study costs down by having a Reserve Study professional update the Reserve

Study every few years (performing a “With-Site-Visit” update), then doing “No-Site-Visit” updates themselves in the in-between years. Software tools are readily available to make this a simple process. The liability exposure for doing these minor in-house updates is low.

### **12. What are the benefits of using a credentialed professional to update your Reserve Study?**

Look for a Reserve Study professional with either a Reserve Specialist (RS) or Professional Reserve Analyst (PRA) credential.

Board members gain some liability protection when they hire an independent credentialed professional for assistance in areas where they lack specific expertise. Even so, Board members need to act wisely, checking to make sure there are no obvious errors like the # of elevators, the street being maintained by the city, or the year the roof was last replaced.

### **13. Isn't our job to keep the dues as low as possible?**

No. It is the Board's job to successfully manage the affairs of the association. Of course the Board should not be wasteful, but the Board's primary job is to manage the affairs of the association not minimize assessments. It is an unfortunate reality that some owners may not be able to afford to live in your association. That is their problem, not the Board's problem. The Board owes their primary duty to the association, not a few delinquent or complaining owners.

### **Where can I go for more information on this subject?**

For stand-alone D&O insurance policies and questions, please visit [www.KDISOnline.com](http://www.KDISOnline.com). For Reserve Studies and Reserve Study related questions and consulting, please visit [www.ReserveStudy.com](http://www.ReserveStudy.com).

# WEBINAR QUESTIONS ASKED BY ATTENDEES

**Q: Are there different state requirements for condo D&O insurance?**

A: There are no state requirements for condo D&O insurance.

**Q: What kind of coverage is there for me if I am a minority vote on a board which is moving forward recklessly?**

A: Board members are defended individually. If your vote is on the record as being different from the (reckless) majority, you will be defended differently. Board members are not all lumped together.

**Q: What is “Full Funding”?**

A: Full Funding is defined as when the cash in Reserves equals the deterioration of the Reserve components. That means when the association is new and the assets have little deterioration, it doesn't take much in Reserves to be Fully Funded.

**Q: Can a Board reverse or change a prior board's multi-yr Reserve Funding Plan?**

A: Yes. Every Board makes their own decisions how to physically and financially care for the needs of the association.

**Q: What if the Board doesn't take a manager's recommendation to raise dues or perform a Reserve Study?**

A: The Board is not required to take their manager's advice. The decisions of every Board member will be compared to written guidelines (state law or governing documents) or practical guidelines (meeting the needs of the association).

**Q: Is a manager covered by their own Errors and Omissions insurance, or are their actions covered by the association's D&O insurance?**

A: It depends on the type of coverage the association has to start with. Presuming the association has coverage that extends to people other than the current Board, a manager is covered by their own E&O insurance when acting as a professional manager, but by the association's D&O insurance when making decisions on behalf of the Board or association.

**Q: What if a Board decides to not do a Reserve Study update or fund Reserves?**

A: If challenged and there is a lawsuit on the matter, those Board members need to hope that a judge does not rule those decisions to be willful for the purpose of saving money for the Board and other current homeowners, as such a decision is prejudicial against future owners. A Board cannot expect to make intentional, bad decisions on purpose and expect their defense costs to be covered by insurance.

**Q: Might the Gardener at the association be covered by a broad D&O policy?**

A: Generally not if the Gardener is an independent contractor. A broad D&O insurance policy can be expected to provide coverage for volunteers, committee members, and employees of the association.

**Q: Is a D&O insurance award for defense only, or for the cost of the new roof that is being fought over?**

A: Defense only. The D&O carrier may clarify this point in a “Reservation of Rights” letter.

**Q: What if the Board recommends an assessment increase, but that increase is voted down by the homeowners?**

A: If the vote is “information only”, the Board still needs to move forward with responsibly running the affairs of the association. If the Homeowner vote dictates the budget, and the Homeowners voted down the assessment increase, any challenge to the Board’s inability to adequately fund the needs of the association will likely be easily defended. The Board made a well-founded decision and was over-ruled.

**Q: Is there a magic number for how much an association should have in reserves? Is the age of the building taken into consideration? Is it based upon a percent of building appraisal or condo dues?**

A: Sorry, no “magic number”. Each association is different physically so their asset mix is different (some associations larger, some smaller, some assets older, some newer, etc.), and each association has different maintenance patterns. A number is calculated in the Reserve Study (called the Fully Funded Balance, or FFB) that is the current value of deterioration of the Reserve assets. The association’s actual Reserve balance is compared to that number, to yield a custom and meaningful parameter called “Percent Funded”. When an association’s Percent Funded is high (70-130%), the association’s Reserves are strong, with a low exposure to special assessments or deferred maintenance. The opposite is true when the association’s Percent

Funded is low (0-30% Funded). See more [here](#) and [here](#).

**Q: Can you please restate the definition of “adequate Reserves”?**

A: Sure! “Adequate Replacement Reserves” is defined as a Replacement Reserve Fund and stable and equitable multi-year Funding Plan that provides for the timely execution of the association’s major repair and replacement expenses as defined by [National Reserve Study Standards](#), without reliance on additional supplemental funding.”

See more [here](#).

**Q: I know neither of you are CPA's, but do you know if assessments paid can be added to the “cost basis” of your home.**

A: That is a question best asked of your accounting professional, but the issues have to do with if the home is a primary residence or income property, and their answer may require you to provide a breakdown between total assessments and the portion going towards Reserves.

**Q: Are D&O policies priced based on size of association? We are small (4 units).**

A: Yes, the D&O premium is based upon the number of units. The smaller the association, the lower the premium. We also take into consideration the average unit value, the different type of amenities and employee count.

**Q: We have a 30 year reserve study that is 88% funded. Where should an association be in their reserve study funding to be considered strong?**

A: The 70-130% range is considered strong. Associations in that range enjoy maximized home values and absence of special assessments and deferred maintenance. See more [here](#).

**Q: Our association is relatively new. What happens when we have a very large 50 year Useful Life asset, but the Board & owners refuse to increase dues to cover it, saying they won't be around when the expense occurs?**

A: Refusing to increase dues or fund reserves is a business decision and why D&O coverage is needed. However, the question will always be why was the decision made? The asset is deteriorating now. So... was the decision made in the best interest of the association? Was there any conflict of interest or self-dealing (like keeping the Reserve contributions low now and forcing the replacement cost onto future owners)? Was the decision made in violation of any

state law? These are the question we ask as underwriters to determine how to handle this situation.

**Q: Board response to finding reserves, “we won’t be around when these expenses occur”. Is this a breach of their fiduciary duty to the association?**

A: As stated above, it is fair and responsible to pay for ongoing deterioration, no matter when the expense actually occurs. Whether they are on the board or not at the time of the expense is irrelevant. Choosing to not pay the “deterioration bill” could be perceived as unfair and prejudicial, as it pushes the expense onto the shoulders of future owners. And as a result a breach of fiduciary claim can be made against the prior board for failing to fund the reserves. There may be a defense provided however any damages paid to repair or replace any property would be excluded.

**Q: If a Community is significantly "behind" in their reserves, should a Reserve Study recommend a special assessment to "catch up" or just increase the contributions and therefore raise the fees (regardless of when the money may be needed to fund the components)?**

A: It depends on the timing of the expenses. Special assessments are not recommended simply to strengthen an association’s Reserve fund, as special assessments are inherently unfair. Special assessments should only be levied when the association is in a cash flow crisis - needing to accumulate cash for an imminent upcoming expense. If the association has time, it is fairer and less unsettling (and in accordance with [National Reserve Study Standards](#) Funding Principles) to strengthen their Reserves with higher Reserve contributions.

**Q: Must the names of the existing board members be named in the D&O policy?**

A: No, the policy provides coverage for all current and past board members, committee members, employees and volunteers acting at the direction of the insured.

**Q: I am looking for a day-to-day guide/policy on when an expense is Operational or Reserve. For example, we recently had work done on a pump. We have a reserve line for Pumps and Motors. Is it Best Practice to charge that expense to Operations or Reserves?**

A: In general, if performing a maintenance project changes the Reserve Study (typically the Remaining Useful Life of the project), it qualifies as a Reserve expense.

We have two webinars addressing this issue: one called Reserve Study Road Map for Managers Part II, see the outline [here](#) which contains a link to the webinar recording, and [here](#).

**Q: What do you say about a board that prefers to use special assessments to pay for big projects rather than ongoing Reserve contributions? Our owners prefer the money to be in their pockets versus in the reserves on the grounds they can make more money with it than putting it in the reserves where it earns very little return.**

A: [National Reserve Study Standards](#) Funding Principles state that Funding Plans should provide for the needs of the association, provide budget stability, spread contributions out fairly over the owners, and be fiscally responsible. Thus waiting for an expense and special assessing as necessary is inherently unfair and risky (what happens in case the owners don't approve the special assessment... then the board doesn't have the cash it needs to do its job preserving the assets of the association). In rare cases special assessing on a last minute basis as a "standard procedure" can be effective, but it requires that the association clearly communicate to the owners that there will be regular special assessment "calls" for their cash, and it requires owners who quickly comply with the special assessment. In general, this is not a recommended strategy for the typical association.

**Q: When computing percent of reserves, you say use the "total budget" as the denominator. Is this the total amount taken in say during a year or is it the total amount excluding the amount put away for reserves?**

A: Total budget is total budget. The [FHA](#) and other governmental-related agencies want to see at least 10% of the association's total budget going towards Reserves. If the association's total budget is \$1,000,000/year, and Reserve contributions are \$250,000 of that (so the Operating Budget is \$750,000), the Reserve contribution fraction in this case is \$250,000 out of \$1,000,000, or 25%.

**Q: What are the top D&O claims against Boards?**

A: 1. Breach of Fiduciary Duty

The most common type of claim is "Breach of Fiduciary Duty", the board of directors has a fiduciary responsibility to act in the associations' best interest. Whenever they fail to act in this way they can be sued for breach of their fiduciary responsibility.

2. Violation of Covenants, Conditions & Restrictions, more commonly known as CCR's

This is very similar to a breach of fiduciary claim but is more specific to the governing documents. The board's job is to enforce the association rules and people get upset when they believe the rule is unreasonable. These rules are constantly challenged resulting in claims against these board members.

3. Breach of contract - this is the fastest growing area for claims today.

Breach of contract claims occur in community associations when an agreement is not honored usually involving an improvement or repair of the association by a contractor. We have seen it happen with painting contractors, roofers, elevator repair, cable security etc.

**Q: Do you recommend a separate D&O policy vs. bundled?**

A: We recommend a Stand-Alone D&O policy that is designed for community associations. A Bundled (packaged) D&O policy, like what you get from many direct writers like State Farm or Farmers, is usually at a lower cost but coverage is very restrictive.

**Q: What is a declarant board's liability for deferring a reserve expense (a planned expenditure in 2016 and not spent; again in reserve budget for 2018 and thus far, no contract for the expense). In my example, this involves (not) seal coating the asphalt private streets in an HOA.**

A: Every board, no matter if a homeowner or declarant board, has the same responsibility to maintain, protect, and enhance the assets of the association. If seal coating is a necessary expense, it should be accomplished as it protects the underlying asphalt structure, extending its Useful Life. If the expense is being neglected because the board is being cheap, that is a risky decision outside of their responsibility to maintain the assets of the association. If the expense is being neglected because the developer is delaying the seal coat (and possible finish top-coat of asphalt) until construction of the final phase is completed, that may be a responsible business judgment decision on their part.

**Q: Would you consider driveway sealing an operational expense or reserve repair?**

A: There is a four-part test found in National [Reserve Study Standards](#) that defines a Reserve Component. Components must be a common area maintenance responsibility, life limited, occurring on a predictable schedule, above a minimum threshold cost of significance. Asphalt seal-coating typically meets these four criteria, meaning it is regularly considered a Reserve component. See more [here](#).

**Q: To obtain bids on the cost of a reserve study what should I provide to the reserve specialist?**

A: Typically expect to provide name of the association, address, # of units, type of association, fiscal year end, rough construction year, a description of common area amenities (pool, spa, tennis, hallways, asphalt, gates, clubhouse, etc.), and your contact information. You can get a free proposal by clicking [here](#) and providing the above information.

**Q: If the board members do not adhere to recommendations from their managing agent with regards to obtaining a reserve study, will that affect their insurability?**

A: It could impact coverage at renewal when the underwriters determine that the exposure for the association has just increased because the board failed to obtain a reserve study.

**Q: What is your opinion as a reserve specialist about the IRS rules and funding for “non-capital” projects like painting or tree trimming?**

A: Reserve Studies guide the association towards paying the ongoing cost of deterioration, avoiding “surprise” expenses like large recurring building repainting projects. That is fundamentally what Reserves are for. So prepare your Reserve Study according to National Reserve Study Standards, and prepare your taxes per IRS standards. In other words, if painting is a significant regularly-occurring common area maintenance responsibility, it is a Reserve component. Your tax preparer can make necessary adjustments if you file the 1120 tax form, and no adjustments are necessary if you file 1120-H. See more [here](#).

**Q: Board minutes are intentionally vague, and omit concerns. Can you comment on board liability exposure from a D&O point of view?**

A: As stated, D&O is “peace of mind” insurance and what happens is that Community association board members make decisions, and problems arise when unit owners, renters, contractors, or management doesn’t like a decision the board made and files a claim. When the lawsuit is filed, the minutes are used to help in the defense of the case. Therefore if the minutes are vague and omit key items then I believe that it’s difficult to defend the association.

**Q: When is it responsible and appropriate to call for a secret ballot vote?**

A: See above.

**Q: A homeowner was storing a recreation vehicle on his property in plain sight from the common area in violation of our CC&Rs. After a year of intervention by the Management Company and a fine and a letter from a lawyer, the owner threatened to sue the directors personally so that the D&O insurance would not cover. Is this a real concern for a board member?**

A: Remember, the board’s job is to enforce the association rules. As a result, people will get upset when they believe the rules are unreasonable. These rules are constantly challenged, resulting in claims against these board members personally. The good news is that the D&O insurance funds the defense and pays settlement.

**Q: What is the thought process to apply reserve funds from one component to pay for another major component (the end result is still depleted fund balance)?**

A: The primary purpose of Reserve funds are to pay the association's "deterioration bill" to maintain the common areas. There are generally no such things as "roof" dollars or "siding" dollars, they are all Reserve dollars. Pay the bill. At the end of the year, if you track individual funds, you can re-adjust those fund balances as necessary as part of your Reserve Study update. See more [here](#).

**Q: As a board member, what is my personal exposure if D&O insurance does not defend a suit by owners?**

A: Generally the association bylaws and state statute will indemnify your expenses if the suit is not covered under the D&O or any other insurance policy. So, you shouldn't have any personal exposure unless you acted improperly.

**Q: During the development period, can a developer board member be sued for failure to adequately fund the reserves?**

A: Yes, and it happens. Many developers set the assessments attractively low to help sell units quicker, and as a result do not have adequate reserves when they are needed.

**Q: Earthquake insurance. Most owners vote not to purchase. What should the Board do, and what is the Board's exposure if EQ insurance is not purchased?**

A: Document why and hope you're not sued down the road!

**Q: Can you explain again, what are the risks to the Board of Directors with respect to non-monetary claims?**

A: Non-Monetary Damages claims have been the number one source of claims for community associations over my 30 years in this business. Fighting over the right to have a pet, your parking space, or the right to hang a flag in your front yard is a major problem and continues to be. This coverage is critical and must never be excluded or silent.

So a letter addressed to the board about the failure of the board to enforce the pool hours could be a claim. Be aware that many policies will deny claims of this nature, because there are no financial damages.

**Q: What's your opinion of staged projects such as replacing a roof (on duplex) over several years rather than all at once?**

A: Doing a project all at once often has the advantage of lower cost (avoiding multiple “mobilizations” and economies of scale), less disruption to the community (only once!), and uniformity (you can utilize the same siding materials, the asphalt or roof looks the same throughout the association, and all the buildings are painted the same color scheme). But sometimes the association simply doesn’t have the cash to do “all at once”, or sometimes the association was built in phases and there are areas of the association that won’t need a new roof for a few more years. So there is no single “good or bad” rule regarding phasing. In some cases it is a good thing, in some cases doing all at once is best.

**Q: What if the reserve study is wrong - what if there is a gross error in the study. In my situation a major component was at the end of its useful life, but the study stated that there is 34 years remaining life? Could the BOD or manager be considered negligent that they didn't catch this glaring error? And the Reserve study was titled "do it yourself" reserve study, so the Reserve Study provider has no responsibility for the contents.**

A: If the Reserve Study was prepared in-house (using the assistance of a do-it-yourself product or some software), primary responsibility of the information in that document falls on the preparer. That is why it is often best to hire an independent, credentialed provider. The board has some exposure by assigning that project to someone who could make such a mistake, and the board also has some exposure by not checking to validate the cost-saving “Reserve Study” they commissioned. The board has greater exposure if they have been notified of the error and do nothing about it. As soon as the error is noticed, it should be corrected.

**Q: Can I safely prepare our association’s "Reserve Study" even though I am not a "reserve professional"? More than most people, I am knowledgeable about our HOA, our costs, and the age and condition of our Reserve Components. We are well-funded, have never had special assessments, and continue to manage and improve our Reserve ratios.**

A: Again, D&O is “peace of mind” insurance and board members make decisions, and problems arise when individuals don’t like the decision the board made and files a claim. So yes, you can do your own reserve study and set your own Reserve contributions. The question is why would you? Why increase exposure when you don’t have to!

**Q: The reserve study calls for contributions of \$2 million a year, but the majority owner (52.9%) has cash flow that can only support association-wide Reserve contributions of \$1 million a year. Is the Board obligated to ask for the vote to collect the full \$2 million? If the vote will not pass then is the board protected as to their duty?"**

A: Same as above

**Q: Does the BOD have to provide a written reasonable timeline schedule for phased work dates to be completed by? Members voted for high assessments based on reasonable time line to begin the refurbish.**

A: A reasonable, responsible plan is always well-advised. Communicating such a plan is also highly advisable. Creating a responsible plan, and communicating that plan minimizes the chances someone will challenge the delays or phasing as reckless or irresponsible.

**Q: Are Reserve Funds withdrawn for taxes considered "borrowing"? If so, must the fund be paid back, how, and in what time period?**

A: Generally no, but I recommend you get specific guidance from your accounting professional on this matter. Generally, interest earned on Reserve funds (which creates the association's tax obligation) accrue to the Reserve fund. But Reserve Funding Plans generally calculate interest earned as "net of taxes", meaning the taxable portion of interest earned was not presumed available for Reserve projects. In that case, I would suggest taxes paid from Reserves, not be considered "borrowing" (Reserve funds used to pay for non-Reserve expenses).

Note that some states require borrowed Reserves be repaid within a certain time period.

**Q: Can monthly payments to Reserve Fund be suspended, not caught up, and can funds "borrowed" during the payback period be extended indefinitely or forgiven completely?**

A: Again, this is a question better asked of your accounting professional. I would encourage you to think that if the budget was published and distributed to owners, the owners are counting that those Reserve contributions are going towards Reserves. If those contributions don't make it to the Reserve fund, I would consider that borrowing, triggering a payback or "catch-up" obligation. Note that in some cases state law allows short term borrowing to be repaid over a longer period (multiple years) if it can be demonstrated to be in the best interests of the association. But remember that Reserves pay the "deterioration bill". Unless mother nature stops deterioration, you can't truly "forgive" Reserve contributions.

**Q: Profit from the sale of a capital asset was transferred into the reserve account. The taxes due were then taken back out of the reserve account, must these funds be paid back?**

A: Third time's the charm. I'll leave that detailed question for your accounting professional!

**Q: On our WA Association, the siding on 1/4 of the buildings has deteriorated badly with signs of water damage inside units. Even though I have pushed for funding siding replacement with a special assessment, as recommended in our Reserve Study, other Board members and owners have voted it down since their units are not impacted. Liability?**

A: This can be a major problem for the board. The board must always do what's in the best interest of the association. This decision does not sound as if it is in the best interest of the association. This could be a significant problem.

**Q: If a component has passed its "useful life" but doesn't need to be repaired or replaced, how is the replacement value moved forward from year to year?**

A: The replacement cost appearing in the Reserve Study's "Component List" is by National Reserve Study Standards always to be the current cost (including fees, installation, permits, disposal, etc.). If replacement is not necessary, adjust your expected replacement cost due to inflation or other factors. The funds that were being readied for that expenditure will be re-allocated as part of the Reserve Study update.

**Q: What do you do when components scheduled for "replacement" aren't ever going to be replaced, but repaired and maintained on an ongoing basis?**

A: If the expense is small enough, the "replacement" project completely drops from the Reserve Study and is handled through the Operational budget (such as replacing poolside furniture piece by piece as necessary as a minor expense). But of course, budget needs to be in place in Operating for such an expense. Generally, significant repair projects qualify as Reserve projects, such as partial sidewalk repairs every x years. In such cases, list those "repair" or "significant maintenance" projects in your Reserve Study.

**Q: Is the BOD liable if there aren't enough funds in the Reserves even though they are trying to hold costs down?**

A: Again, D&O is "peace of mind" insurance and board members make decisions, and problems arise when individuals don't like the decision the board made and files a claim. Do your best job without conflict, and you should be okay.

**Q: How enforceable is Florida 718.112(2)F2.a which requires Reserve funding for roofing, painting, and paving and other (non-roofing, painting, and paving) projects over \$10,000?**

A: I'm not an attorney, but this section of the law clearly in states that Reserves "must include, but are not limited to, ...". So this law should not be seen as a limitation on what should be set aside towards Reserves, but as a minimum to be compliant with state law. But be reminded that

all the assets at your association are deteriorating, not just painting, roofing, paving, and those above \$10,000. Your responsibility as a board is to provide for the needs of the association (paying its bills). So set aside all the Reserves that are necessary, not just the bare minimum that is required by your local laws.

**Q: Instead of focusing on associations with Reserves that are only 15-20% funded (with high special assessment risk & D&O liability exposure ), please address the funding plans that are in conflict with typical Professional Reserve study recommendation to be 100% funded because the board has chosen a lower objective. Might lower objectives be adequate to cover known cash flow requirements in any given year? For example, if the board adopts a policy to be between 40% and 60% funded, is the Board ever at risk of perceived breach of fiduciary obligation if they ignore the recommendation to pursue a higher objective?**

A: It's all about risk management. The cost of deterioration is significant, often 15-40% of an association's total budget. Even so, the difference between "Fully Funding" Reserves and a lower objective like barely providing enough Reserves to cover upcoming expenses should be only 3% or 4% of an association's total budget. So why expose the association to a higher risk of special assessments for what is likely only about \$10/month? It is responsible to budget for the known cost of deterioration at the association. Exposing the association to a future special assessment, and exposing your decision to the ire of future homeowners saddled with that special assessment, is a business judgment decision you'll need to make. If an independent, credentialed Reserve Study provider recommended contributions of \$X/mo, and you chose to budget 90% of \$X/mo, "just because you wanted to keep contributions low", you likely have some exposure.

**Q: If we had a full Reserve Study in 2016 when should we get it updated?**

A: Your physical assets and your finances are in a constant state of change. Since Reserve contributions often comprise [15-40%](#) of an association's total budget, it is worthwhile adjusting that figure annually to make sure your long-range planning is "on track", as doing so (typically with a combination of With-Site-Visit updates and No-Site-Visit updates) [measurably lowers](#) an association's special assessment risk.

No-Site-Visit updates are effective and inexpensive. An alternating cycle of a With-Site-Visit update followed by two No-Site-Visit updates is a very effective, cost-effective, and popular pattern of annual updates. Check your Reserve Component List. If it reflects what you see when you walk around the association, get a No-Site-Visit update this year. If not, get a With-Site-Visit update this year.

**Q: Could Kevin give more information on how to ask for the proper D&O insurance?**

A: Look for a Stand-Alone D&O insurance policy that is designed specifically for community associations. Most do not; they are designed for either non-profit corporations or for profit corporations. A Stand-Alone D&O policy designed for community associations must extend coverage to volunteers, committee-members, community association managers and employees.

It's important to stay away from D&O policies not designed for community associations like for profit corporations or not for profit D&O policies that have specific exclusion that will eliminate coverage for many community associations because of their unique exposures that I will discuss later. These policies can be great forms but will not respond as well as a community association specialty policy.

There is a need today more than ever because of the increase in D&O claims that you provide your insured with a very broad comprehensive D&O policy designed for community association.