RESERVE STUDY LAW

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According to a prominent Seattle area attorney, the first condominium recorded in King County was in 1964, by then name of “El Condo”. This is the coolest name I’ve ever heard for a condo. Forget Tall Trees, Whispering Brook, etc.—give me “El Condo”. I was born in 1964 and I would like to think I’ve gotten better over time—you know, learned from my mistakes. I’ll argue that condominiums are a little slower in their progress. My experience with condominiums and perhaps personal ideology, tells me a law to disclose the most significant expenses likely to be faced over time is generally a good thing. As of 2012, 30 states across the country have laws addressing reserve accounts. Money issues are at the root of many association problems, and implementing a well-crafted reserve study program can greatly reduce the risk of devastating special assessments and help people to manage their personal finances better. While not perfect, Washington Senate Bill 6215, signed into Washington law in 2008 goes a long way toward helping those who live in condominiums help themselves. I would like to reinforce the general usefulness of the study; what it should include, suggestions for choosing a provider and what to tell your realtor. My hope in co-authoring this law was to ultimately level the playing field, where the market rewards owners within well-run associations, not punishes them by the incorrect perception that the lowest dues is always the best value. The full text of the law can be found at the following link: http://apps.leg.wa.gov and searching for RCW 64.34 I highly suggest that you read the law in it’s entirety and have a discussion with your counsel for any questions.

What needs to be in the study? Sections 2, a-k of the law states the items that need to be listed in the study. Essentially, the study should tell you: what you are reserving for, how often and how much those projects are expected to cost, this year’s ideal or “fully funded” reserve balance, your current reserve level in comparison to that ideal and “projected reserve account balance for thirty years and a funding plan to pay for projected costs from those reserves without reliance on future unplanned special assessments. . .” Knowing which years the larger expenses are likely to occur and what puts the association at greater risk of cash flow problems allows the board to become proactive to find the best value when executing those projects and accumulating the necessary funding. Begin the process well in advance to develop a professional scope of work and specifications, approaching bidders during their slower season if possible. Let the community know in advance what you are preparing for— nobody likes surprises when it comes to their money.

<u>How much should you set aside in reserves?</u> This question will likely be debated forever. The new reserve study/account law does not mandate how much reserves or for that matter any reserves be set aside. The law mandates reserve studies as disclosures, not reserve accounts— reserve accounts (see Sec. 1.1) are "encouraged". In my mind, it comes down to "How much financial risk are you comfortable putting yourself and your neighbors in?" If the answer is "not much," then point the association toward the 70-100% funded range where there is statistically low probability of special assessment. The reserve study will show you projected expenses in each year of the thirty-year reporting period and reserve balances at the beginning and end of those years. In my experience, the larger the project, the greater potential for cost overruns and surprises. Components like closed cavity decks and others that can reveal hidden damage when disassembled should be approached conservatively. I have long been a proponent of Fully Funded as the most fair and responsible approach, but the law leaves it to the discretion of the board of directors. We have learned in performing over 25,000 reserve studies since 1986 that on average, the difference between a baseline funding contribution (simply keeping your reserve balance above zero, resulting in a low Percent Funded and little or no margin for Reserve "surprises") and a "safe" fully funded contribution is about 13%. Stated another way, if your reserve contributions are $75 per unit per month and your association has a high risk of special assessment versus $85 per unit per month and you have a low risk of special assessment, would you choose the former or latter? For those of you who have been through a large special assessment, in hindsight would you have set aside $10 more a month to avoid that process? To be fair, many of you inherited a financial position well below the curve and it was too late to make that determination yourselves. You can change it going forward however.

<u>How do you choose a Reserve Study provider?</u> This question obviously has potential land mines for me—I will do my best to be objective. I can tell you the new law has brought more choices for you in the marketplace and therefore your due diligence will be more important than ever. The best value for you is a study that provides a thorough and realistic budget model and tool(s) you can use to make planning decisions for your community's current and future considerations. There is no entity to oversee reserve studies for their accuracy or completeness, only a statement in the law that an initial reserve study and with-site-visit update every three years must be prepared by a reserve study professional, or disclosed that it was not prepared with the assistance of a reserve study professional. As of 2012, if a reserve study provider chooses not to recommend funding for any of the "Big Seven" projects (painting, roofing, pavement, siding, windows, decks & plumbing), they must provide explanation within the study. The study must be updated annually. The definition of a "Reserve study professional" within Senate Bill 6215: "means an independent person suitably qualified by knowledge, skill, training or education to prepare a reserve study in accordance with sections 1 and 2 of this act." Like many areas of the law, this is subject to interpretation, and will likely be interpreted differently. The word independent is key in this definition.

Look for one of two almost identical professional credentials in the field, CAI's RS designation or the PRA designation administered by the Association of Professional Reserve Analysts (APRA). Both require a combination of education/experience and adherence to a similar set of National Standards (terminology, disclosures, procedures, etc.). A good reserve study is formed out of a multi-disciplinary approach, requiring strong observational and research skills and the ability to disseminate information from a variety of sources. As with so many professions, there is simply no substitute for experience. Ask for sample actual reports, references and qualifications. Look for a Report format that clearly provides the three results expected from a Reserve Study; a clear listing of Reserve Components, an evaluation of the current Reserve Fund balance (Percent Funded), and a recommended 30-yr Funding Plan.

<u>What should you tell your realtor?</u> First, whether or not you are in compliance with the law. If so, emphasize there is a plan in place to meet the projected future expenses of the association. This alone will put you ahead of many communities. Most associations in Washington are currently below the 70-100% or "strong" funded level. Percent funded is a primary measure of current Reserve financial strength, but you must look a little deeper into the report to understand when your significant expenses are likely to occur in the coming years in order to be fully prepared. The bottom line: Operating from a strong reserve funded position will pay dividends for your community in many ways. There is generally far more upside to complying with the new reserve study law than not. Ask your legal counsel to explain the new law in more detail and keep up the good work!