THE BIG PICTURE

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Below are some big picture thoughts to consider with respect to how community associations function in our society and how owners and industry professionals can have a hand in achieving the key objectives as I have stated them in this infographic. The read will be a bit long and dry in places, but I think the background is important for perspective if you can hang in there. However, realizing we live in a sound-bite 24-hour news cycle world, I will start with the conclusion to maximize the chance of you receiving the heart of the message.

Conclusion: Condominium and homeowner associations remain a viable and growing housing choice in the market. Residential real estate purchases are largely based on emotion and/or proximity to employment, schools, amenities and services. If the expectation to receive peace of mind during ownership and maximum unit value whenever an owner is ready to sell is also true, several pieces need to be in place in a community association. Some owners will be lucky enough that their local market conditions will drive demand and unit values much faster than other areas even if they screw this up; most will not.

In all cases here are the pieces that should be in place for community associations to reach the key objectives and improve the overall industry model:

1) Understand the building(s) construction well, anticipating needs to ensure they are solid and waterproofed.
2) Develop a vibrant volunteer organization thru committee structure and operate your association like a business while providing all a clear understanding of your governance (law, rules, policies).
3) Have a long-term financial plan as soon as possible and be transparent with it; the longer you go with inadequate assessments that don't reflect the true cost of ownership, the worse off you will be.
4) Create a public voice from your community, forging relationships with your legislators and local officials. If you think the courts are wrong to take away the ability to limit rentals, ratify budgets and that realistic financial projections should be in place from the beginning of a development, let them know.

5) Partner with and educate owners, buyers, realtors and lenders about how well you run your association and what your selling advantages are.

More and more people are paying attention to these things and learning from the mistakes of the past – ignoring them will cost many owners thousands or tens of thousands of dollars and numerous headaches. It takes time and will to build a community that brings peace of mind and maximum unit value, but the payoff is great if you go about it the right way, working closely with your business partners.

THE LONG, DRY PART

The concept of common interest real estate has been in the world for a long time. The development of Condominiums took off in this country with the Fair Housing Act of 1968, authorizing the use of mortgage insurance on single family units in multi-family structures as urban population density increased. State laws underpin the ability to govern and create title within this form of ownership.

WA public policy: The Horizontal Property Regimes Act was the initial Condominium statute, adopted 1963, RCW 64.32 The first condominium was recorded in Washington in 1964. Then followed the Condominium Act *(applies to condominiums created after July 1, 1990)* RCW 64.34. This new Act coincided with the state's adoption of the Growth Management Act in 1990. The GMA was enacted in response to rapid population growth and concerns with suburban sprawl, environmental protection, quality of life, and related issues. The GMA has been amended several times, and is codified in many chapters but primarily in Chapter 36.70A RCW. Policy responsibility in this regard is divined further to comprehensive planning at the local level, with the GMA as the backdrop. The Homeowners Association Act RCW 64.38 was adopted in 1995 to guide the formation and legal administration of HOA's.

The Condominium Act has been amended quite a few times since 1990 – for our overview let's look at the key language in the first section, RCW 64.34.005 "Findings—Intent" amending the act in 2004 to include the following:

(1) The legislature finds, declares, and determines that:

(a) Washington's cities and counties under the growth management act are required to encourage urban growth in urban growth areas at densities that accommodate twenty-year growth projections;

(b) The growth management act's planning goals include encouraging the availability of affordable housing for all residents of the state and promoting a variety of housing types;

(c) Quality condominium construction needs to be encouraged to achieve growth management act mandated urban densities and to ensure that residents of the state, particularly in urban growth areas, have a broad range of ownership choices.

(2) It is the intent of the legislature that limited changes be made to the condominium act to ensure that a broad range of affordable homeownership opportunities continue to be available to the residents of the state, and to assist cities' and counties' efforts to achieve the density mandates of the growth management act.

Reliable construction: What were the times like in the 1990's when I joined the industry and leading up to the mid 2000's when this amendment was drafted? In a word, booming. Unfortunately as it turned out there were several key factors during that period that proved to be quite problematic and costly for multi-family construction in Washington:

1) The introduction of unproven building materials and construction techniques
2) Increased energy efficiency requirements of buildings leading to *tighter* construction
3) Expansion of construction labor force to meet demand, but skills often lagging the construction techniques needed for our climate and changes in the building codes.

These factors ultimately lead to widespread construction defects and rehabilitation claim funding by insurance companies likely ending up in the billions of dollars when tallied today. Insurance carriers refused to underwrite any new multi-family construction and the state legislature was called to action. A few things jump out at me when reading the above from RCW 64.34.005: The legislature does appear to recognize the balancing act of needs and expectations in a stratified society, while at the same time acknowledging the difficulty. This amendment was drafted during the time of my first year on the Community Associations Institute Legislative Action Committee when we were working on legislation, EHB 1848, that was to eventually become Washington law addressing the construction defect issues, RCW 64.55 The state was between a rock and a hard place to meet their obligations under the law while balancing the economic benefits of boom time with the long-term consumer protections and sensible regulations needed to avoid the same mess again in the future. Can quality construction that is "affordable" be achieved as stated in the RCW or is the word choice of "encouraged" a tacit admission that despite the best policy directives the market is going to do what it's going to do?

Fast forward to present day, 2016. After about a seven year period of recession our region is booming again. This time the job growth is largely in the urban sector revolving around companies like Amazon. Had to be, right? If you've lived in the area for any length of time you know we don't have the transportation infrastructure to continue to grow with suburban sprawl as the model. Construction cranes are all over the place in the cities, but very few condominiums are being built; many thousands of apartment units, only a few hundred condominium units. Is this solely a result as many say of millennials being adverse to ownership, and therefore developers find their maximum profit in building apartments? Or is there some truth to the murmurs that our state's litigious history and warranty protections in the Condominium Act are a significant factor in developer's decisions?

There are vocal groups calling on the cities for affordable housing as rents continue to climb, placing Seattle as one of the highest rental markets in the country. Mayor Murray's office has assembled a task force, HALA (Seattle Housing Affordability and Livability Advisory committee). In reading the committee's report I noted quite a few developers on the committee and a repeated message that regulations are too burdensome and we ought to try the newer lower cost materials like cross laminated timbers used in some other areas. And allow for an additional story of wood construction or not require seismic retrofitting. We've also seen the green movement and increased pressures to take the tightening of construction to the next level largely through air barrier technologies. Is any of this sounding familiar? Having worked with the legislature and other public policy makers for more than a decade, I can attest that loud voices are often heard regardless of the merit of the message.

Some policy advances along the way have helped point community associations in the right direction. Key among them have been addressing the construction defect issue and broadening disclosures to potential buyers and owners. There is more work to be done. Affordable construction is a misnomer if substandard materials and techniques are used that wind up costing more to maintain, repair and replace over time, or worse prove to be defective. If initial budgets & assessments are inadequate to begin with, it **will** wind up costing more over time. If there are a bunch of owners who could marginally afford to purchase in the community in the first place, what will happen when the true cost of ownership reveals itself as it always does? It will unfairly burden owners at the time and will cost much more in the long run as owners with means subsidize those without. We should fight for realistic budgets from the beginning. There has been some improvement, but the status quo remains in most cases. Take a look at this financial projection for a marquis new high-rise development in Seattle for which we did the reserve study to be included in the Public Offering Statement. Our recommendations were ignored in favor of the FHA, Fannie Mae, Freddie Mac minimum guideline of setting aside 10% of the operating expenses into reserves. How does this picture look to you, or the important first-time, fixed income, "affordable housing" buyers? And this plan assumes they will *raise* their reserve contributions 3% each year… **Poor funding in the first 10 to 15 years when building assets are shiny and new is common and often leads to insurmountable financial difficulty for associations.**

30-Yr Reserve Plan as budgeted within Public Offering Statement **25434-0**

Fiscal Year Beginning: **01/01/14** | **Interest:** **1.0%** | **Inflation:** **3.0%**

Year	Starting Reserve Balance	Fully Funded Balance	Percent Funded	Rating	Annual Reserve Contribs.	Loans or Special Assmts	Interest Income	Projected Reserve Expenses
2014	$0	$768,946	0.0%	Weak	$350,000	$0	$1,758	$0
2015	$351,758	$1,584,029	22.2%	Weak	$360,500	$0	$5,345	$0
2016	$717,603	$2,447,325	29.3%	Weak	$371,315	$0	$9,074	$0
2017	$1,097,992	$3,360,993	32.7%	Fair	$382,454	$0	$12,869	$16,391
2018	$1,476,924	$4,310,396	34.3%	Fair	$393,928	$0	$16,816	$0
2019	$1,887,668	$5,331,127	35.4%	Fair	$405,746	$0	$21,001	$0
2020	$2,314,416	$6,409,223	36.1%	Fair	$417,918	$0	$25,350	$0
2021	$2,757,684	$7,547,206	36.5%	Fair	$430,456	$0	$22,836	$1,399,596
2022	$1,811,379	$7,306,116	24.8%	Weak	$443,370	$0	$20,424	$0
2023	$2,275,172	$8,528,600	26.7%	Weak	$456,671	$0	$24,822	$65,239
2024	$2,691,427	$9,750,661	27.6%	Weak	$470,371	$0	$29,401	$0
2025	$3,191,198	$11,107,583	28.7%	Weak	$484,482	$0	$34,203	$57,653
2026	$3,652,229	$12,477,761	29.3%	Weak	$499,016	$0	$39,197	$0
2027	$4,190,442	$13,981,317	30.0%	Weak	$513,987	$0	$44,679	$0
2028	$4,749,108	$15,563,856	30.5%	Fair	$529,406	$0	$21,843	$5,679,018
2029	-$378,661	$11,379,376	0.0%	Weak	$545,289	$0	$0	$3,295,880
2030	-$3,129,252	$9,559,934	0.0%	Weak	$561,647	$0	$0	$0
2031	-$2,567,605	$11,117,683	0.0%	Weak	$578,497	$0	$0	$57,850
2032	-$2,046,958	$12,700,708	0.0%	Weak	$595,852	$0	$0	$85,122
2033	-$1,536,228	$14,342,405	0.0%	Weak	$613,727	$0	$0	$2,034,067
2034	-$2,956,568	$14,066,391	0.0%	Weak	$632,139	$0	$0	$0
2035	-$2,324,429	$15,918,849	0.0%	Weak	$651,103	$0	$0	$0
2036	-$1,673,326	$17,869,795	0.0%	Weak	$670,636	$0	$0	$0
2037	-$1,002,690	$19,923,471	0.0%	Weak	$690,755	$0	$0	$2,333,075
2038	-$2,645,010	$19,681,216	0.0%	Weak	$711,478	$0	$0	$223,607
2039	-$2,157,139	$21,651,340	0.0%	Weak	$732,822	$0	$0	$0
2040	-$1,424,317	$23,959,183	0.0%	Weak	$754,807	$0	$0	$0
2041	-$669,510	$26,386,010	0.0%	Weak	$777,451	$0	$0	$33,319
2042	$74,622	$28,902,564	0.3%	Weak	$800,775	$0	$4,772	$0
2043	$880,168	$31,581,713	2.8%	Weak	$824,798	$0	$0	$19,887,763

HOW CAN RESERVE STUDIES HELP?

In my view, mostly in ways many don't currently use them: I am in favor of reserve studies by an independent professional at the time of the public offering, and a **requirement** that the initial budget include a contribution rate for a low-risk reserve funding plan. This will help the responsible lenders and realtors guide their buyers to appropriate housing that is within their means. Secondly, many (most) boards do not disclose the reserve study to all owners nor use it as a communication and recruiting tool. This is likely because of a feeling they are underfunded and/or don't want to be subject to the scrutiny and questioning of owners. The better approach of disclosing and using the study to their advantage cannot only give owners the confidence their board is working a plan, but those that are interested are often the next volunteers in the all-important association governance structure previously mentioned. As part of my work over the years with the Community Associations Institute, recruiting volunteers is perennially a key topic of interest.

Can reserve studies help maximize unit values? First, please understand that if your association is less than 50% funded you are not the outlier – most Washington associations that we have measured are less than 50% funded, and this data comes from roughly 1/3 of the total association market. There are thousands of associations out there not likely to have any professional plan in place or be in a better financial position. Use this to your advantage! Legislation requiring reserve studies was enacted by an overwhelming majority of the legislature in 2008 on the heels of the construction defect law. The market (sellers, buyers, realtors) have historically (wrongly) valued low assessments by themselves as desirable. Comparing reserve studies between properties levels the playing field to help reward the good financial stewards rather than punishing them by losing sales in their communities from the misperception that lower assessments by themselves are a better value. And again, showing a prospective buyer a professional reserve study typically casts your association in a better light than the market competitor with no plan or a poorly conceived one.

Let's broaden our picture a bit to include a national and historical perspective. Thomas Jefferson said "A right to property is founded in our natural wants". Surveys indicate the majority of Americans still believe the idea of home ownership is part of the American dream; decades of national policy have touted America as a home ownership society. However, many feel the loosening of mortgage underwriting standards resulted in the over-leveraging of the American public leading to the housing crisis. "A home is supposed to be our ultimate evidence that in America, hard work pays off, and responsibility is rewarded", President Obama said recently. He then said "In the runup to the crisis, banks and the government too often made everyone feel like they had to own a home, even if they weren't ready. That's a mistake we shouldn't repeat." Well said, Mr. President.

Housing policy is precarious and must carry through to the local level, including sufficient oversight. One of the push-pulls policy makers face is that 70% of our economy is driven by the engine of consumer spending. The access to home equity has been an increasingly important part of that equation – again, long-term thinking and stability should prevail.

In the wake of the housing crisis, according to a long time banking associate, there were a disproportionate number of foreclosures within condominium associations. Both condo's and HOA's suffer further as banks do not want to pay assessments on those properties. Washington is one of the few states where condominium associations have the ability in some cases to have lien priority to recover up to six months of assessments from lenders, but many of those properties were held on to for much longer and recovery was difficult. As a former appraiser, I will tell you that comparable sales and inventory within the association are most heavily weighted. In short, it therefore takes associations longer to recover than other housing types.

So what are you doing here? What am I doing here? Helping to protect against what many consumers don't know, guiding association(s) to avoid the costly and large headaches of special assessments and deferred maintenance and to be ready for the day when an owner chooses to sell their unit in hopes of realizing maximum value. If we all ask the questions and shine a light on both what is wrong and right with our industry we grow, and we prosper.