Making the Case

The easy part is analyzing your reserve study and determining that you need to increase assessments.

The hard part is selling the increase to residents.

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By Chris Andrews, RS

IT'S THAT TIME again. You're thinking about next year's budget, and in your hands you have the latest reserve study, which recommends a sizeable increase in your association's reserve budget.

Your community isn't alone. In recent years, steep increases in materials and contractor costs have resulted in similarly hefty reserve-funding recommendations at many associations. Without raising assessments, your association simply won't be able to properly maintain its amenities, infrastructure, and other common assets.

Your board of directors reviews the study, and just about everyone agrees that the reserve fund needs more money—and that increasing monthly assessments is the fiscally responsible thing do to. But there's a holdout. One board member doesn't want to increase assessments. He says the board's job is to keep fees as low as possible, and thinks association residents won't agree to an increase. Now what do you do?

LAYING THE GROUNDWORK

Most associations are legally obligated by their CC&Rs to preserve, protect, and enhance their property. In some areas, state statutes impose even more explicit duties. California Civil Code Section 1366(a), for example, states that "the association shall levy regular and special assessments sufficient to perform its obligations under the governing documents and this title."

But sometimes the black-and-white logic of state laws is far removed from the politically sensitive dynamics of association governance. From past experience, you know that a planned monthly assessment increase will stir up resistance from at least a few vocal residents who don't like change of any sort, especially the type that requires them to spend more money. And what if one or two of these people are members of your board? All it takes is one discordant voice to sow dissent among a five-person board, and you'll have little chance of passing a reserve-funding increase.

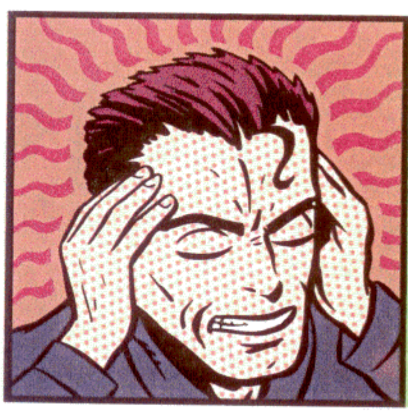
Your task then becomes convincing any dissenting board members that an increase is the right thing to do. Depending on the requirements imposed by your governing documents or state statutes, you also might need to convince a majority of your members. In California, for example, the Civil Code requires member approval if a proposed new assessment is 20 percent higher than the previous fiscal year's assessment, or if a proposed special assessment exceeds 5 percent of the budgeted gross assessments for the fiscal year. Given the fact that you may face community resistance as well as certain restrictions, how do you make your case effectively?

Be diplomatic. First, break the news gently. In these situations, association members are most receptive to hearing that assessments must be increased due to "factors out of our control" or "new information not available to us previously." For example, significant increases in worker's compensation insurance in recent years have led to dramatic hikes in roofing, painting, and paving contractors' prices. There is really no rational argument against these reasons.

Be diligent. Residents tend to be much less receptive to assessment increases resulting from board incompetence. The classic example is negligence that causes an expense to be much higher than it would have been if the board had been diligent in pursuing its duties—such as not painting trim and siding, leaving it prone to dry rot and warping, or failing to sealcoat asphalt frequently enough to prevent potholes.

Be thorough. Before you utter the words "assessment increase," build a strong case for the increase by mentioning some or all of the following—during meetings, in your newsletters, and on your website—as applicable:

- Insurance, labor, and other costs to maintain association property have increased significantly.
- Some new reserve expenses have become apparent since the last budget and the last reserve study were prepared. For example, you've detected some slab leaks, or identified several buildings that need to be fumigated for termites. It's almost always easier to tie an increase in funding to forthcoming capital-replacement projects that people can see for themselves are necessary.



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ILLUSTRATIONS BY PAUL GILLIGAN

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- The association never had a proper reserve study done before. Now that one has been prepared, you have a comprehensive inventory of capital assets—reserve components—with up-to-date replacement costs for each item.
- There have been many planned and unplanned reserve expenses in recent years. Compile an itemized list of these expenses, and show how they have exceeded your recent reserve income and depleted available reserves for future expenses.
- Your new reserve study indicates that in past years the association didn't set aside sufficient funds to repair or replace those items that would depreciate in value.
- If your reserves are noticeably underfunded, cite the fact that mortgage lenders view poorly funded associations as higher-risk—and that many of them review the reserve study before approving a loan. For reverse mortgages, for example, the Federal Housing Administration (FHA) requires that an association be at least 65-percent funded for capital-expense depreciation; the FHA actually prefers 80 percent or higher. (Depreciation is a representation in dollars of how much each asset—roofing, streets, and so on—is "used up" over a period of time.) Senior citizens who have applied for reverse mortgages have been all set for approval only to have a final review of their association's percent-funded status nix the deal.
- If the association doesn't maintain its property, real-estate values for each home are often adversely affected. Ironically, in a poorly maintained association, the net reduction in property values often far exceeds the amount of the proposed assessment increase.

After you've laid the groundwork, explain that a reserve-funding increase or special assessment is necessary. Once you've mentioned the amount of the increase to your members, that's when you're likely to hear some strong objections. But don't worry—logic and reason should prevail in the end.

OVERCOMING OBJECTIONS

One of the key lessons in sales-training courses is learning how to "overcome the objections" of potential customers to close a sale. The same philosophy applies to convincing your members of the need to increase assessments. The good news is, in these situations, the objections you hear usually have a few common themes. And if you know what people are going to say before they say it, you can respond more effectively. Here are some typical objections and how to overcome them:

"I can't afford the increase." Remind the person making this objection that the association is a business whose primary purpose is to maintain its common assets for the good of the homeowners in the community. It isn't fair for a handful of people claiming hardship to hold hostage the entire association and everyone's property values.

Although the association is usually governed by an all-volunteer board, it's not exactly a socialist organization. The cold reality is that you don't have the right to live in the association if you're no longer able to uphold your responsibility to share in the costs—as described in the governing documents to which everyone agreed during escrow. None of this is to say that when a member is going through a true hardship—a medical emergency or unexpected job layoff—you shouldn't be flexible and accommodating. But, that said, once your assessment increase or special assessment is passed, it's remarkable to see how resourceful people actually can be in spite of their claims of hardship.

"As a senior citizen, I won't be here in 15 years when the roof needs replacement or even in 10 years when the streets need repaving. Why should I have to pay for those costs now?" Seniors aren't the only ones who pose this question. Young people who consider their condominium a starter home and don't plan to live there for more than several years ask the same thing.

The problem with this "short-timer" logic is that all residents benefit from the use of the roofs, streets, pool, and so on while they're living in the association. If their roof is a 30-year roof and they live in the association for five years, the value of the benefit they derive during their stay is 5/30th—one sixth—the cost of the roof replacement. Thus, it is indeed fair that they pay for their incremental use of the common elements, even though they may not be living in the association in the future when the actual replacement occurs.

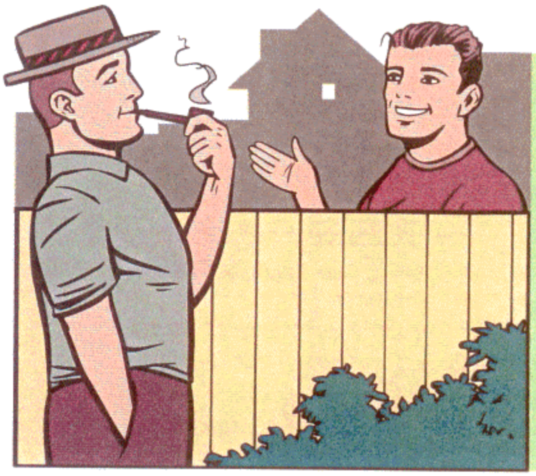
Similarly, you can remind new residents that they're currently enjoying capital improvements paid for by other members before they moved in. Another response to short-timers who hope to sell their units in the next few years is to tell them that their property values may increase significantly more than any additional money they pay in assessments—but only if the association is well-maintained via those increased assessments.

"Why don't we just special-assess for future capital expenditures like roofing, paving, etc.?" The primary drawback to using a special assessment to increase your reserve funding is that you may have trouble collecting the necessary money from every owner when large expenses occur. Suppose, for example, some owners can't cover a $10,000 special assessment when your association desperately needs a new roof. It's better to collect the money gradually every year, so your association has those funds when they're needed.

What's more, in the roofing example above, if the association doesn't have sufficient reserve funds to replace its mon areas and individual homes. Do you want a mold lawsuit? In the end, having to defer maintenance that you've already deferred is poor planning.

Another drawback of this funding method is that it unfairly penalizes those homeowners who happen to be living in the association at the time of the special assessment. Better to conduct and follow a proper reserve study, which, by calculating an annual funding amount, ensures that all residents pay equally for the depreciation that occurs while they live in the association.

"Our fees are already too high!" Determine the assessment rates of other associations in your area with similar amenities, and share this information with your members. They may be pleasantly surprised to find that other communities' assessments are considerably higher. (If that isn't the case, figure out why.) Then, explain again how the reserve study works, and show them the list of reserve components that the association is obligated to maintain. Ask the dissenting members—in a nice way—if they don't want to raise assessments to the appropriate level, which items in the reserve study do they want the association to



Ask the dissenting members—in a nice way—if they don't want to raise assessments to the appropriate level, which items in the reserve study do they want the association to **stop maintaining?**

roofing as soon as necessary, the eventual cost to do so may increase dramatically. While the board tiptoes through the drawn-out process of levying a special assessment, more roof leaks and costly interior damage—followed by dry rot and mold—may occur to your com-

stop maintaining?

If they persist, get specific. Say, for example, that the proposed reserve-funding increase to which they object is $10,000 per year more than last year. Ask them to find a $10,000-per-year item in the reserve component list—or a $100,000 item that occurs every 10 years—that they deem to be "non-essential." For example, do they really want to vote to drain the pool, fill it with dirt, and plant flowers there? If so, would they mind if you documented them in the minutes as having taken that position?

"I can get a higher investment yield on my money than the association can, so why should I put more of my money into the association's reserve account when it only earns a CD rate of return?" Ask the people making this objection if they anticipate selling their unit at some point in the next few years, before a major reserve expense such as roofing. If so, do they plan on writing a check to the association's reserve fund to cover the depreciation of all the common elements that occurred during their tenure? Or, like many people, do they secretly hope to avoid having to pay for those large expenses altogether?

The problem with the "I can get a better return somewhere else" argument is that there is no guarantee that the people who pose it will in fact own their unit in the future when those reserve funds are needed. If they're so confident that they can get a better investment yield on their money, would they be willing to enter into a contract with the association to repay the sum total of the reserve assessments they didn't have to pay—with compound interest at CD rates—when

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they sell their unit in the future?

Unfortuanately, because the escrow process doesn't have a built-in mechanism requiring sellers to pay for the depreciation that has occurred during their tenure, people are often able to sell their units and avoid paying for deferred common-area maintenance, while new owners are burdened with those expenses.

IF ALL ELSE FAILS...

If none of these points manages to overcome the objections you hear, it might be time to escalate the debate while remaining civil and fair.

Appeal to duty. If the objections come from board members, inform them that their fiduciary duty obligates them to do what's best for the association—and that there may be penalties for *not* doing so. In California, for example, a case called *Raven's Cove Townhomes* v. *Knuppe Development* held that board members can be individually liable for failing to properly fund a maintenance-reserve account. (For more information about this case, visit http://davis-stirling.com/ds/cases/ravenscove.htm.) You can also convince dissenting board members to accept full responsibility for their actions by reminding them that their vote against prudent reserve funding will be documented in the minutes.

Exercise your authority. If your board is in agreement on the assessment increase, but several residents oppose it vehemently, inform them that board members have been elected to act as fiduciaries on behalf of the association and will do what they deem is in its best interest. Depending on the wording of your CC&Rs, members may have the right to force the board to call a special meeting to discuss the issue. They may even try to force a membership-wide vote on the increase, but most CC&Rs give a board the ultimate say in whether to bring an issue to the membership for vote—unless, of course, the proposed increase exceeds the board's authorized amount. In other words, unless you have to put the increase to a general vote, members often don't have much say in the matter.

Document everything. If the board agrees to a member vote and the increase is rejected, then it's the membership, rather than the board, that may be seen as complicit in underfunding your reserves. To protect yourself and your fiscally prudent allies, keep a tally of everyone who voted for and against the proposal, and document that in your minutes.

Launch a campaign. Get as many members' e-mail addresses as you can, and use them to campaign for the assessment increase. Send equivalent copies through the postal mail to those members who don't have e-mail, so everyone has equal access to the information. After some rigorous lobbying, some members who had opposed the increase will capitulate, and you'll have won more votes. Or, they'll become even more entrenched, at which point you must realize that you'll never convince them. Conserve your energy, and focus your efforts on the remaining rational individuals. In the end, persistence coupled with logic and reason should prevail.

Some of this may seem like playing hardball against the opposition, but remember—the opposition is playing hardball against the association's duty to maintain its property. **cg**

AT-A-GLANCE

Your reserve study says you need to boost assessments. How do you get everyone to go along?

LAYING THE GROUNDWORK. To convince dissenting board members and residents that an assessment increase is in order, you need to be diplomatic, diligent, and thorough.

OVERCOMING OBJECTIONS. Most objections to a proposed increase will fall along predictable lines, including "I can't afford the increase" and "Our fees are already too high!"

IF ALL ELSE FAILS... If people still object, bring out the big guns—fiduciary duty, board authority, and active campaigning.

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RESOURCES: *BEST PRACTICES REPORT #1: RESERVE STUDIES/MANAGEMENT.* AVAILABLE FREE FROM CAI'S FOUNDATION FOR COMMUNITY ASSOCIATION RESEARCH, AT WWW.CAIRF.ORG/RESEARCH/BPRS.PDF.

RESERVE FUNDS: HOW AND WHY COMMUNITY ASSOCIATIONS INVEST ASSETS (A GUIDE FOR ASSOCIATION PRACTITIONERS), BY MITCHELL H. FRUMKIN, PE, PP, MBA, RS, AND NICO F. MARCH, CFM. RETAIL: $25. CAI MEMBERS: $15.

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