

Welcome to the
**WASHINGTON STATE CHAPTER *of*
Community Associations Institute**

*The leading professional organization providing education, resources,
and advocacy for community association living.*



1

The Consequences of Inadequate Reserves



2

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3

Insurance Considerations

Aging buildings can result in an increase of losses

Change in underwriting philosophies

- Requiring confirmation of building updates

- Requesting copies of Reserve Studies

- Limiting coverage

Increase in premiums & deductibles

- Challenges with abiding by new lending requirements

Insurers leaving the market



4

Insurance Considerations

WUCIOA for All requirements -

In the case of a building that contains units divided by horizontal boundaries described in the declaration, or vertical boundaries that comprise common walls between units, the insurance maintained under subsection (1)(a) of this section, to the extent reasonably available, must include the units and, unless provided otherwise in the declaration, all improvements and betterments to the units.

Most insurance companies cannot/will not insure a portion of the building (roof only, etc.)



5

5

Buying? Selling? ... Here comes disclosures!

An inclusive but not complete list of where

PSA Clauses

Information verification period

Optional Clauses

HOA Verification

Resale certificate

All the things! (but especially the reserve study disclosure and budget report, annual budget, two years of minutes and financial statements showing information on deferred maintenance and funding levels/reserve balances)

Form 17

Contact info for the community Board or Manager



6

Your real estate agent is on the lookout....

Washington state real estate licensees differ from your Association Manager – when we represent you as your buyer broker or listing agent, we are a fiduciary.

We owe a buyer or seller these duties in general: Reasonable care and skill, honesty and good faith, presenting all written communications, disclosure of material facts, accounting of trust funds, providing agency law pamphlet, and making agency disclosures



7

Your real estate agent is on the lookout.....

..... but cannot offer opinions or be held liable for a buyer or seller's understanding of a concept. That said, other than material facts, we are directing our clients to review:

For the listing broker's description of funding in advertisement for a unit for sale vs what the association discloses (PSA Form 21)

Any and all financial information for drafting a buyer's estimate (Optional Clauses Form 22D)

Full review of resale certificate and all pertinent documents, especially the reserve study, what is contained in it, and if it is not provided – why. (Form 27CIC for RCW 64.90 communities and Form 27 for RCW 64.34)

Material facts are facts which would affect the decision of a buyer to decide to buy and a real estate agent can make those known to a buyer.



8

8

... and so is a buyer's lender

Not disclosing reserve information, not providing a reserve study in disclosure, and most of all – the presence of deferred maintenance coupled with underfunded reserves are weighed by an underwriter. A buyer's loan application may be rejected if the underwriter deems the burden of the total payment is too high and therefore a risk for the lender. A lender's denial of a loan on a unit due to the Association financial health can quickly devalue a unit on the real estate market.

If Fannie Mae or Freddie Mac deem the property to have too much deferred maintenance, they will add the association to their list of properties that do not qualify for conventional financing.

A regular assessment which is higher but is inclusive of robust reserve contributions looks different than a lower regular assessment but a higher additional assessment for a project which may also not address future reserve contributions.

An underwriter is making a decision, not only regarding the value of the unit, but also regarding the buyer's ability to pay the ongoing assessments or special assessments.

An upcoming special assessment (even if not assessed yet) because of lack of reserve funding may also affect the underwriter's risk assessment of the buyer's ability to pay.



9

9

Boards: can you be held liable for loss of value because of lack of funding?

It depends.



10

10

Maintaining Value Via Commitment to Reserves Is on the Board and all Members of the Association.

Disclose! Disclose! Disclose! As a seller on your Form 17 and as an Association on a Resale Certificate and via your professional reserve study.

Know that as a Board you are making recommendations for the longevity of the community, which is why your organization exists.

Know that every unit owner and Board member is a seller, and that the highest and best outcome of their sale of any unit is a reflection of value of all units.

How communities fund projects, reserves, etc. is scrutinized by lenders; if there is a risk for future toll on a borrower, lending may not be obtained for one or many units in your community



11

11

Reserve Study Requirements

With a few exceptions, Washington State statute requires associations with significant assets to perform a reserve study and update that study annually.

Some governing documents may also feature a reserve study requirement.

Currently, there is no statutory requirement to fund the reserve account in Washington State.

According to CAI National, 12 states have mandatory reserve funding requirements for condominiums.

Who looks at a reserve study?

Managers, boards, owners, buyers, lenders (owner and association), insurance underwriters

Reserve study recommendations are disclosed as part of annual budget.



12

What Are Underfunded Reserves?

Sectors of the industry may define this differently based on their specific requirements (i.e. lending vs insurance)

An association is generally considered underfunded if:

- A special assessment is recommended by reserve study;

- Projects are being deferred and/or phased due to inability to pay.

Associations that are 0-29% funded are typically known to have the highest risk of a special assessment.

Caution: A well-funded association that is contributing significantly below reserve study funding models may be considered underfunded.



13

Common Causes of Underfunded Reserves

- Associations failing to perform and regularly update a reserve study;

- Associations failing to budget for reserves within the range provided by the study;

- Construction defects not covered by litigation proceeds;

- Premature failure of an item;

- Hidden damages and/or increased scope of work for major projects;

- Economic factors;

- Inadequate initial budget set by builder/developer.



14

Four Ways to Pay for Reserve Projects



REGULAR
CONTRIBUTIONS
TO RESERVES



SPECIAL
ASSESSMENT



BANK LOAN



DECLINE IN
PROPERTY
VALUES



15

The Fully Funded Balance

Fully funded balance = the cumulative amount the association's assets have deteriorated as of the date of the reserve study.

The reserve study funding plans are intended to fund reserves as the assets deteriorate therefore current owners are contributing toward what they "used", not the future of that item.



16

Underfunded Reserves & Deferred Maintenance

Preventive maintenance projects commonly postponed when reserves are underfunded:

Postponing maintenance can lead to a shorter useful life of the item or increased costs at the time the project is finally performed.

Associations with underfunded reserves may feel pressured to select least expensive vendor regardless of quality of work:

Underfunded associations also often opt for least expensive product, even if that product carries a higher maintenance cost over the life of the item.

Associations with underfunded reserves may spend money repairing an item that should be replaced.

Many underfunded associations phase or partially complete projects to “save money”.



17

Common Objections to Funding Reserves

“I won’t be here in 30 years.”

“The reserve study project costs are too high.”

“People will have to move if we increase assessments to fund reserves.”

“We’ll just do a special assessment for that project at the time.”

“No one uses the clubhouse so we don’t need to save money for it.”

“We can reduce reserve funding needs by phasing projects.”



18

18

What if Owners Reject the Budget?

Research projects and obtain scope of work and timeline to substantiate reserve study, provide information to owners.

Hold a meeting and bring in experts – reserve consultant, building envelope consultant, attorney, etc.

Avoid promises to limit future increases and/or avoid special assessments.



19

19

Questions?

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20

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Working Together to Serve YOU

Locally & Nationally

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