

“RESERVING FOR THE FUTURE”

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Adequate reserve funding is critical to the long term health and welfare of any Association. A “capital reserve account” provides funds on an as needed basis to ensure the various improvements within the project are maintained, repaired and replaced at appropriate intervals as recommended by competent professionals. What happens if reserves are not kept up or prematurely depleted? The consequences are serious: the Board is forced to (1) levy a burdensome special assessment; (2) borrow the money; or (3) defer the work. Deferring the work should not be an option but too often is perceived as the expedient short term “political solution” usually adopted so as to avoid controversy or criticism from the membership.

Too often a newly elected Board discovers buried in the Association files or minutes a prior decision to put off necessary repair work, such as asphalt resurfacing, re-roofing or repair of a perimeter wall. While perhaps a popular “money saving” decision, it is short sighted and serves as the seed for long term financial problems for the Association. Specifically, the common area improvements or building components will continue to deteriorate and will eventually cost the Association which more to repair and/or replace than if dealt with in a proactive fashion. Perhaps equally important, the legal protections of the “Business Judgment Rule” will be of little value to the Board where the Board knowingly defers necessary maintenance and/or repair work because they do not want to be “unpopular” by raising assessments or spending money. While there are certainly many occasions where reasonable delay is necessary in order receive appropriate bids from licensed and insured contractors, this type of delay is related to the “process” of implementing the maintenance or repair as opposed to “deferring” the work itself.

The Politics of Spending Money: Board members often perceive themselves as political candidates who have expressly or impliedly promised to keep assessments from being raised and are reluctant to spend existing reserve funds for fear of being forced to raise assessments or go back on their “campaign promises.” Allowing these types of practical pressures to influence the Board’s decision is a mistake. The Board is in place to protect long term property values and preserve the value of the community. Failure to properly maintain the project will decrease the expected useful life of the common area improvements and lessen the value of the community. Additionally, deferring maintenance and repair work causes an inequitable concentration of costs associated with major repairs to be paid for by those owners in the project who happen to be members at the unfortunate time of the eventual complete repair and/or replacement of a particular building component. This “cost shifting” approach is contrary to the intent of the governing documents and the very purpose of the reserve fund. Left unchecked, potential buyers will be discouraged from buying and may be unable to obtain financing from institutional lenders. When this occurs, it is very likely the Board who knowingly deferred the maintenance and repairs will be forced to respond to well-founded allegations of breach of fiduciary duty and loyalty to the Association.

Anticipate and Avoid Common Pitfalls: Far too many Boards ignore the recommendations of reserve specialists or contractors. Recommendations are useless if not followed by the Board. Being pro-active in dealing with maintenance, repair and replacement issues is always preferred to procrastination. In the long term, all members of the Association will be grateful once they become aware of the cost savings associated with early intervention and proper maintenance. It is our firm’s experience that necessary increases in assessments (although unpopular at first) will pay dividends to the members in the form of a well maintained project which will hold its investment value and provide a return to the individual members if, and when, they decide to sell their home(s). Finally, maintaining the reserves will help avoid the inevitable “finger pointing” which results when a new Board eventually takes over and discovers the “deferred maintenance” has reached critical levels requiring substantial expenditures for which there are insufficient reserves - - requiring a substantial special assessment.

The Golden Rule of Reserves: Be efficient but mindful of the business realities of running an Association -- it costs money. Take a pro-active role in not only ordering and reviewing reserve studies, but ensuring that their recommendations are acted upon. Reserve study recommendations should be followed. If additional reserve funds are necessary, the Board must be willing to communicate to the membership why additional funds are necessary and raise assessments accordingly. This approach will help preserve long-term property values in the community and serve the best interest of all members in the Association.

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