NO RESERVES, OLD BUILDING, WHERE DO WE GO FROM HERE?

This Course is approved by the DBPR Council of Community Association Managers, for 4 hours of continuing education credit in the area of:

<u>Insurance Financial Management (IFM) and Additional Instruction (ELE)</u>

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INTRODUCTION

Course Description

Welcome to the 4-Hour CAM CE course No Reserves, Old Building, Where Do We Go From Here? Thank you for choosing Gold Coast Professional Schools. Our objective is to provide you with the best possible course and materials.

Community associations proliferated after the Federal Housing Administration authorized federal home mortgage insurance for homes in community associations in 1963. The buildings, residences, garages, clubhouses, and other structures that were built during the 20 years that followed are now between 30 and 50 years old. Many of them are in disrepair and in need of substantial and expensive renovation.

This course follows the progress of a fictional board of directors and owners of a fictional property called Carefree Living Condominium Association (hereinafter referred to as Carefree).

Disclaimer

The Carefree Living Condominium Association and all persons named in this presentation are fictional. Any resemblance to any association or person, living or dead, is strictly coincidental.

As the student, your role is to guide the Carefree Condominium Association community as it struggles to:

- Identify and accept its new reality
- Understand the causes
- Interact successfully with local government officials
- Interact successfully with legal, financial, and building professionals
- Bring itself back to a healthy state of being

After each section, you'll be presented with questions and answers relevant to the information presented in that section. Our intent is to get you thinking about how you, as a community association manager, would handle these issues.

Outline

The following topics are covered in this course.

- The Carefree Condominium Association
- The problems
- The problem causers
- Should we fix it?
- How do we fix it?
- Summary

THE CAREFREE LIVING CONDO ASSOCIATION

The Property

The Carefree property is a 35-year old, 200-unit, high-rise building that's being forced to confront, like so many of its residents, the impact of the aging process on its physical structure, as well as its pocketbook.

History

The owners of Carefree are predominantly elderly retirees who are living on fixed incomes.

Each year since inception, they voted to partially-fund their reserve accounts. However, the economic downturn of 2008 shook the owners to the core, depleted their portfolios, and dramatically reduced their income from money markets, CDs, and bank deposit accounts.

Beginning in 2009, the owners voted to waive any funding of their reserve budget. Consequently, the reserve accounts have become substantially depleted.

THE PROBLEMS

Outline

The following topics are covered in this section.

- The problems
    - The board's inaction
    - The financials
        - The balance sheet
    - Unsafe structures
        - The engineer
        - The project begins

The Board's Inaction

There are several problems facing our Carefree community; however, the seven member board of directors is afraid to address them because it knows the association doesn't have the money to do anything about them.

Some are concerned about the impact that a special assessment might have on their own finances and are worried that they might have to move.

The majority of the board members have held office for many years. A number have decided to complete their term and not seek re-election, thus leaving the problems for a new board.

However, the annual meeting is not scheduled for another nine months and the problems appear to be getting worse.

Let's exam the problems.

Budget Deficit

Carefree's annual budget is operating at a deficit and doesn't contain adequate reserve funding.

Concrete Issues

Carefree's close proximity to the ocean has made its concrete structures more susceptible to water intrusion and corrosion.

There's evidence of structural damage including spalling, rust spots, and exposed rebar that's visible on the balconies, exterior walls, and the elevated garage.

Elevators

The two elevator cars are frequently out of service.

Water Leaks

There have been a number of leaks from the riser lines that supply water to the units.

Fire Safety

The county's fire department has cited the association for failure to comply with the state's fire safety requirements.

Deferred Maintenance

Carefree also has a need to spend funds on deferred maintenance items, such as:

- Paint the drab interior and exterior of the building
- Repair cracked and potholed roadways and parking areas

Board's Inaction Q&A 1

What is the difference between a capital expenditure and deferred maintenance?

The Florida Department of Business and Professional Regulation (DBPR) defines a capital expenditure[1] as any expenditure of funds for the purchase or replacement of an asset whose useful life is greater than one year or for the repair of an asset that will extend its useful life for a period greater than one year.

Deferred maintenance is defined as any maintenance or repair that is performed less frequently than yearly and results in maintaining the useful life of an asset.

Board's Inaction Q&A 2

What are some examples of deferred maintenance?

Deferred maintenance includes:

- Painting
- Balcony repairs
- Equipment repair that occurs less than yearly

Board's Inaction Q&A 3

Can a maintenance activity be both a capital expenditure and deferred maintenance?

A repair that extends the useful life of an asset for a period greater than one year, and is performed less frequently than annually, meets the definitions of both capital expenditure and deferred maintenance.

Examples include:

• Repairs to a balcony rather than replacement

• Equipment replacements as defined previously

The Financials

During most of its history, Carefree's board of directors has had at least one member who had been either an accountant or bookkeeper prior to retirement. Unfortunately, once the economic fortunes of the association began to decline, members who expressed concern over its finances were ignored or characterized as doomsayers. At this time, however, there is no one on the board, including the treasurer, who understands financial statements.

During the board meetings, the association's manager, Jeremiah Green, is asked to provide the financial report.

Jeremiah is painfully aware of the board's unwillingness to face the reality of its situation from the negative reaction to his past attempts to communicate the dire nature of its finances. Because of this, Jeremiah now simply reads the numbers without any commentary.

[1] Florida Department of Business & Professional Regulation, Division of Condominiums, Time Shares and Mobile Homes, Budgets & Reserve Schedules A Self-Study Training Manual, July, 2010

Although there are no financial professionals on the board, important parts of the balance sheet, and income and expense statement are understandable to nonprofessionals, if they simply took the effort to look closely at them.

The Carefree board, however, is in deep denial and doesn't want to look at its reality as reflected on the financial reports.

The Balance Sheet

Please use the "Carefree Balance Sheet" below as reference throughout this section.

Carefree Living Condominium Association
Balance Sheet
06-30-15

Assets		
Current Assets		
1010	Checking – Operating	120,000.62
1015	Accounts Receivable	180,200.74
1020	Allowance for Uncollectible Debt	(90,053.26)
1312	Prepaid Insurance	50,000.26
Subtotal Current Assets		260,148.36
Reserves		
1017	Bank Reserve CD Due 7/15/16	50,000.00
1018	Reserve Money Market Account	45,000.78
Subtotal Reserves		95,000.78
Other Assets		
1310	Renter's Security Deposits	5,000.00
1440	Deposits - Other	2,000.00
Subtotal Other Assets		7,000.00
TOTAL ASSETS		362.149.14

Liabilities & Equities		
Current Liabilities		
2200	Accounts Payable	102,662.48
2520	Prepaid Assessments	32,085.07
Subtotal Current Liabilities		134,747.55
Reserves		
2541	Painting	7,500.89
2542	Paving	2,025.97
2542	Roof	3,082.00
2543	Pool	22,027.46
2544	Elevators	1,007.57
2545	Plumbing	7,698.02
2546	Contingency	6,000.00
2547	Interest	658.80
Subtotal Reserves		50,000.71
Other Liabilities		
2530	Security Deposits	5,000.00
Subtotal Other Liabilities		5,000.00
TOTAL LIABILITIES		187,748.26
Equity		
4500	Operating Fund Balance	182,401.22
	Current Year Net Income/Loss	(10,000.34)
TOTAL OWNERS EQUITY		172,400.88
TOTAL LIABILITIES & EQUITY		362,149.14

Balance Sheet Q&A 1

What is a balance sheet?

The balance sheet presents the financial picture of the association on one particular day, an instant in time, the date it is written[2].The following information is on the balance sheet:

- Assets - The amount the association has today
- Liabilities - The amount the association owes today
- Equity - The amount the association is worth today

[2] Thomas R. Ittelson., Financial Statements A Step-by-Step Guide to Understanding and Creating Financial Reports, Career Press, 2009, p.17

Balance Sheet Q&A 2

What does the balance sheet report?

The balance sheet reports what is referred to as the “accounting equation.”[3]

The Accounting Equation				
Has Today	=	Owes Today	=	Worth Today
“Assets”	=	“Liabilities”	=	“Owner’s Equity”

Balance Sheet Q&A 3

What are assets?

Assets are everything the association has – cash in the bank, inventory, machines, and buildings – all of it.

Assets are also certain “rights” the association has that have a monetary value, like the right to collect cash from persons or entities that owe it money.

Assets are valuable and must be quantifiable for an asset to be listed on the balance sheet. Everything in an association’s financial statements must be translated into dollars and cents[4].

Assets are classified as current, other, or fixed.

By definition, current assets are those assets that are expected to be converted into cash in less than 12 months. The category, other assets, is a catchall category that includes intangible assets such as the value of patents, trade names, and so forth. Such assets typically are not owned by community associations.

A company’s fixed assets (so-called property, plant and equipment, or PP&E) are generally the largest and most important non-current asset grouping[5]. Such assets are typically not included on a community association’s balance sheet because they are considered to be the property of the owners, not of the association.

Community associations often list security and other types of deposits as Other Assets. They include the reserves as an additional type of asset.

Balance Sheet Q&A 4

What are the Carefree association’s assets?

Please refer to the assets section of the balance sheet.

Carefree’s assets include:

- Checking - operating
- Accounts receivables
- Allowance for uncollectible debt
- Prepaid insurance
- Bank reserve CD
- Reserve money market acct.
- Renter’s security deposits
- Other deposit

Assets		
Current Assets		
1010	Checking – Operating	120,000.62
1015	Accounts Receivable	180,200.74
1020	Allowance for Uncollectible Debt	(90,053.26)
1312	Prepaid Insurance	50,000.26
Subtotal Current Assets		**260,148.36**
Reserves		
1017	Bank Reserve CD Due 7/15/16	50,000.00
1018	Reserve Money Market Account	45,000.78
Subtotal Reserves		**95,000.78**
Other Assets		
1310	Renter’s Security Deposits	5,000.00
1440	Deposits - Other	2,000.00
Subtotal Other Assets		**7,000.00**
TOTAL ASSETS		**362.149.14**

[3] Thomas R. Ittelson., Financial Statements A Step-by-Step Guide to Understanding and Creating Financial Reports, Career Press, 2009, p.17
[4] Thomas R. Ittelson., Financial Statements A Step-by-Step Guide to Understanding and Creating Financial Reports, Career Press, 2009, p.18
[5] Thomas R. Ittelson., Financial Statements A Step-by-Step Guide to Understanding and Creating Financial Reports, Career Press, 2009, p.25

Balance Sheet Q&A 5

What are the prepaid expenses?

The prepaid expenses are:

- Bills the association has already paid for services not yet received
- Expenses, such as prepaid insurance or salary advances
- Current assets, not because they can be turned into cash, but because the association will not have to use cash to pay for them in the near future because they've been paid already[6]

Balance Sheet Q&A 6

How much of the Carefree association's accounts receivable has been determined to be uncollectible? What does uncollectable mean?

Please refer to the current assets section on the balance sheet.

The amount of the uncollectible receivables is $90,053.26, as shown here.

Current Assets		
1010	Checking – Operating	120,000.62
1015	Accounts Receivable	180,200.74
1020	Allowance for Uncollectible Debt	(90,053.26)
1312	Prepaid Insurance	50,000.26
Subtotal Current Assets		**260,148.36**

Accounts receivables are considered to be current assets.

Carefree's balance sheet shows accounts receivable in the amount of $180,200.74. However, it also shows an allowance for uncollectible debt of $90,053.26, in parentheses to express a negative amount. The uncollectible debt must be subtracted from the total accounts receivable, leaving $90,147.48 that can be classified as current or collectible.

The amount of uncollectible debt is often based on the historical percentage of receivables that are not collected. Many associations determine the amount of uncollectible debt on their balance sheets by the amount that is past due more than 365 days, as described on the association's aging report.

It's entirely possible that some of the debt classified as uncollectible will be collected, often as a result of a short sale or a bank foreclosure. If it's collected as a result of a sale, the association is entitled to receive all amounts due, including maintenance fees, interest, late charges, fines, and legal fees, less any amount the association may have waived during the negotiations with the buyer. If, during the auction following a summary judgement of foreclosure, someone submits a higher bid than the association, the new owner will be responsible for all amounts due the association.

If the first mortgage holder, typically a bank or finance company, forecloses on the property or accepts a deed in lieu of foreclosure, they are obligated by law to pay the association 1% of the amount of the first mortgage or twelve months of maintenance fees, whichever is less[7]. If the association forecloses on an owner, rather than on the first mortgage holder, it forfeits its legal right to collect the 1% of the first mortgage or twelve months of maintenance fees. The same rule applies to homeowners' associations. Cooperatives are the lesser of six months of maintenance fees or 1% of the first mortgage.

Balance Sheet Q&A 7

What are liabilities?

Liabilities are economic obligations of the association, such as money that it owes to lenders, suppliers, employees, etc. Liabilities are categorized and grouped on the balance sheet by:

1. To whom the debt is owed, (accounts payable to suppliers, accrued expenses to employees or others for services, current debt owed to lenders, or taxes owed to government)
2. Whether the debt is payable within the year (current liabilities) or is a long-term obligation[8]

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6 Thomas R. Ittelson., Financial Statements A Step-by-Step Guide to Understanding and Creating Financial Reports, Career Press, 2009, p.24
7 Peter M. Dunbar, Esq., The Condominium Concept, Fourteenth Edition, 2014, Pineapple Press, p. 140
8 Thomas R. Ittelson., Financial Statements A Step-by-Step Guide to Understanding and Creating Financial Reports, Career Press, 2009, p.30

Balance Sheet Q&A 8

What are the Carefree association's liabilities?

Current Liabilities		
2200	Accounts Payable	102,662.48
2520	Prepaid Assessments	32,085.07
Subtotal Current Liabilities		**132,747.55**
Reserves		
2541	Painting	7,500.89
2542	Paving	2,025.97
2542	Roof	3,082.00
2543	Pool	22,027.46
2544	Elevators	1,007.57
2545	Plumbing	7,698.02
2546	Contingency	6,000.00
2547	Interest	658.80
Subtotal Reserves		**50,000.71**
Other Liabilities		
2530	Security Deposits	5,000.00
Subtotal Other Liabilities		**5,000.00**
TOTAL LIABILITIES		**187,748.26**

Please refer to the liabilities section of the balance sheet.

The liabilities are accounts payable, prepaid assessments, reserves, and security deposits as shown here.

Balance Sheet Q&A 9

How can it be determined whether the association has sufficient funds in its reserve accounts?

The association should have a reserve study conducted.

A reserve study determines the amount of money that should be put aside for replacement of physical structures and equipment and for deferred maintenance.

Balance Sheet Q&A 10

What is a reserve study?

A reserve study is an in-depth evaluation of a property's physical components and an analysis of its reserve funds.

Based on a thorough on-site inspection, a custom reserve study details anticipated replacements or repairs to common-area elements and recommends annual reserve funding to cover capital expenditures for the next 30 years[9].

Balance Sheet Q&A 11

Carefree has a reserve account designated as contingency. Is this a proper reserve account?

Contingency reserves and other categories of expense not restricted to a specific use are not considered reserves under the Condominium Act, and are appropriately stated in the operating portion of the budget rather than the reserve portion of the budget[10].

The same rule applies to homeowners' associations and cooperatives.

Balance Sheet Q&A 12

What is owner's equity?

If you subtract what the association owes (total liabilities) from what it has (total assets), you are left with its value to its owners, the owner's equity. On the balance sheet, owner's equity is expressed as the total of:

1. Operating fund balance - the equity from past years
2. Current year net income/loss - the surplus and loss described on the association's most recent income and expense statement

Assets - Liabilities = Equity

Balance Sheet Q&A 13

What is the amount of the Carefree associations' owner's equity?

Equity		
4500	Operating Fund Balance	182,401.22
	Current Year Net Income/Loss	(10,000.34)
TOTAL OWNERS EQUITY		**172,400.88**

Please refer to the equity section of the balance sheet.

The Carefree association's total owner's equity is $172,400.88 as shown here.

Balance Sheet Q&A 14

Carefree has an annual budget of $1,200,000. How much cash or cash equivalents should it have for unanticipated or unbudgeted expenses?

The association should have a minimum of three months of expenses for unanticipated or unbudgeted expense. This amount is typically recommended by accountants who serve community associations. Carefree would require $300,000 in cash or the equivalent.

9 ReserveAdvisors.com

10 Peter M. Dunbar, Esq., The Condominium Concept, Fourteenth Edition, 2014, Pineapple Press, p. 114

Balance Sheet Q&A 15

Solvency (also referred to as liquidity) refers to the ability of a business to pay its liabilities when they come due. How solvent is Carefree?

The current ratio tests the short-term liability-paying ability of a business. It's calculated by dividing current assets by current liabilities. The general rule or standard is that a company's current ratio should be 2 to 1 or higher[11].

260,148.36**/**134,747.55 = 1.93

Based on the current ratio of 1.93, Carefree has a solvency problem that will become worse when unbudgeted and unanticipated expenses happen.

Unsafe Structures

One morning, Jeremiah arrives at the office and opens the mail. Inside is a notice from the county building department, citing the association for unsafe structures, including the balconies, building exterior, and parking garage. The notice provides the association with sixty days to fix the problems and threatens daily fines for each day past the deadline that it fails to comply.

Jeremiah immediately contacts the association's president, Dr. Sam Dumont, a retired physician. Dr. Dumont in turn calls an emergency meeting of the board to discuss the notice. Upon Jeremiah's suggestion, the board reluctantly votes to hire a structural engineer to conduct an inspection and to estimate the cost of repairs.

The Engineer

The structural engineer, Joanne Dexter, examines each balcony, the exterior walls, and the parking garage, then submits her report to the board.

Her report provides a detailed description of the damage from water intrusion in each structure. It estimates that the cost of repair to the association is approximately $2,000,000, an average of $10,000 for each owner of the 200-unit building.

Joanne also includes in her report that there is likely additional damage that will be revealed once repair and/or restoration work begins.

Project Begins

At the next board meeting, Joanne is asked to present and explain her structural report to the owners who are in attendance. When they hear the estimated cost of the repair ($2,000,000), many owners respond hysterically, question the validity of the report, and shout that they cannot pay such a large amount.

Joanne responds that the approximate cost of the repair can more accurately be determined by submitting the project for competitive bidding by licensed, reputable contractors. She informs the board that the actual extent of damage will not be determined until the work is in progress, and that they should expect to receive change order requests from the contractor that will increase the cost of the project from the contracted amount.

The meeting ends with the board voting to hire Joanne to prepare bid specifications, solicit bids from contractors, and function as the project manager once the contract is awarded.

[11] John A. Tracy, *How To Read A Financial Report*, Seventh Edition, 2009, John Wiley & Sons, Inc. p. 129

PROBLEM CAUSERS

Outline

In this section, we look at the following probable causes of Carefree's problems.

- Age and weather
- The economy
- Changing demographics
- The board of directors
- The community association manager

Age and Weather

In general, a building's state of health depends on the quality of the building materials, maintenance performed on those materials, and environmental conditions.

Barring the unpredictable and random occurrence of natural or man-made disasters and accidents, buildings that are created with superior building materials for which regular maintenance has been performed endure for a longer period of time.

Carefree's owners are fortunate in that their buildings and other physical structures were properly built by a reputable developer who used quality materials and workmanship.

The structures were also well maintained by the association's board of directors until the economic downturn of 2008, when preventive and restorative maintenance were substantially reduced.

Environmentally, Carefree's proximity to the ocean can be viewed as a negative factor, given salt water's impact on concrete structures. The impact of rising ocean levels on shoreline communities, such as Carefree, may become even more significant in the future.

In some respects, Carefree is experiencing a mid-life crisis, so to speak, which is characterized by the negative manifestations brought about by aging and improper maintenance.

However, there is a potential for revitalization and renewal.

Age and Weather Q&A

Is there a relationship between the life cycle of a condominium building and the age and wealth of its owners?

If the owners are wealthy and money is of little or no concern, physical structures, equipment, and amenities are likely to be well maintained.

In a multi-generational association, the dependency on fixed income owners will be reduced, thereby providing greater diversification in the sources of income to the community. In a more homogeneous community, like Carefree, the life cycle of the building and its owners might mirror each other where the aging of the building and its owners appear to be concurrent.

The Economy

The most dramatic effects of the economy are experienced during the heights and depths of the economic cycle, where periods of boom and bust inevitably follow one another despite the best efforts of federal regulators. And, as was painfully obvious following 2008, the financial fortunes of community associations were severely affected, evidenced in steep increases in accounts receivable, liens, foreclosures, and legal expenses. Loss of employment, reduction of pensions, and low interest rates on investments and bank deposit accounts caused many owners to place their units on the market only to experience difficulty finding buyers once banks tightened their lending practices. Some units were abandoned by their owners and, consequently, neglected.

Associations seeking funds to perform expensive repairs or restorations found it more difficult to collect special assessments or to borrow money.

Many associations released or reduced the hours of employees, deferred needed maintenance, and reduced services, especially high ticket budget items, such as security and insurance.

Many reduced or eliminated funding for their reserves. Some associations with high levels of debt defaulted on their bank loan payments and, in some extreme cases, ended up in receivership.

The Economy Q&A 1

What are some of the potential impacts of a bad economy on an association?

During a bad economy, an association might experience:

- Increased accounts receivables, liens, foreclosures, and legal expenses
- Failure to pay vendors on time or at all
- Abandonment of units
- Difficulty collecting special assessments and borrowing money
- Reduction of services and deferral of maintenance
- Reduction or elimination of reserve funding
- Loan defaults and receivership

The Economy Q&A 2

What is receivership?

In law, receivership is the situation in which an institution or enterprise is being held by a receiver, a person "placed in the custodial responsibility for the property of others, including tangible and intangible assets and rights," especially in cases where a company can't meet its financial obligations or enters bankruptcy[12].

The receiver is appointed by the court.

The Economy Q&A 3

What are the duties and powers of the receiver appointed for a community association?

The receiver shall have all powers given to the board pursuant to the declaration and bylaws. If the court orders termination, it includes any other powers that are necessary to conclude the affairs of the association.

a) Employ directors, agents, attorneys, and other professionals to liquidate or conclude its affairs

b) Conduct the affairs of the association as necessary for the liquidation or termination.

c) Execute contracts and collect, pay, and settle debts and claims for and against the association

d) Defend lawsuits brought against the association

e) Sue in the name of the association for all sums due or owed to the association or to recover any of its property

f) Perform any act necessary to maintain, repair, or demolish unsafe or uninhabitable improvements or other condominium property in compliance with applicable codes

g) Sell at public or private sale or exchange, convey, or otherwise dispose of assets of the association for an amount deemed to be in the best interests of the association, and execute bills of sale and deeds of conveyance in the name of the association

h) Collect and receive rents, profits, accounts receivable, income, maintenance fees, special assessments, or insurance proceeds for the association

i) Contract and do anything in the name of the association, which is proper or convenient to terminate the affairs of the association *F.S. 617.0302*

[12] Philip, Ken & Keren Kaminski. Receivership: A Value Adding Tool. Secured Lender January/February 2007 Vol. 63 Issue 1, pages 30 - 34

Changing Demographics

Although Carefree's population and leadership are primarily elderly, there has been an influx of younger owners with families. These new owners are alarmed at the recent developments and, in conjunction with some of the older owners, have formed a committee with the stated objective of preserving their property values. They named the committee Preserve Our Property or POP.

Some of the older residents, including the board members, concerned about the potential impact of an organized opposition on their finances, interpreted the acronym to mean Punish Old People. The stage is now set for a generational battle for control of the association and its future.

Changing Demographics Q&A 1

How can the conflict within Carefree become a constructive or destructive force?

If a conflict results in unresolved and/or previously unaddressed issues being brought to the surface and effectively addressed, and the parties to the conflict have treated each other with respect and courtesy so as not to leave behind feelings of resentment and desire for vengeance, the conflict can be seen as constructive.

The worst-case scenario occurs when the conflict is characterized by personal attacks on the character, integrity, and competence of the individuals involved and the issues have not been successfully resolved.

Another possible outcome is that one side prevails and the issues are satisfactorily resolved, at least in the short term. However, the virulence of the conflict often results in resentment and grudges among the losers. Those owners, both overtly and covertly, at times through costly and time-consuming litigation, seek to undermine the current leadership. If successful, they may regain power and the reformers original victory can then best be described as Pyrrhic[13].

Even in circumstances where the parties of the conflict have exercised good judgment and discipline, with respect to personal attacks on their opponents, conflict might continue. However, in circumstances where the conflict is limited to issues rather than personalities, the likelihood of it being manageable and constructive increases and the probability of guerilla warfare decreases.

Board of Directors

So the conflict at Carefree has heated up and board has become increasingly defensive and resentful.

The POP members have increased their attack on the board and blame them for mismanagement and for failing to properly perform their fiduciary duties.

There has even been discussion of a recall.

The CAM

Some board members have begun deflecting the criticism by blaming Jeremiah, the manager. They are claiming that he has neither kept them informed of their deteriorating financial situation nor has he provided them with the guidance they require to address the problems.

Jeremiah, believing he is being scapegoated for the failure of the board, is now angry and his morale has been lowered to the point that it has become a struggle to come to work each morning.

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13 Steven Pinker, *The Better Angels of Our Nature, Penguin, 2009, P.263*. A Pyrrhic victory is a victory that inflicts such a devastating toll on the victor that it is tantamount to defeat.
Someone who wins a Pyrrhic victory has been victorious in some way; however, the heavy toll negates any sense of achievement or profit (another term for this would be "hollow victory).

Problem Causers Q&A

So who is responsible for Carefree's financial mess?

Could it be Wall Street because it caused the economic recession?

Could it be the advances in healthcare technology because they have caused people to outlive their income?

Could it be the manager because it's his job to take the blame for whatever goes wrong?

Responsibility for the well-being of a community association ultimately lies with its owners. Whether they realize it or not, they are all shareholders in a common enterprise that is a home to many, if not most of them, but is also a business enterprise.

The owners are responsible for electing the board members and ensuring that they are properly managing the association. If they are not, the owners are responsible for replacing them with others who will. The board is responsible for ensuring that its officers are doing their jobs properly, and if they are not, replacing them with officers who will. Additionally, the board is responsible for ensuring that the manager and/or management company, if it has one, is effectively implementing its policies, as well as those described in the governing documents.

Community associations are representative democracies. As such, they are dependent on the willingness of its citizens to participate and to make intelligent decisions with respect to its policies and leadership. Sometimes it takes courage to take on a dictatorial president or an entrenched board of directors who have strayed from the path of good governance. However, without the willingness to fight for the betterment of one's community, within legal and ethical boundaries, that community will decline and eventually fail.

SHOULD WE FIX IT?

Outline

In this section, we look at the following issues as the community decides whether to fix the problems or not.

- Funding the project
- Governing documents
- Who pays for it?
- Citation extension
- The vote

Funding the Project

At the next board meeting, Joanne Dexter, the engineer hired by the board, presents four sealed bids from general contractors for the concrete restoration project. The bids ranged from $1,850,000 to $2,010,000. Joanne assured them that all of bidders are experienced, highly reputable companies. The board votes to award the contract to the lowest bidder, pending legal review of the contract.

The board then enters into a discussion about how to fund the project. Joanne recommends that the board add an additional 15% to the cost to pay for the change orders she anticipates plus another 8% for her fees. Jeremiah, feeling somewhat better now that he observes the board taking action, informs the board that the cost should also include legal fees, which he estimated at 2% of the cost of the project. He informs them that, since there are no funds in the building reserve account, the total cost of the project, $2,220,000, will have to be raised either through a special assessment, by borrowing from a bank, or by a combination of both.

Governing Documents

Jonah Goldstein, a retired attorney, informs the board that the association's governing documents require an affirmative vote of two-thirds of the owners in order for it to pass a special assessment for any amount in excess of $50,000.

Jeremiah advises the board that it's his understanding that the county ordinance requiring correction of unsafe structures trumps the association's governing documents, and the project has to be done regardless of the vote of the owners. He recommends that the board seek legal counsel to resolve the issue, but not to delay, since they will be fined if the work is not started within the time constraints imposed by the building department.

Governing Docs Q&A

If the governing documents require a two-thirds vote of the owners to pass a special assessment in excess of $50,000, can the Carefree board forego the vote based on the local government requiring compliance with their building code?

In Tiffany Plaza Condominium Association, Inc. v. Spencer, 416 So.2d 823 (1982), unit owners brought action against the condominium association challenging the collection of an assessment for construction of a rock revetment on beachfront common property. The Circuit Court entered a judgment for the unit owners, and the association appealed.

The Second District Court of Appeal, held that, under a provision in the condominium declaration prohibiting any alteration or improvement of common elements for any reason unless unit owners who do not consent to alteration or improvement are relieved from initial cost thereof, the condominium association could properly assess all unit owners for construction of the rock revetment to protect the beachfront common element from damage if in fact construction of the revetment was found to be necessary to protect the beachfront from erosion or damage.

This decision by the Second District Court of Appeals appears to suggest that the Carefree board could act without an affirmative vote of the members required by the association's declaration of condominium, if it was protecting a common area from damage. An argument can certainly be made that performing concrete restoration on the balconies and other structures is protecting those structures from further damage as well as protecting the owners from unsafe structures. As with all instances in which the governing documents require interpretation, it is necessary to consult with the association's attorney.

Who Pays for It?

Jeremiah tries to explain to the owners that the balconies are limited common elements, and that the governing documents are clear that these are the responsibility of the association. He asks the members if the roof was leaking and needed repair, would they think that the cost should be borne only by the owners on the top floor. Some owners responded that they had never looked at it that way before and, yes, it made sense that only the owners of the expensive penthouse units should be responsible for paying for the repair of the roof above their apartments. Jeremiah decides to remain silent for the rest of the meeting.

Dr. Dumont, the president, interjects that that will be another issue referred to the association's attorney. He then directs Jeremiah to contact the association's bank and inquire as to the possibility of a loan.

After another half hour of unproductive discussion, he adjourns the meeting.

Who Pays for It? Q&A

Who is responsible for repair or replacement of the balconies?

Who pays for the repair depends on the governing documents.

Typically, if an area is a limited common element, such as most balconies, the association is responsible, but there can be exceptions, based on the provisions of the association documents.

Citation Extension

Soon after the meeting, the association's attorney, Tom Clock of the Law Firm of Clock, Bill, Baffle, and Delay, informs President Dumont, first verbally and then in writing that the association's documents require the board to obtain an affirmative vote of two-thirds of the owners to pass the special assessment and that all owners are subject, in their proportionate share of ownership, to the special assessment. He recommends that, because of the expected delay in obtaining approval of the owners, the difficulty of collecting the funds, and the duration of the project, he contact the building department to request an extension.

Dr. Dumont immediately calls the district commissioner, whom he knows personally, and requests her assistance in obtaining an extension. The commissioner assures Dr. Dumont that she will take care of the problem. Later that day the president receives a call from the building official granting an extension. He asks the official if all balconies require repair at this time. The official responds that he would be satisfied if the balconies, classified by the engineer as having severe or moderate damage, were repaired or replaced.

Citation Extension Q&A

What will be the consequences of performing restoration only on the severely and moderately damaged balconies?

Restoration projects require legal and engineering services, mobilization, and special equipment expenses each time they occur.

Failure to repair the mildly damaged balconies at the same time as the others will result in more frequent and expensive repairs in the future.

The Vote

President Dumont directs Jeremiah to immediately schedule, and widely publicize, an emergency board meeting.

Approximately 50% of the owners attend. The board votes to approve the special assessment, contingent on approval of the owners.

Jeremiah is directed to prepare the fourteen-day notice of the owner's meeting, as well as the ballot and limited proxy, review them with Tom Clock for legal sufficiency, and mail them out as soon as possible.

The owners agree to assist in gaining the necessary votes and proxies.

At the meeting, the owners vote to approve the special assessment to perform concrete restoration on the severe and moderately damaged balconies, the building, and parking lot at a revised cost of $1,600,000, an average of $8,000 a unit.

The next day, four of the oldest board members hand their resignation letters to Jeremiah.

The Vote Q&A 1

Is there a way for the association to use the funds in their reserve accounts for the concrete restoration project?

Yes, the owners could've been given the opportunity to vote to establish pooled reserves and/or to transfer the funds from the existing reserve accounts into a single account.

The Condominium Act requires the majority vote of the total voting interests, present in person or by proxy, at a duly noticed and quorumed owner's meeting, in order to create pooled reserves and to transfer the funds. The same rule applies to homeowners' associations and cooperatives. *F.S. 718.112(2)(f)2. - 3.*

The Vote Q&A 2

What is the formula to fund pooled reserves?

The formula to fund the pooled reserve account must provide for an annual contribution that will ensure that the balance on hand is equal to or greater than the annual projected outflows from the account[14].

HOW DO WE FIX IT?

Outline

In this section, we look at the following issues as the community decides how to fix their problems.

- Setting priorities
- The special assessment
- Managing the process

[14] Peter M. Dunbar, Esq., The Condominium Concept, Fourteenth Edition, 2014, Pineapple Press, p. 115

Setting Priorities

Carefree's current financial problems can be viewed as having three major components. The board must determine the order of priority for each component.

1. Fund the concrete restoration project
2. Fund the repair or replacement of
    a. The elevators
    b. The riser lines
    c. The installation of sprinklers and engineered life safety systems that are being required by the state statute as enforced by the local fire department
3. Fix the annual budget, which, as is evidenced by a review of the balance sheet, is operating at a deficit and doesn't contain any reserve funding

Setting Priorities Q&A 1

How should the Carefree board rank its priorities with respect to the three major components?

The concrete restoration project: The board understands that they must, if they want to avoid the negative consequences of failing to comply with the building department, immediately fund and initiate the concrete restoration project.

The elevators: The board can hire an independent consultant, consult with their current service provider, or wait for the annual inspection to determine the elevators' condition and how soon extensive repairs and/or replacement are required.

Installation of fire safety systems: Florida community associations must install mandated fire life safety systems by December 31, 2016.

Or, they can submit a plan for the systems that's prepared by a professional engineer that addresses sprinkler and sound and visual warning systems, as well as other life safety requirements with a completion date of January 1,2020, to the local fire department no later than December 31, 2016. [F.S. 718.112(2)(l)]

The Florida legislature, sensitive to the complaints of cash-strapped associations and their owners regarding the expense of installing such systems, set back the required date for achieving compliance. However, some local municipalities have set earlier deadlines in conflict with the state statute. Fortunately, Carefree is under the jurisdiction of a county whose commission has determined to accept the state's time frames. However, it must still initiate the process if it intends to achieve compliance and not be subject to fines and legal action.

The annual budget: Carefree is operating at a deficit of approximately $1,670 per month. This should be addressed as soon as possible.

The priorities should be:

1. Fund the concrete restoration project
2. Revise the annual budget
3. Fund other capital projects (e.g., elevators)

Setting Priorities Q&A 2

How should the board address the budget deficit?

The board should revise its budget in order to ensure sufficient income to cover its expenses. The new budget should include a contingency account funded in the amount of 5 to 10% of the expenses to provide a cushion for unanticipated costs.

The board is required to provide members with 14 days' notice of the meeting and a copy of the proposed revised budget. The board also has the option of covering the budget shortfall with a special assessment. It could add the amount of the deficit to the special assessment intended to fund the concrete restoration project.

The Special Assessment

By passing the special assessment, the board has seemingly addressed the immediate issue of restoring the damaged concrete structures. However, passing an assessment and collecting it are two different processes.

While the board included the cost of anticipated change orders in the assessment, it didn't add in the amount of money that won't be collected from delinquent owners. The association's aging report shows that 15% of owners are delinquent over 90 days. This oversight might result in another special assessment to fund the unanticipated deficit.

Additionally, the Carefree board hasn't addressed the operating budget deficit, the other previously referenced capital projects, and the need for a long-term plan that will ensure its future solvency through adequate funding of its reserves.

Many associations borrow money, collateralized by a special assessment, to fund capital projects. Carefree's high delinquency rate and budget deficit make it highly unlikely that it could find a lender willing to extend credit to the association.

So the money has to come from the approximately 85% of the owners who are in good standing, plus any monies that result from sales, collection from liens, and foreclosures.

The Special Assessment Q&A 1

How should Carefree proceed to put its financial situation in order?

To put its financial situation in order, Carefree should follow these steps:

1. Review and revise the association's accounts receivable process
2. Direct the association's attorney to expedite legal action to foreclose on liens that are over 45-days old, and obtain summary judgements on accounts that are in the process of foreclosure
3. Lease units that the association acquires title to through foreclosure
4. Collect rent from persons leasing from delinquent owners
5. Amend the association's documents to permit screening of prospective owners and create financial standards that they must meet in order to purchase a unit
6. Revise the annual budget to cover the deficit
7. Hire a reserve specialist to perform a reserve study
8. Create a pooled reserve
9. Fully fund the reserve in the revised and subsequent budgets
10. Determine the immediacy of any repairs and pass a special assessment, if necessary, to obtain funding

The Special Assessment Q&A 2

What affect will the increased cost of owning a Carefree unit have on the owners?

The increased cost of owning a Carefree unit might affect the owners in these ways:

- Some will be forced to seek additional funding sources to supplement their incomes, which might include getting help from family members, obtaining reverse mortgages, or borrowing money.
- Some might be forced to liquidate assets that were intended for their heirs.
- Some, who have been in the collection process, might decide to pay their delinquent balances.
- Some might seek less expensive living arrangements and lease or sell their units.

The Special Assessment Q&A 3

What factors will determine whether the association will revive or continue its downward trend?

The factors include:

- An immediate infusion of money
- A stable source of revenue to meet its future and operating and capital expenses
- A responsible and prudent board of directors
- Effective and efficient management
- Owners who are willing and able to meet their financial obligations

Managing the Process

Carefree has taken a major step towards dealing with its financial issues by passing the concrete restoration special assessment and electing new board members. However, there's still much work to do.

Jeremiah, as manager, is responsible to facilitate the concrete restoration and other projects that are likely to occur in the near future, as well as the new policies the board created to restore the association to a state of financial well-being. The areas that require his effective and efficient management include:

- The capital projects
- The board of directors
- The owners
- The money
- Himself

Managing the Process Q&A 1

What are the CAM's responsibilities to facilitate implementation and completion of a capital project, such as Carefree's concrete restoration?

The CAM should:

- Work closely with the project managers to monitor compliance with the contract, including specifications and timeframes, change order procedures, safety requirements, and access restrictions
- Be available for, and in communication with, building department inspectors and officials to ensure compliance with posting and other requirements
- Before approving payment of the contractor's invoices, the CAM should confirm that the invoices:
    - Are in good order
    - Are signed by the project managers
    - Include the applicable releases of liens
- Provide frequent status reports to the board and owners
- Issue notices to owners regarding access related issues
- Ensure that a notice of completion has been filed with the building department when the project is complete

Managing the Process Q&A 2

In this situation, how can Jeremiah, the CAM, manage the president and board of directors?

Jerimiah can best manage the board through effective and honest communication, especially with the president. To be an effective communicator, he needs to know and understand the personality, background, motivation, and preferred form of communication for each board member. He must also be a good and patient listener in order to understand and appropriately respond to the board's concerns. It would also be helpful for him to identify the directors who are most influential in the community and allocate his time and efforts accordingly.

Managing the Process Q&A 3

In this situation, how can Jeremiah manage the owners effectively?

Jeremiah must manage the owners through effective communication. He must also be compassionate for those who are being adversely affected by the special assessment. When they complain, criticize, and have emotional outbursts, he has to remember not to take it personally. He must listen attentively, provide a diplomatic response, and tactfully end an unproductive conversation. It would be wise for Jeremiah to know which owners are most influential.

Managing the Process Q&A 4

In this situation, how can Jeremiah manage the money?

For Jeremiah to manage the money effectively, he should:

- Review the financial reports with the treasurer before board meetings to ensure that they are complete and accurately demonstrate the financial situation of the association
- Stay current on the progress of the association's efforts to reduce its receivables, payables, and deficit
- Stay current on the association's attorney's efforts regarding liens and foreclosures
- Advocate for a reserve study
- Advocate for a budget revision

Managing the Process Q&A 5

In this situation, what should Jeremiah do to make sure that he's capable of effectively managing the association during stressful times?

Jeremiah must be capable of effectively managing himself before he can effectively manage a community association, especially one that's in crisis or transition. To do this, he should:

- Manage his thoughts, emotions, speech, actions, and time
- Take action to make sure that he's both mentally and physically healthy
- Make sure he has a personal-support system in place, that consists of family, friends, and, if applicable, spiritual individuals
- Seek assistance of professionals, such as physicians and therapists, if applicable
- Develop a support network at the association that consists of like-minded board members, owners, employees, vendors, and other managers
- Take some time to exercise and have fun

SUMMARY

During this course, we've observed an association's journey from the brink of destruction to a place where it has an opportunity for meaningful and lasting transformation. During that journey, Carefree experienced denial and acceptance, and conflict and resolution. It shed the parts of the past that required release and embraced a functional vision of the future.

With a capable manager, board, and a changing population receptive to change, Carefree Living Condominium Association has a chance to restore its financial health.

If successful, its residents will again enjoy condo living in South Florida.

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NO RESERVES, OLD BUILDING, WHERE DO WE GO FROM HERE?

Use the answer sheet on page 119 to indicate your responses

1. Which of the following is not a capital expenditure?
   a. Replacement of playground equipment whose useful life is greater than one year
   b. Repair that is performed less frequently than annually and results in maintaining the life of an asset
   c. Replacement of office furniture whose useful life is greater than one year
   d. Repair of an asset that will extend its life greater than one year

2. What is an example of deferred maintenance?
   a. Removing black algae from the swimming pool
   b. Changing air conditioner filters
   c. Painting the guardhouse interior
   d. Replacing a stop sign

3. What is not shown on a community association's balance sheet?
   a. The amount owed to an association
   b. The association's worth
   c. The value of the common area's structures
   d. The value of assets as equal to the value of liabilities plus equity

4. The first mortgage holder forecloses on a condominium unit for which the owner owes the association money. What is the association entitled to receive?
   a. The entire amount owed
   b. 1% of the amount owed or six months of maintenance fees, whichever is more
   c. The legal fees and interest
   d. 1% of the amount of the first mortgage or 12 months of maintenance fees, whichever is less

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5. What happens if the association forecloses on a unit and takes title?
   a. The first mortgage holder forfeits its lien rights.
   b. The association can rent the unit.
   c. The association can bill the first mortgage holder for the cost of repairing the unit.
   d. The association is exempt from paying the unit's property taxes.

6. On a balance sheet, what does the current ratio show?
   a. The short-term ability of an association to pay its debts.
   b. The ratio of owner occupied units to rented units.
   c. The percentage of owners who are over ninety days delinquent.
   d. The ratio of debt to equity.

7. When is an owner excused from paying their share of a special assessment?
   a. If the assessment is for the repair of a limited common area such as a balcony
   b. If the board of directors are mismanaging the association's money
   c. If the owner has pre-paid his maintenance fees
   d. Never

8. During a severe economic downturn or recession, what should the association do?
   a. Reduce the pressure on owners to pay their maintenance fees on time
   b. Reduce or eliminate non-essential services
   c. Eliminate reserve funding
   d. Levy fees on owners when they use the exercise room and tennis courts

9. Select the statement that accurately describes conflict among board members and owners.
a. It is to be avoided at all costs.
b. It should not influence the decision making process during board meetings.
c. It inevitably leads to irrational decisions.
d. It can be revealing and constructive.

10. A board's dysfunction results in the association experiencing severe financial problems. What should the owners do?
a. Sue the board of directors
b. Blame the manager
c. Elect a new, more responsible board
d. Complain to their spouses and/or neighbors

11. A community association needs to eliminate a deficit in its operating budget. Which of the following is NOT an option?
a. Revise the annual budget
b. Transfer funds from its reserve accounts without a vote of its members
c. Pass a special assessment
d. Borrow money from a bank

12. On the balance sheet, what does the uncollectible debt account show?
a. Money that will never be collected
b. Money that has been written off as uncollectible
c. Money that is overdue two or more years
d. Money that the board has determined is unlikely to be collected

13. Which of the following is NOT a community association asset?
a. The value of its buildings
b. Accounts receivable
c. A certificate of deposit for reserve funds
d. Renters' security deposits

14. Which of the following is a community association liability?
a. Uncollectible debt
b. Prepaid insurance
c. The cost of replacing an old golf cart
d. Accounts payable

1

15. What is the purpose of a reserve study?
a. To determine the amount of money needed if the association overspends its budget
b. To determine the amount of money that should be put aside for replacement of physical structures and equipment and for deferred maintenance
c. To determine the value of an association's assets
d. To create a fixed schedule for replacement of equipment

16. Which of the following is NOT an action required to accurately determine the amount of a special assessment for a major capital project?
a. Survey neighboring associations that have performed similar projects and determine how much was spent
b. Competitive bidding by licensed contractors based on specifications and scope of work developed by a licensed professional
c. An estimate of the cost of change orders, and professional and legal fees
d. An estimate of the amount of the uncollected special assessment for the project

17. Which of the following is NOT an action that could be taken to reduce an association's accounts receivable?
a. Replacing the association's attorney
b. Reducing the grace period
c. Establishing and adhering to a fixed schedule for referring delinquent accounts for legal action
d. Extending the grace period for hardship cases

18. What is NOT the CAM's responsibility for an association's capital project?
a. Monitoring the progress of the project
b. Providing status reports to the board and owners
c. Determining if the contractor is in compliance with the bid specifications
d. Authorizing payment of invoices upon approval of the project manager

19. What can a CAM, who is in the midst of an association crisis, do to manage his or her stress?

a. Work additional hours
b. Request needed support from the association president, family, friends, employees, and others
c. Increase their food and alcohol consumption
d. Reduce their exercise workout to allow more time for relaxation

20. A community association has a large elderly population living on modest incomes. What could the association do?

a. Make its maintenance fees affordable
b. Reduce or eliminate funding for reserves
c. Defer capital projects until younger, more affluent owners outnumber the elderly owners
d. Pass a budget that provides sufficient funding to cover the actual operating expenses of the association and legally required reserve accounts

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