

# **PRE-PURCHASE DUE DILIGENCE ASSESSMENT**

## **Happy Homeowners Association**

**Van Nuys, CA**



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800.218.0302

9/15/2018

## HAPPY HOMEOWNERS ASSOCIATION

1	BUYER / REPORT ORDER DATE:	John and Jane Doe	8/28/2018
2	BUYER / PHONE & EMAIL:	555.555.5555	
3	AGENT / PHONE OR EMAIL	Not reported	
4	REFERRING BROKER	Not reported	
5	LENDER / LOAN NUMBER:	Not applicable	Not applicable
6	LEGAL NAME OF ASSOCIATION:	Happy Homeowners Association	
7	INCORPORATION DATE:	9/23/1980	
8	PHYSICAL ADDRESS:	123 Main Street, Van Nuys, CA	
9	UNIT NUMBER THAT IS SUBJECT TO BUYER'S OFFER:	#225	
10	ALLOCATED INTEREST OF UNIT INDICATED ON LINE 9:	1.00%	
11	MANAGEMENT COMPANY:	A-One Property Management, Inc.	
12	MANAGING AGENT / PHONE:	555.555.1234	
13	CURRENT CIDA SCORE OF THE ASSOCIATION:		59.75

### CIDA REPORT

**DO NOT DISTRIBUTE.** The information contained in this CIDA REPORT is confidential and intended for the private use of the purchaser of the report and any licensed real estate professionals who have a legal, agency relationship with the purchaser of the report.

**CIDA REPORT Disclaimer:** This due diligence report (CIDA REPORT) analyzes various financial and historical records of the above named Association. The information was obtained from the seller of the subject property; the homeowner's association in which the subject property is located; government agencies and CIDA's database of homeowner's association records. All of the data examined as part of this due diligence effort is information that is a matter of public record or information which the above named buyer or mortgage lender has requested as part of the real estate disclosure and/or mortgage underwriting process. The information was provided in response to the buyer's offer to purchase real property owned by the seller, subsequent to the seller's acceptance of said offer. It is assumed that the seller is entitled to possess and distribute the information which has been provided to the buyer and/or the mortgage lender. Any information that was requested, but not provided, will be duly noted in the report which follows.

**Integrity of Data:** It is beyond the scope of this CIDA REPORT to confirm the accuracy of the information provided. For the purposes of this report it is therefore assumed that the information provided is accurate. The accuracy and timeliness of information is relevant to the overall analysis and in particular the CIDA SCORE that the Association receives. Failure to provide information that is current and timely is a negative factor that can have an adverse impact on the Association's CIDA SCORE.

This CIDA REPORT only makes use of information that is of verifiable origin. Hearsay evidence, rumors and verbal discussion are not considered in the formation of opinions or conclusions regarding the Association's financial practices. In those instances where the analyst is required to formulate subjective opinions, the available information is combined with industry accepted practices and assumptions to formulate the opinions expressed herein.

**No Warranty Implied or Expressed:** Due to the lack of control over the timeliness, completeness or accuracy of the data provided for this review, CIDA does not guarantee or warrant the financial condition of the Association, regardless of the CIDA SCORE or any opinions expressed herein, with respect to the financial stability of the Association which is the subject of this CIDA REPORT.

**Introduction:** CID Analytics, Inc. (CIDA) has reviewed available financial documents and historical records of the above named Association in order to develop an opinion of the financial stability of the Association with respect to identifying any circumstances which might result in an adverse financial burden for the Association's members; or which may result in an increased element of risk for a mortgage lender whose funds are to be secured by a lien interest in the unit which is the subject of the buyer's offer.

## HAPPY HOMEOWNERS ASSOCIATION

## SECTION I - INFORMATION SUMMARY

This CIDA REPORT makes use of financial information and historical records that are typical of the data a homeowner association (HOA) is expected to maintain or which may be required by the laws of the state where the Association is located. For a description of the documents that are most commonly examined during the due diligence process, please refer to the Document Explanation found at the end of this report. In some instances there may be additional documents that are relevant to the financial stability of the Association. In circumstances where CIDA finds evidence of the existence of such documents, CIDA will issue a request for the additional documents prior to completing the due diligence examination. Instances where a request for additional documents was not fulfilled will be duly noted in the report which follows.

The records and documents indicated below were reviewed during the preparation of this CIDA REPORT:

**FINANCIAL**

14	COMPLETE RESERVE STUDY - coincides with the current budget year:	No
15	RESERVE STUDY SUMMARY - coincides with the current budget year:	Yes
16	RESERVE STUDY OR RESERVE STUDY SUMMARY - coincides with a previous budget year:	No
17	INCOME & EXPENSE STATEMENT - previous budget year (year-end):	Yes
18	INCOME & EXPENSE STATEMENT - current budget year (year-to-date):	No
19	BALANCE SHEET - previous budget year (year-end):	Yes
20	BALANCE SHEET - current budget year (year-to-date):	No
21	ANNUAL OPERATING BUDGET REPORT - current budget year:	Yes
22	ANNUAL OPERATING BUDGET SUMMARY - current budget year:	Yes
23	INDEPENDENT ACCOUNTANT'S REVIEW OR AUDIT REPORT - previous budget year:	Yes
24	INDEPENDENT ACCOUNTANT'S REVIEW OR AUDIT REPORT - year other than previous year:	Yes
25	PENDING OR ANTICIPATED LITIGATION SUMMARY:	Yes
26	STATEMENT OF FEES (if required by statute)	Yes

**GOVERNANCE & ADMINISTRATION**

27	ARTICLES OF INCORPORATION:	Yes
28	ASSOCIATION DECLARATION (CC&Rs):	Yes
29	SUPPLEMENTAL OR AMENDED DECLARATIONS:	Yes
30	ASSOCIATION BYLAWS:	Yes
31	ASSOCIATION RULES & REGULATIONS:	No
32	ASSOCIATION BOARD MEETING MINUTES - previous 12 months:	Yes
33	BOARD APPROVED RESOLUTIONS:	No
34	CERTIFICATE OF INSURANCE - current policy period:	No
35	CERTIFICATE OF INSURANCE - previous policy period:	Yes
36	INSPECTION REPORTS - pertaining to common elements:	No
37	ASSESSMENT & RESERVE FUNDING DISCLOSURE SUMMARY	Yes
38	SETTLEMENT NOTICE REGARDING COMMON AREA DEFECTS	No

**COMMENTS**

Reserve study summary was provided in place of a complete reserve study.

State law requires that the Association provide a copy of the complete reserve study to a buyer if requested.

The Association's CIDA SCORE would improve if a complete reserve study were provided.

CIDA recommends that the buyer obtain a copy of the complete, current reserve study for the buyer's records.

The buyer may forward a the complete reserve study to CIDA for further review if a copy is made available.

The year-to-date financial statement was not provided for this review.

Delinquent dues and late fees levied against unit # 225 totaled \$913 as of 8/16/2018.

The regular monthly assessment as of 8/16/2018 was \$449. Payment is due on the 1st day of each month.

Unit #225 was not subject to any current outstanding special assessments as of 8/16/2018.

## HAPPY HOMEOWNERS ASSOCIATION

## SECTION II - ASSOCIATION DETAILS

The following details pertain to limitations on the use of the subject property which may result from zoning restrictions, land-use laws or legally binding relationships between the subject property and a neighborhood or master association:

## PROPERTY USE &amp; ZONING

39	Is the subject property a condominium or planned unit development (P.U.D.)?	Condominium
40	Is the subject property restricted to residential occupancy?	Yes
41	What percentage of floor space is zoned for non-residential use?	0.00%
42	If the subject property is a condominium, was it converted from another form of use?	No
43	If response on Line 42 is Yes, what year was the property converted to a condominium?	Not applicable
44	What is the municipal zoning classification of the subject property?	(Q)RD1.5-1 - Restricted Density Multiple Dwelling Zone
45	Is the subject property subordinate to a master association?	No
46	Is the subject property governed by statewide land-use code?	No
47	Is the subject property located in an urban, suburban or rural setting?	Urban
48	Is the subject property located in a Coastal Zone as defined by the California Coastal Commission?	No
49	Is the subject property located within a Targeted Neighborhood Initiative (TNI) area?	Yes
50	Is the subject property located within an economic Revitalization Zone?	No
51	Is the subject property designated as a Renewal Community under the Housing and Urban Development guidelines?	No
52	Is the subject property located in a state or federally funded urban renewal district?	No
53	Is the subject property located within a state or federally designated historic district?	No

## PUBLIC SAFETY

54	What is the approximate elevation of the subject property above sea level?	755'
55	What is the nearest fault line to the location where the subject property is located?	Northridge
56	Is the location of the property subject to liquefaction in the event of a seismic event?	No
57	Is the subject property adjacent to an open body of water?	No
58	Is the Association responsible for any swimming pools, spas or hot tubs?	Yes
59	Is the subject property located within a FEMA designated flood area?	No
60	Is the subject property located within a wild lands fire hazard area?	No
61	Is the subject property located within a tsunami inundation area?	No
62	Is the subject property located within a steep slope hazard area?	No
63	Is the location of the property subject to earthquake induced landslides in the event of a seismic event?	No
64	Is the subject property located in an area that is prone to tornados?	No
65	Is the subject property located in an area that is prone to hurricanes or typhoons?	No
66	Is the subject property subject to temperatures above 100° Fahrenheit for 30 or more days a year?	No
67	Is the subject property subject to temperatures below 20° Fahrenheit for 30 or more days a year?	No

The following details pertaining to the subject property were obtained from association records and/or government agencies:

## PHYSICAL CHARACTERISTICS

68	In what year or years was the subject property constructed?	Circa 1981
69	Have all stages or phases of the development been completed?	Yes
70	If answer to previous question is No, what percentage of the development is complete?	
71	Has construction of all residential units been completed?	Yes
72	If the answer to previous question is No, what percentage of the units have been completed?	
73	Does subject property contain outdoor public plazas or pedestrian spaces?	No
74	Does subject property contain interior space to which the public has unrestricted access?	Not reported
75	What is the total number of residential units or lots?	133
76	What is the total number of commercial units or lots?	0
77	Does the subject property contain below-grade living space?	Not reported
78	Does the subject property contain below-grade parking, storage or mechanical rooms?	Not reported
79	What is the maximum number of floors above grade level?	3 or less
80	What is the maximum number of floors below grade level?	Not reported
81	Number of parking units or spaces that are located on association-owned property:	Undetermined
83	Are parking spaces deeded or assigned?	See Comments

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84	Are any enclosed parking spaces located in the same building/s as the residential units?	Yes
85	Are any enclosed parking spaces located in stand-alone garages or parking structures?	Not reported
86	Is the subject property served by a fire sprinkler system?	Not reported
87	Is the subject property served by a fire monitoring/notification system?	Yes
88	Is the subject property monitored by CCTV security cameras?	Not reported
89	Is access to the subject property restricted by access-control/monitoring equipment?	No
90	Does the subject property contain a rooftop garden, eco-roof or "green roof?"	No
91	Is the subject property served by one or more elevators?	No
92	Total number of elevators located within the subject property:	Not applicable

## LEGAL STATUS

93	What is the state statute that governs the Association?	Civil Code Section 4000-6150; Corporation Code Section 7110
94	Are the seller or Association required by statute to disclose HOA financial data?	Yes
95	Is the buyer entitled to HOA financial data by statute if they request it?	Yes
96	What is the name of the original or successor Declarant?	Big Time Development, Inc.
97	Is the Association under the control of the original or a successor Declarant?	No
98	Are any residential units under the control of the original or a successor Declarant?	Not reported
99	Are reserve contributions from declarant-owned units being deferred?	No
100	Does the Association pay dues or membership fees to a master association?	No
101	Do owner/members of the subject property pay dues to a master association?	No
102	Is the number of units that may be rented restricted by the governing documents?	No
103	Is the month-to-month rental of units restricted by the governing documents?	No
104	Are rentals of less than 30 days duration restricted by the governing documents?	No
105	Are rentals for hotel or transient purposes restricted by the governing documents?	No
106	Does the subject property contain timeshares or fractional ownership units?	No
107	Is the subject property located leased land?	No
108	Is the subject property an age-restricted community that limits ownership to age 55 and over?	No
109	Is the subject property approved for FHA mortgage insurance?	Yes
110	If the answer to the previous question is Yes, when does the current approval expire?	6/30/2020

## ASSOCIATION GOVERNANCE &amp; ADMINISTRATION

111	Is the Association managed by a professional community association manager?	Yes
112	Is the managing agent an employee or an independent contractor (IC) of the Association?	IC
113	Are management staff located onsite during normal business hours?	Not reported
114	Is the subject property monitored by onsite or offsite security personnel during off-hours?	Yes
115	Is the managing agent an authorized signer on the Association's bank accounts?	Not reported
116	Does the managing agent provide bookkeeping services to the Association?	Yes
117	Does the managing agent assist in the preparation of the Association's annual budget?	Yes
118	Do management company employees perform maintenance on association-owned property?	Not reported
119	Number of voting board members required by the Association's governing documents?	5
120	Are Board members required to be owners in order to serve on the Board?	No
121	Are one or more Board members routinely absent from regularly scheduled Board meetings?	No
122	Does the Association hold monthly meetings of the Board of Directors? (Do not include annual meeting)	Yes
123	Does the managing agent attend the Board meetings on a regular basis?	Yes
124	Are any Association documents archived with a third-party archiving service?	Not reported
125	Are any Association documents archived by the management company?	Yes
126	Do owners or buyers have to pay for HOA documents?	Yes

## COMMENTS

Subject property is more than 30 years old and may require replacement or renovation of legacy systems and components. Items that may require replacement or renovation and are not included in the replacement reserve study include plumbing pipes; electrical branch wiring; electrical distribution panels and switchgear; electrical transformers, transfer switches and emergency power equipment; common area doors and windows.

The Condominium Plan that was provided for this review is illegible. Details regarding onsite parking, including the boundaries of any deeded parking units are unknown.

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## SECTION III - FINANCIAL ANALYSIS

The most recent financial data available for the Association are the income statement, balance sheet and operating budget indicated in Section I of this report. Balance sheets prepared by management may be unaudited. For the purposes of this analysis the information provided by the Association is assumed to be correct.

## CURRENT FINANCIAL CONDITION

127 Does the Association use a calendar or fiscal year for financial reporting & budgeting purposes?	Calendar year
128 What is the last day of the Association's current budget year?	12/31/2018
129 What is the ending date of the Association's most recent financial data?	12/31/2017

The following information is current as of the date indicated on Line 129 unless otherwise noted:

130 What is the current number of non-owner occupied units?	Not reported	
131 What is the current number of units that are used as second homes?	Not reported	
132 Total of amount the Association's funds that are not federally insured?	Not reported	As of 12/31/2017
133 Total accounts receivable currently in arrears:	\$4,002	Amount listed as doubtful on balance sheet
134 Total amount currently in collections:	Not reported	
135 Current accounts receivable:	\$9,366	Includes delinquent accounts
136 Total funds:	\$372,850	All sources of liquid funds
137 Accumulated reserve fund balance:	\$302,569	Liquid funds only
138 Total assets:	\$378,214	Includes receivables & prepaid accounts
139 Loans due to banks and third party lenders:	\$0	
140 Loans due to reserve fund:	\$0	
141 Projected revenue for current budget year:	\$716,604	
142 Year-to-date operating income:	Not reported	
143 Year-to-date operating expense:	Not reported	
144 Year-to-date operating income or loss (-):	Not reported	
145 Reserve allocation for current budget year:	\$89,172	
146 Year-to-date reserve transfer:	Not reported	

## RESERVE STUDY STATUS

The definition of a *current* reserve study is one that includes a reserve funding and spending projection that begins on the same date as the current budget cycle. A reserve study which conforms to the format set forth in the CAI Reserve Study Required Contents and most state laws, will cover a minimum period of thirty (30) years. Information regarding the Association's reserve study provider and current status of the report includes the following data:

147 Is the reserve study provided for this review current according to the above definition?	Yes
148 Did the most recent reserve study include a site visit by the reserve study provider?	No
149 The reserve study provided for this review covers what year?	2018
150 The most recent reserve study that included a site visit occurred in what year?	2017
151 Is Association in compliance with state laws regarding reserve studies & reserve study updates?	Yes
152 Was the reserve study prepared by an independent third-party provider?	Yes
153 Was the reserve study prepared by a CAI-certified Reserve Specialist® (RS)?	Yes
154 Does the reserve study disclose potential conflicts between the provider and the Association?	No
155 Does the reserve study provider perform other professional services for the Association?	Not reported
156 Does the reserve study provider/Association relationship create a potential conflict of interest?	Undetermined
157 Does the reserve study include a percent funded analysis?	Yes
158 Does reserve study include expenses other than for repair/replacement of common elements?	No
159 Was the most recent reserve study prepared or updated by the Board of Directors?	No
160 Was the most recent reserve study prepared or updated by the management company?	No

## RESERVE FUNDING DETAILS

The following information was obtained from the reserve study, financial statements, annual operating budget, Independent Accountant's Review or Auditor's Report provided for this review, unless otherwise noted:

161 Are replacement reserves maintained in a separate account from other association funds?	Yes
162 Does the Association utilize a fund accounting system?	Not reported
163 Beginning reserve fund balance indicated in the reserve study as of 1/1/2018?	\$61,687
164 Reserve fund balance indicated on the year-end 2017 balance sheet?	\$302,569

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165	Is the amount on Line 164 no less than 97% of the amount on Line 163?	Yes
166	Total reserve expenditures for the remaining years covered by the study?	\$5,376,425
167	What is the remaining number of years covered by the reserve study?	30
168	Average annual reserve expenditures for the remaining years covered by the study?	\$179,214
169	What is the minimum year-end reserve fund balance resulting from the study?	\$1,497
170	Is the amount on Line 169 equal to or greater than the amount on Line 168?	No
171	What is the current year reserve contribution resulting from the reserve study? (See Comments)	\$100,344
172	What is the current year reserve contribution according to the approved operating budget?	\$89,172
173	Is the amount on Line 172 equal to or greater than the amount on Line 168?	No
174	Is the amount on Line 172 equal to or greater than the amount on Line 171?	No
175	What is the maximum annual increase in the reserve contributions resulting from the study?	3.00%
176	What is the annual inflation rate assumed in the reserve study?	3.00%
177	What is the annual interest yield on reserve deposits assumed in the reserve study?	1.00%
178	Is the inflation rate indicated on Line 176 between 2.5% and 3.5%?	Yes
179	Is the interest rate indicated on Line 177 between 0% and 1%?	Yes
180	Does the reserve study include a contingency funding provision?	No
181	If previous response is Yes, what percentage of reserves are allocated to contingency funding?	Not applicable
182	Is the current percent funded level at least 60%?	No
183	Is the current percent funded level at least 70%?	No
184	Is the current percent funded level at least 80%?	No
185	What is the lowest percent funded level over the next 10 years?	< 1%
186	What is the lowest percent funded level in the years after year 10?	1%

The funding metrics outlined below are used to gain a sense of the relative strength of the reserve funding plan presented in the reserve study. A Yes response to any of these questions is a positive factor in terms of the Association's CIDA SCORE and the reserve funding strategy. A response of No, Undetermined or Not Reported may be a negative or neutral factor:

187	Is the minimum percent funded level at least 60% in each of the next 10 years?	No
188	Is the minimum percent funded level at least 70% in each of the next 10 years?	No
189	Is the minimum percent funded level at least 80% in each of the next 10 years?	No
190	Is the minimum percent funded level after year 10 at least 50%	No
191	Is the minimum percent funded level after year 10 at least 60%	No
192	Is the minimum percent funded level after year 10 at least 70%	No
193	Is the current reserve contribution at least 15% of total annual revenues?	No
194	Is the current reserve contribution at least 20% of total annual revenues?	No
195	Is the current reserve contribution at least 25% of total annual revenues?	No
196	Is the current reserve contribution more than 30% of total annual revenues?	No
197	Do peak reserve expenditure cycles coincide with peak percent funded levels?	Yes

## RESERVE FUND EQUITY

Reserve fund equity is determined by dividing the current available reserve funds (liquid assets only) by the number of Association members that contribute to the reserve fund. The reserve equity is used to determine the *average* funded and unfunded reserve spending liability for each member of the Association. The reserve spending liability is the future spending obligation established by the Association's reserve study. The degree to which the current reserves offset future spending obligations is the *funded* portion of the reserve spending liability. The *unfunded* reserve spending liability is equal to the future spending obligations minus the current liquid reserve funds available at the time the reserve equity calculation is performed. The following data has been used to calculate the current reserve equity and unfunded reserve spending liability:

198	Current reserve fund balance (liquid reserves only):	\$302,569
199	Number of owners that contribute to the reserve fund:	133
200	Average per unit reserve fund equity:	\$2,275
201	Average per unit reserve spending liability:	\$40,424
202	Funded reserve spending liability percentage:	6%
203	Unfunded reserve spending liability percentage:	94%

A Yes response to any of the questions below is a positive factor in terms of the reserve equity, reserve spending liability and the CIDA SCORE that is reflected in this report. A response of No, Undetermined or Not reported may be a negative or neutral factor:

204	Is the unfunded reserve spending liability less than 85%?	No
205	Is the unfunded reserve spending liability less than 80%?	No
206	Is the unfunded reserve spending liability less than 75%?	No

## HAPPY HOMEOWNERS ASSOCIATION

## LOANS &amp; SPECIAL ASSESSMENTS

Outstanding loans and special assessments may result in a liability for the buyer if a due-on-sale-clause is not included in the resolution authorizing the loan or special assessment. When an Association borrows money from a third-party lender, a special assessment is typically levied to satisfy the lender's requirements for securing the borrowed funds. The special assessment may result in a lien on each unit or lot that is subject to the special assessment until such time as the owner has paid the assessment in full. In some instances a serial assessment may be levied which allows the owners to pay the special assessment in a series of installment payments. CIDA recommends that all buyers ask the seller to pay any outstanding loans or special assessments owed by the seller as a condition of the sale. The following information regarding outstanding loans and special assessments was obtained from the documents made available for this review. Outstanding loans or special assessments are a negative impact factor in terms of the Association's CIDA SCORE:

207 Does the balance sheet list loans due to a third-party lender?	No
208 Does the balance sheet list loans due to the Association's reserve fund (Interfund borrowing)?	No
209 Is there a written schedule for repaying any money borrowed from the reserve fund?	Not applicable
210 Will outstanding loans due to the reserve fund be repaid within 12 months?	Not applicable
211 Is the unit or lot that is the subject of the buyer's offer encumbered by a special assessment?	No
212 Does available information confirm that a special assessment is pending?	See Comments
213 Does available information indicate a special assessment is likely within the next 12 months?	See Comments
214 Does the examiner believe a special assessment is likely within the next 12 months?	See Comments

## COMMENTS

The Association's reserve funding status is extremely weak. The Assessment and Reserve Funding Disclosure Summary confirms that the percent funded level as of 1/1/2018 was 6.4% based on a reserve fund balance of \$61,687 and \$5,376,425 in projected reserve expenditures over the next thirty (30) years. The 12/31/2017 balance sheet indicates that the reserve fund balance was \$302,569 as of the end of 2017. The discrepancy between the two reserve fund balance figures is not explained.

The 2018 reserve study was prepared by a nationally prominent reserve study provider. The study recommends that a one-time special assessment of \$704,900 be levied to cover the reserve funding shortfall. The reserve funding schedule that is included in the Reserve Study Summary includes \$590,000 in 2018 under the Loan or Special Assessments column.

The reserve fund contribution recommended by the reserve study for 2018 is \$100,344 not including the one-time special assessment.

The reserve contribution included in the 2018 operating budget is \$89,172. The discrepancy between the 2018 recommended reserve contribution and the amount budgeted for transfer to the reserve fund is not explained.

The Statement of Fees estimates that the reserve deficit on an average, per-unit basis is \$6,738.

The source of the funds that was used to increase the reserve fund balance to \$302,569 was not disclosed. It is possible that the Association levied a special assessment to generate the funds, but the Statement of Fees provided for this review confirms that there are no special assessments outstanding at this time.

CIDA recommends that the buyer request a more recent accounting of the reserve fund activity and the source of funds that has been used to fund the reserve account, aside from the regular monthly reserve transfers that are included in the annual operating budget.

The unfunded reserve spending liability is 94% of total projected spending over the next thirty (30) years. The unfunded reserve spending liability is extremely high for an Association that is almost forty (40) years old.

CIDA recommends that the buyer request a reduction in the purchase price that is equal to or greater than the estimated per-unit reserve fund deficit of \$6,738.

## HAPPY HOMEOWNERS ASSOCIATION

## SECTION IV - STATUTORY COMPLIANCE

## RESERVE STUDY

Certain states require HOAs to conduct a reserve study and to update the study periodically. Oregon, Washington, California, Nevada, Utah and Hawaii are among the states that require all or most HOAs to conduct a reserve study to determine the appropriate level of reserve funding. **California Civil Code §5550** requires that a reserve study based on a "reasonably competent and diligent visual inspection" be conducted at least once every three (3) years. The Board of Directors must review the study or "cause the study to be reviewed" each year. Good governance practices require that all reserve studies be updated each year so that the study reflects the beginning reserve fund balance as of the first day of the current budget year in addition to other financial variables that typically change from one year to the next.

215	Does state law require that the reserve study be updated each year?	Yes
216	Do the Association's governing documents require that the reserve study be updated each year?	No
217	Was a current reserve study provided in response to the buyer's request for HOA documents?	Yes
218	Is the current reserve study an update of the study prepared for the previous budget year?	Yes
219	Is the reserve study provided for this review more than 2 years old?	No
220	Was a current reserve study provided even though it wasn't required by state law?	Not applicable
221	Was the most recent reserve study prepared by a reserve planning professional?	Yes
222	Does the examiner believe the Association is in compliance with state reserve study statutes?	Yes

## INDEPENDENT AUDIT OR ACCOUNTANT'S REVIEW

The laws of some states require certain HOAs to engage an independent CPA to audit or review the year-end financial statement. **California Civil Code §5305** requires any Association with gross income exceeding **\$75,000** per year to have the year-end financial statement reviewed by an independent CPA who is licensed by the California State Board of Accountancy. In those instances where the governing documents require an audit of Association finances the governing documents take precedence over the statute. The *Independent Accountant's Review Report* is a limited inquiry that provides "limited assurance" that the financial statement is materially correct. The review is conducted in accordance with generally accepted accounting standards (GAAS). An *Independent Audit Report*, if required, must conform with GAAS and must include a statement attesting to whether the Association financial records and accounting practices are in accordance with generally accepted accounting principles (GAAP) recognized in the United States.

223	Is an Independent Audit or Review of the annual financial statement required by statute?	Yes
224	Is an Independent Audit or Review required by the governing documents?	No
225	Has the Association ever waived the requirement for an Audit or Review, if allowed by statute?	Not applicable
226	Was an Independent Audit or Review for the most recently ended fiscal year provided?	Yes
227	Was an Independent Audit or Review for any previous fiscal year provided?	Yes
228	Does the Audit or Review identify any inconsistencies in the Association's financial statement?	No
229	Does the CPA responsible for the report provide other professional services to the Association?	No
230	Does examiner believe Association is in compliance with statute requiring an Audit or Review?	Yes

## COMMENTS

The Independent Accountant's Review Report for 2017 does not include details regarding the concentration of credit risk. Credit risk refers to the amount of money the Association may have on deposit with commercial banks that is more than the FDIC insurance limit of \$250,000.

The Association's governing documents require that all Association funds be held in insured accounts.

The Association's replacement reserve fund balance exceeded the FDIC insurance limit of \$250,000 as of 12/31/2017.

CIDA recommends that the buyer confirm the bank balance of all accounts maintained by the Association to ensure that all funds are insured.

## HAPPY HOMEOWNERS ASSOCIATION

## SECTION V - INSURANCE

HOAS are typically required to maintain certain types of insurance coverage by the Association's governing documents . Some insurance coverage may be left to the discretion of the Board of Directors. If the Association has employees, it is required by law to carry worker's compensation insurance. Casualty policies may carry a *guaranteed replacement cost* endorsement, which will result in the policy paying for the full replacement cost if the covered damage results in a total economic loss. In those instances where the damage is not deemed to be a total loss the policy is typically subject to a coverage limit, which is the maximum amount that will be paid out under the policy when a total economic loss is not incurred. The casualty policy may or may not provide *walls-in* coverage. A walls-in policy will cover damage to fixtures, equipment and personal property within the walls of the individual units in an attached, common interest housing development. Many Associations carry liability insurance that specifically insures the officers and directors against liability resulting from their actions while serving in an official capacity as a director or officer of the organization. Details regarding the Association's insurance coverage are indicated below:

## INSURANCE COVERAGE ANALYSIS

231	Is Casualty insurance a guaranteed or extended replacement cost policy?	Yes
232	What is the per occurrence coverage limit of the Casualty insurance policy?	\$40,839,300
233	Does Casualty insurance policy cover damage from seismic events (earthquakes)?	Yes
234	If previous response is Yes, does replacement provision extend to earthquake damage?	No
235	Does Casualty insurance policy cover damage from wind and hail?	Not reported
236	If previous response is Yes, does replacement provision extend to wind and hail damage?	Not reported
237	Does Casualty insurance policy cover damage from flooding?	Yes
238	If previous response is Yes, does replacement provision extend to flood damage?	No
239	What is the dollar limit of the Association's Fidelity insurance policy?	\$500,000
240	What is the <i>per occurrence</i> limit of the Association's Commercial General Liability policy?	\$4,000,000
241	What is the <i>aggregate</i> limit of the Association's Commercial General Liability policy?	\$6,000,000
242	What is the coverage limit of the Association's commercial general liability umbrella policy?	Not reported
243	Do the Association's bylaws require Director's & Officer's liability insurance coverage?	No
244	If previous response is Yes, what is the minimum coverage required under the bylaws?	Not applicable
245	What is the coverage limit of the Association's Director's & Officer's liability policy?	\$2,000,000
246	What is the deductible for claims resulting from earthquake damage?	20% of claim
247	What is the deductible for claims resulting from flood damage?	20% of claim
248	What is the deductible for claims resulting from wind and hail damage?	Not reported
249	What is the deductible for other claims covered by the Casualty insurance policy?	\$10,000
250	What is the deductible for claims covered by the Director's & Officer's liability policy?	\$1,000
251	What is the deductible for claims covered by the Fidelity policy?	\$10,000
252	Is the coverage limit of the Fidelity policy equal to 3 months of aggregate assessments + cash balance of all association accounts as of the most recent balance sheet?	Yes
253	Does the deductible under any policy exceed \$10,000 or 1% of the face value of the policy?	Yes
254	Does examiner believe insurance coverage is consistent with the requirements of the Bylaws?	Yes
255	What are the expiration dates of the Association's Liability and Casualty Insurance Policies?	6/28/18 & 1211/17

## COMMENTS

The Association's Liability Insurance policies expired on 6/28/2018.

CIDA recommends that the buyer request confirmation of the current liability insurance coverage.

The Association's Property (Casualty) Insurance policy expired on 6/28/2018.

CIDA recommends that the buyer request confirmation of the current Casualty insurance coverage.

The Association's Earthquake (EQ) and Flood Insurance policies expire on 12/11/2018.

The deductibles under the EQ and Flood insurance policies exceed the lesser of \$10,000 or 1% of the face value of the policy.

Assuming catastrophic property damage from an EQ or flood, a maximum claim value of \$30M, and a deductible equal to 20% of the claim value each owner would be responsible for paying is \$45,112 in deductibles under the EQ and Flood insurance policies.

## HAPPY HOMEOWNERS ASSOCIATION

## SECTION VI - LITIGATION

## CURRENT &amp; PENDING LITIGATION

Associations may initiate lawsuits for a variety of reasons. The most common types of lawsuits are collection actions against delinquent owners and suits against contractors, developers and material suppliers, seeking financial damages for defective workmanship or materials used in the construction process. Collection actions are usually handled on a contingency fee basis and will typically have a minimal financial impact on the owners in terms of litigation costs. Lawsuits to recover damages related to construction defects can, and often do, have an adverse financial impact on the owners. If legal counsel is not engaged under a contingency fee agreement, it is likely that the attorney's fees and other litigation costs will have to be paid by the Association as the case progresses. Financing of a lawsuit will often result in borrowing by the Association, either from its own reserve fund or from a third party lender. These loans must be repaid by the Association regardless of the outcome of the lawsuit. As an alternative to borrowing the Associations may levy a special assessment to finance litigation expenses. Details pertaining to any current or pending legal actions that have been confirmed by CIDA are indicated below:

256 Is the Association currently a plaintiff in a lawsuit related to defective construction or materials? **Not reported**  
 257 If previous response is Yes, is legal counsel retained under a contingency fee agreement? **Not applicable**  
 258 Is the Association currently a plaintiff in a lawsuit that is not related to construction defects? **No**

The following details pertain to ongoing litigation in which the Association is a plaintiff:

259 Is ongoing litigation subject to mediation? **Not applicable**  
 260 Is ongoing litigation subject to binding arbitration? **Not applicable**  
 261 Is ongoing litigation scheduled for mediation within the next 12 months? **Not applicable**  
 262 Is ongoing litigation scheduled for arbitration within the next 12 months? **Not applicable**  
 263 Is ongoing litigation scheduled for trial within the next 12 months? **Not applicable**  
 264 Has a trial court ruling in favor of the Association been appealed by the defendant? **Not applicable**

## COMMENTS

In 2016 the Association was named as a codefendant in a lawsuit as a result of a pedestrian who slipped and fell while walking on the sidewalk in front of the condominium complex. The City of Los Angeles was also named as a defendant in the lawsuit.

The Association is being defended in the lawsuit by Farmers Insurance, the underwriter of the Association's Commercial General Liability insurance policy.

In a letter from Farmers dated 7/18/2018 the Claims Representative states that his office had received confirmation from the Association's legal counsel that an agreement had been reached with the plaintiff to dismiss the claim against the Association because the area of the loss is under the control of the City.

The letter also states that the value of the claim is within the \$2M liability limit of the CGL policy.

It appears that the litigation has or will be settled to the satisfaction of the Association and should not be a concern for a buyer, based on the information provided for this review.

## HAPPY HOMEOWNERS ASSOCIATION

## SECTION VII - MANAGEMENT OPERATIONS

HOAs may be self-managed by members of the community, by management companies that are independent contractors, or by professional managers who are employees of the Association. Small HOAs with fewer than twenty members may find that it is not economical to hire a third-party agent to oversee the administrative affairs of the organization. As a result, it is commonplace for smaller HOAs, whether they are condominiums or planned developments, to be self-managed. HOAs that are self-managed will often have the same individuals serving on the board for extended periods of time due to lack of interest and the amount of time that is required to manage *and* govern the Association. Professional management is typically a better option, although it must be stated that the management industry in almost all states is completely unregulated with no mandatory training, testing or licensing of managers or management companies. The most common business model among management companies is the so-called "portfolio" management company. A portfolio manager is someone that works for an independent management company, managing more than one Association, typically from a centralized location, attending to their clients on an as-needed basis. Portfolio management companies are often understaffed, underpaid and overworked. The results are often typical of what might be expected in such cases.

Onsite managers who are employed by an independent management company and assigned to work exclusively for one Association are typically found in large-scale planned communities (1,000 homes or more) and sometimes in high-rise condominiums. In some cases onsite managers may be employed by the Association and may or may not supervise a staff of subordinate workers. The variety of services provided by management companies ranges from bookkeeping and routine administrative work to a comprehensive menu of integrated management and property maintenance services. In such circumstances it is not uncommon to find that the management company is generating multiple revenue streams from its relationship with the Association. These ancillary revenue streams often generate more revenue for the management company than the management services which are supposed to be the core business of the company. Such practices raise questions about the potential conflict of interest that exists when a primary vendor like a management company is enriched through the act of providing down-line services such as property maintenance, security, concierge and janitorial services. The following analysis attempts to provide some clarity regarding the extent to which independent management is efficient and ethical in the performance of its duties. The analysis does not take into consideration the efforts of board members who serve as defacto managers of the Association due to the small size of the Association or for other reasons.

## PROFESSIONAL MANAGEMENT

265	Is the Association managed by a Accredited Association Management Company™?	No
266	Does the management company provide non-administrative services to the Association?	Not reported
267	Does the management company have a preferred vendor program?	Undetermined
268	Does the management company receive revenue from the Association for any services other than the performance of administrative tasks?	Undetermined
269	Percentage of annual revenues budgeted for management services (includes "Misc. Administrative" expense)	6.11%
270	Percentage of annual revenues budgeted for non-administrative services that are provided by management company?	Undetermined
271	Percentage of annual revenues budgeted for landscape maintenance services?	5.70%
272	Percentage of annual revenues budgeted for property maintenance other than landscaping?	12.87%
273	Is the management company or managing agent involved in the preparation or updating of the Association's reserve study?	No
274	Does the Association prepare a year-to-date financial statement at the end of each month?	Undetermined
275	Are year-to-date financial statements available to the owners within 30 days of the month-end?	Undetermined
276	Is the Association in compliance with statutes that govern homeowner associations in the state where the subject property is located?	Yes
277	Is the Association in compliance with all provisions of the governing documents that pertain to financial reporting?	Yes
278	How many HOAs has CIDA examined that are managed by the Association's management company?	0
279	What is the average CIDA SCORE for HOAs managed by the management company?	Not applicable
280	What is the median CIDA SCORE for HOAs managed by the management company?	Not applicable

## COMMENTS

The allocation of various operating expenses as a percentage of total revenue is consistent with similar Associations that have been examined by CIDA.

None of the allocation are excessive or unreasonable in the opinion of CIDA's examiners.

## HAPPY HOMEOWNERS ASSOCIATION

## SECTION VIII - CIDA SCORE

## CURRENT &amp; PREVIOUS CIDA SCORE

The CIDA SCORE is a proprietary rating system developed by the creators of the CIDA REPORT. The scoring process utilizes a numerical scale that ranges from 0 to 100, with 100 being the best score possible. The CIDA SCORE provides a quick method for comparing the fiscal governance and reporting practices of the subject property to other HOAs that have been rated by CIDA. The scoring matrix that is used to calculate the CIDA SCORE is designed in such a way that an Association which is average in terms of its financial condition will theoretically receive a score between 60 and 65. By using 60 as a baseline for what constitutes an average CIDA SCORE we can easily see when an Association's financial condition is above average or below average.

An above-average CIDA SCORE is an achievable goal for any well-managed Association. As of the beginning of **2018**, the majority of the HOAs that have been examined by CIDA have received scores between **50** and **75**. A CIDA SCORE of **75** or more is consistent with an Association whose governance and financial management practices are well above average. Associations that earn a CIDA SCORE of **80** or higher are an elite group whose fiscal practices are almost flawless. A CIDA SCORE in the **50** to **60** range is typical of an Association that only needs to make minor improvements in the fiscal governance practices of the organization in order to achieve a score that is above average. A CIDA SCORE below **50** is indicative of an organization that has the potential to be financially unstable. A CIDA SCORE below **50** indicates financial uncertainty, which is most often due to ongoing litigation, underfunded reserves, and/or excessive borrowing by the Association that has resulted in a personal liability for the owners. A CIDA SCORE of **67** or higher is within the top twenty percent of more than **450** HOAs that have been examined by CIDA

The current and previous CIDA SCORE for the subject property is indicated below along with the average and median scores as of the date of this CIDA REPORT.

<b>281</b> The Association's current CIDA SCORE as of the date indicated:	<b>59.75</b>	<b>12/31/2018</b>
<b>282</b> The Association's previous CIDA SCORE as of the date indicated:	<b>No prior score</b>	
<b>283</b> The current median CIDA SCORE as of the date indicated:	<b>55.75</b>	<b>8/25/2018</b>
<b>284</b> The current average CIDA SCORE as of the date indicated:	<b>55.25</b>	<b>8/25/2018</b>

## COMMENTS

The Association's CIDA SCORE is slightly above average. A score of 59.75 is 4 points higher than the current median score of 55.75, which takes into account more than 500 HOAs in eight (8) states that have been examined by CIDA since the beginning of 2012.

A CIDA SCORE in the 55-60 range is within reach of becoming a top 20% score (67) within improvements in the governance, administration and reserve funding practices of the Association.

Information regarding the requirements for achieving an above average CIDA SCORE may be found on the following page.

END OF REPORT

**IMPROVING THE CIDA SCORE:** The following policies are required in order to maintain a CIDA SCORE that is above average:

- Update the reserve study every year
- Fund the reserve account according to the recommendations of the reserve study provider
- Do not borrow from the reserve fund
- Adopt a reserve funding strategy that results in a minimum percent funded level of **60%** in all years except those years when peak reserve spending is scheduled to occur
- Fund the reserves at a level that will avoid special assessments or borrowing by the Association
- Do not borrow money from a bank or third-party lender
- Avoid litigation if at all possible
- Include a due-on-sale clause in the special assessment resolution if a special assessment is levied
- Do not allow the management company or the Board of Directors to prepare or update the Association's reserve study
- Do not allow the reserve study provider to perform other services for the Association
- Do not spend the reserve funds on any expenses other than those identified in the reserve study as reserve fund expenditures
- Limit the number of rentals to **30%** of the residential units
- Do not allow rentals for hotel or transient purposes
- Do not allow rentals for a period of less than six (**6**) months
- Do not allow month-to-month rentals
- Obtain FHA mortgage insurance certification if the property is a condominium
- Prepare a year-end financial statement that conforms to generally accepted accounting principles and make the financial statement available to the owners within thirty (**30**) days of the end of each fiscal year
- Prepare a year-to-date financial statement every thirty (**30**) days that conforms to generally accepted accounting principles
- Hold a meeting of the Board of Directors at least once every sixty (**60**) days and conduct the meetings according to the protocols established by Robert's Rules of Order
- Require that all Board members attend all meetings except in cases of emergency
- Replace chronic absentee Board members with individuals who are able to attend meetings on a regular basis
- Prepare meeting minutes that conform to the format established by Robert's Rules of Order
- Approve the meeting minutes and make them available to the owners within forty-five (**45**) days of the meeting at which the minutes were taken
- Maintain insurance coverage that is consistent with the requirements of the governing documents

- Maintain Fidelity insurance with a minimum coverage limit that is at least three **(3)** times the aggregate monthly assessments plus the cash balance of all Association accounts as of the date of the most recent balance sheet
- Maintain commercial general liability insurance with a minimum coverage limit of **\$2,000,000** per occurrence; **\$4,000,00** in the aggregate
- Maintain Director's & Officer's liability insurance (D&O) with a minimum coverage limit of **\$1,000,000**
- Maintain a General Commercial Liability policy with a minimum coverage limit of **\$15,000,000** which extends coverage to the D&O and Fidelity insurance policies
- Provide a current certificate of insurance to all owners each year when the Association's insurance policies are renewed
- Provide all Association documents to any owner immediately upon request
- Provide all Association documents to prospective buyers immediately upon request

It is almost always in the buyer's best interest to become involved in the governance of the Association by serving on the Board of Directors. HOA members may choose to be passive members of the community or proactive leaders who provide the guidance and direction that is required to ensure a successful and sustainable community over the long term.

If it is not possible for an owner to serve on the Board of Directors it is imperative that they attend Board meetings and stay abreast of Association business in an effort to improve governance and hold decision-makers and management accountable to the membership.

## Document Explanation

Documents that are relevant to the pre-purchase due diligence process include the following items:

**Summary of Documentation:** The documents requested for this review are relevant to the Association's fiscal management practices. All of the requested documentation should be among the historical records of any well-managed, well-governed homeowners association, regardless of whether the laws of any particular state require that the Association maintain such documentation. The Association's fiscal management practices should conform to the Community Associations Institute's (CAI) nationally recognized Best Practices Guidelines; the American Institute of Certified Public Accountants (AICPA) *Audit & Accounting Guide for Common Interest Realty Associations* as well as any statutory requirements that may exist in the state where the subject property is located. Certain types of documents and records are critical to the financial success of any homeowners association and are considered essential to good governance and the fiscal stability of the Association.

**Independent Accountant's Review or Audit Report:** Some states, including California, require homeowner associations with a minimum number of members or a minimum level of annual revenue to have the annual financial statement reviewed or audited by an independent CPA. The Independent Accountant's Review Report is sometimes referred to as a "financial review" within the industry, while an audit is typically referred to as an Audit or Auditor's Report. The process for conducting a financial review is similar to that for performing an audit. When preparing a financial review or audit for a homeowner association, the Auditor examines the year-end financial statement which consists of a balance sheet, statement of revenue and expense and a statement of cash flows. The standards of proof under the review guidelines are not as strict as they are when conducting an audit but both procedures require that the final report include an attest statement which states whether the auditor believes the financial statement that was reviewed or audited accurately reflect the financial condition of the organization in all material respects.

The audit or financial review must be performed by a licensed CPA who is an independent, third-party consultant. In those instances where the Auditor finds discrepancies in the financial statement the report will disclose whether the financial statement has been modified based on the advice of the Auditor. Financial statements that are not subjected to a review or audit by an independent auditor are generally referred to as *unaudited* financial statements. Unaudited financial statements may be prepared by management, the Board of Directors or anyone that the Board chooses to prepare the financial statement. A financial statement that has been audited or reviewed by a CPA is the most important document available for establishing the current financial condition of the Association. The failure of an association to obtain an audit or a financial review when it is required by law is a negative factor that has an adverse impact on the Association's CIDA SCORE.

**Repair & Replacement Reserve Fund Study:** The purpose of the repair and replacement reserve fund study (reserve study) is to identify all major common area repair and replacement expenditures expected to occur within thirty years of the beginning date of the reserve study. The reserve study should clearly identify all predictable and determinant expenditures which can reasonably be expected to occur in more than two and less than thirty years. **OR, CA, HI, NV, UT, DE** and **VA** require most homeowner associations within each state to conduct a reserve study and to update the reserve study periodically. The state of Washington *encourages* homeowner associations to conduct a reserve study unless doing so would impose an "unreasonable hardship" on the organization. Failure to update the

reserve study is a violation of state law in most states which require a reserve study, but it may also result in an underfunded reserve account in future years due to the dynamic nature of the reserve planning process. The reserve study should be prepared by an independent and objective third party who has no current or prior involvement with the Association that could result in a conflict of interest.

The “independent and objective” requirement, therefore, precludes the Board of Directors, the Association’s management company or any other vendor that provides other services to the Association from performing its reserve study. It is often the case that the independent and objective requirement is ignored by the Association and the reserve study provider. The failure of an association to prepare a reserve study and to maintain an updated reserve study is a negative factor that has an adverse impact on the Association’s CIDA SCORE. The reserve funding analysis contains several elements that CIDA examiners consider relevant to the long term financial stability of the Association. Among the most important of these elements are the following:

**Percent Funded Level:** The percent funded calculation provides insight into the relative strength of the Association’s reserve funding plan. The formula for calculating the percent funded level for a single component is:

**Fully Funded = PV x CA / EUL.** Where **PV** = present value; **CA** = current age; and **EUL** = expected useful life.

Hence the Fully Funded calculation for a component with a current age (**CA**) of 3 years, a present value (**PV**) of \$10,000 and an expected useful life (**EUL**) of 10 years would be: **\$10,000 x 3 / 10 = \$3,000.00**

The percent funded figures that appear in most reserve studies are an average that is calculated by adding the percent funded level of each individual component and then dividing the total by the number of components in the reserve study component inventory. From an analytical standpoint what the percent funded level tells us is the degree to which the Association’s current accumulated reserve funds offset the value of commonly owned assets that has been lost to depreciation if those assets are scheduled to be replaced with the reserve funds.

If the reserve study projects that the Association will spend \$1,000,000 over the next thirty years to renovate or replace commonly owned assets and the accumulated depreciation of those assets is measured at \$400,000 at a particular point in time, then the accumulated reserves would need to be \$400,000 at that time in order for the reserves to be fully funded. The percent funded calculation is generally expressed as of the ending or beginning date of the fiscal reporting cycle. If the percent funded level is less than 100% it means the Association is deferring some portion of the obligation for funding its reserves into future years, which in turn means that future owners will bear an inordinate share of the burden for the future replacement cost of common area improvements.

In those instances where the percent funded level is less than 100%, the number of components which are fully funded and the number which have been allocated none of the accumulated reserves will depend on how high the percent funded level is; the remaining life expectancy of the components and the replacement cost relative to the accumulated reserve fund balance. If the percent funded level is below 60% it is possible that as many as 50% of the components identified in the component inventory may be unfunded at any particular time. For this reason it is a generally considered sound reserve planning strategy to fund the reserves in an amount that results in a minimum percent funded level of at least 60%. The percent funded levels indicated in the Association’s reserve study are an important component of the CIDA SCORE because they tell a buyer whether the Association’s reserve funding strategy is one which “kicks the can down the road” and thereby shifts the burden of funding the

reserves to future generations of owners. Some reserve study providers do not include a percent funded analysis in their reserve studies (See discussion of Reserve Equity below). Low percent funded levels and reserve studies that do not contain a percent funded analysis are both factors that have an adverse impact on the Association's CIDA SCORE.

**Minimum Reserve Fund Balance:** The minimum reserve fund balance refers to the minimum year-end reserve fund balance that results from the Association's thirty year reserve funding plan. If the year-end fund balance is inordinately high, it means the reserve funding plan results in "dead money," which refers to money that is never spent and will theoretically remain in the reserve fund in perpetuity. If the minimum year-end reserve fund balance is low, relative to the average annual reserve fund expenditures; it means the Association is running the risk of a reserve fund deficit if reserve expenditures exceed the amount or frequency assumed in the reserve study.

The baseline that is considered the minimum acceptable reserve fund balance is 100% of the average annual reserve fund expenditures over the thirty year period covered by the reserve study. If the total expenditures over the thirty years covered by the reserve study are projected to be \$3,000,000 that means the average annual reserve expenditure is \$100,000. Therefore a reserve funding projection that results in a minimum year-end fund balance of \$100,000 or more in order for the reserve funding schedule to not have adverse impact on the Association's CIDA SCORE.

**Reserve Equity & Future Spending Liability:** The concept of reserve equity and future reserve liability were developed by CIDA to measure the financial impact of the Association's reserve funding obligations on future owners. The reserve equity versus future reserve liability calculation is a useful tool for evaluating the strength of a reserve study that does not contain a percent funded analysis. The per unit reserve equity is determined by dividing the current accumulated reserve fund balance by the total number of units within the Association.

The per unit reserve liability represents the average amount of money that each owner is obligated to pay into the reserve fund over the thirty year study period. Hence, if the Association's reserve study indicates that there will be \$1,000,000 in reserve fund expenditures over the thirty year period covered by the study and there are 100 unit owners within the Association, then the future reserve liability would be an average of \$10,000 per owner ( $\$1,000,000 / 100 = \$10,000$ ). The future reserve liability may be *funded* or *unfunded*. The funded and unfunded liability is expressed as a percentage. The formula used to determine the funded portion of the reserve spending liability is the reserve equity figure divided by the total reserve expenditures established by the reserve study. The unfunded liability is determined by subtracting the funded reserve liability percentage from the number 1.

The per unit unfunded liability represents the average amount of money that each owner must contribute to the reserve fund over the period covered by the reserve study to meet the funding obligations set forth in the reserve study. Hence, if the reserve equity is \$100,000 and the total projected reserve expenditures are \$1,000,000 then the reserve liability is 10% funded ( $\$100,000 / \$1,000,000 = .10$ ) and 90% unfunded. In the case of an association with 100 residential units, each owners average unfunded reserve liability is \$9,000, and the funded portion of the liability is \$1,000. In general, the older the Association, the higher the reserve equity should be. Hence the higher *funded* reserve liability percentage should be. There are no hard and fast rules for determining what the funded portion of the reserve liability should be at any particular point in time, due to the dynamic and recurring nature of most reserve expenditures.

**Insurance Documentation:** The Association's governing documents typically contain language that specifies certain types of coverage and coverage limits that the Association must maintain at all times. These coverage requirements may or may not include a requirement to maintain Directors and Officers Liability insurance (D&O) coverage. D&O coverage insures the Board members against personal liability and will typically provide legal defense for Board members, in the event a lawsuit is filed against the Association. In the absence of D&O coverage an owner who serves on the Board of Directors could be held personally liable for financial judgments and litigation costs resulting from a lawsuit. Therefore, it is imperative that the Association maintain adequate D&O coverage regardless of whether state law or the governing documents requires that the coverage be maintained.

Indemnity or Fidelity insurance provides coverage when an officer, employee or an agent of the Association (such as a manager) is found to be at fault as a result of a specific event that results in a legal claim against the Association. Other important insurance considerations include whether or not the Association maintains a Commercial General Liability (CGL) Umbrella policy; whether the coverage limit of the Fidelity policy is consistent with the underwriting requirements of the FHA, Fannie Mae and Freddie Mac, and the size of the deductibles required by the policies. When preparing a CIDA REPORT our examiners will review the Certificate of Insurance to determine what coverage is maintained by the Association and whether or not the coverage is consistent with the statutory requirements and the Association's governing documents.

**Board Meeting Minutes:** As a prospective buyer of a home in an HOA the Board meeting minutes are often the only insight you have into the inner-workings of the Association. When a Buyer purchases a home in any type of common interest development (CID), whether it is a condominium or a planned development you are either going to have someone else managing your investment or you can decide to be a proactive owner and become involved in the governance process by serving on the Board of Directors and/or one of the committees that most large associations require to operate successfully. By choosing to become a proactive owner you are putting yourself in a position to exercise control over the financial decisions and governance practices of the non-profit corporation that you have invested in by virtue of having purchased a home in an HOA.

Serving on an association's Board of Directors can be time-consuming and is generally not a responsibility that is to be taken lightly. Many HOA's often find it difficult to get people to serve on the Board of Directors and when this happens it can lead to what is known as an "entrenched board" meaning a Board of Directors that has become entrenched in their position as Board members simply because no one else is interested in serving on the Board. When a Board does become entrenched it is almost never a good situation for the Association. As a result it is imperative that new Board members step into the role of decision-makers, even in those cases where serving on the Board is expected to be a time-consuming endeavor. The most successful homeowners associations tend to be ones that have a high degree of owner participation that results in a steady and deliberate turnover of the Board's membership.

All meetings held by the Association's Board of Directors are supposed to follow Robert's Rules of Order for conducting a public meeting. The laws of most states generally include rules regarding the reporting requirements for all meetings held by the Board of Directors. Most state statutes preclude the Association's Board of Directors from conducting any official business of the Association outside of the formal Board meeting environment. As a result, the meeting minutes can provide valuable insight into the governance, operations and management practices of the Association. Specifically, the meeting minutes provide a written summary of the business that was discussed at each Board meeting.

## **CIDA REPORT**

Depending on how detailed the meeting minutes are, the reader may learn a lot about the historical operation and decision-making practices of the Board of Directors, or they may learn very little.

Patterns of neglect or incompetence on the part of management and/or the Board of Directors are sometimes found when reviewing the meeting minutes. For the purposes of preparing a CIDA REPORT it is standard procedure to request the meeting minutes for the previous twelve months if the Board of Directors meets on a monthly basis. If the Board meets less than six times year CIDA may request the minutes from the twelve most recent board meetings.