

The Full Cost of Self Management

The number one reason homeowner associations self manage is they think they are saving money. But this myopic attitude often leads to higher costs, avoidable problems and unnecessary headaches over time. Although an Association may save \$15 - \$30 a month per unit in management fees, the benefits provided by a professional management company can outweigh the cost of monthly fees. All too often, we find a consistent pattern of problems with self-managed properties in the following areas:

1. Financial/bookkeeping/reserves
2. Maintenance
3. Administrative/Board
4. Governance/Legal

Financial/bookkeeping/reserves:

Financial recording and reporting is a large responsibility for an association. It is not as simple as collecting dues and paying the bills. There are state statutes that the association needs to follow. RCW 64.34.425 requires that the financials included in a resale have to be reported in an accrued format. RCW 64.34.372 further defines how the funds are to be kept and the requirements for both having an audit, and in the case of associations under 50 units, the statute provides the methodology for waiving an audit.

Association funds need to be segregated. Persons charged with the custody of funds may not commingle them with funds which do not belong to the association. Reserve funds must be kept in a separate account and must be disbursed on the signature of two officers or directors of the association. Without the proper education and training, it is easy for the association to find themselves in a situation where they are not following state law and may place the association in a position to be sued for mismanagement.

The reserve fund for future repair or replacement for common elements is another area where self manage boards might struggle. It is very easy to fall into the trap of thinking that putting money away each month for reserves raises the dues. Some boards feel that future owners can pay for a component when it needs to be replaced.

A professional reserve study is a must that acts as a continuous 'blueprint' for the future. Board members change and future Board members may not understand the logic or reasons that prior decisions were made based on internally conducted reserve studies. A professional Reserve Study firm will be available to discuss the reserve study, the methodology used, and considerations that went into the analysis years after the reserve study was conducted. Consistency is another benefit of having a professional reserve study conducted. A professional reserve study will also reduce claims of financial mismanagement because the Board sought out the advice of independent reserve study experts. Demonstrating sound fiscal management to the owners with a professional reserve study will provide the owners with a high comfort level that their investment in their property is being managed properly.

Maintenance/Administrative:

A high percentage of self-managed properties do not have a maintenance plan for operating maintenance and a reserve study for future projects. This often leads to deferred maintenance. Deferred maintenance often leads to more expensive maintenance over time. Some actual examples I've experienced are extending the recommended maintenance cycles such as painting the buildings every 12 years vs. the recommended 7 years, never top coating decks to keep them waterproofed, and not sealing the asphalt on a regular cycle. Deferred maintenance usually leads to higher maintenance cost in the long run. Replacing siding that is cracked and warped, replacing decks that are rotted, and overlaying the parking lot eventually costs more money to the owners. I also find these decisions by the Board or homeowners are partially based on lack of knowledge and money. Underfunded reserves and lack of experience are the culprits in deferred maintenance.

I have found in addition to deferred maintenance that often the maintenance that is done is completed by incompetent contractors or contractors that do not care and are only in it for the money. I have seen this happen on flat roofs that don't last more than 5 years because the work was done so poorly that the leaking resurfaces again. If the Board would have sought out outside help to put together the specifications and monitor the work, the cost of the owners would be far less than dealing with leaky roofs, interior repairs, and eventually replacing the roofs again. I know of a board that hired a contractor to remove carpet and resurfaced the walkways with a rubberized waterproof membrane. The walkways were not sloped right, the seams were not tapped, and the coating had clumps of material on it. It looked terrible and the end result was puddles of water in the walkways. The association was forced to live with it or do the work over again. Right now they are living with it. These properties don't have an extensive vendor list that they can rely on for competent, honest, and competitive contractors. Self-managed properties will often perform the work themselves (work parties) to save money. This can lead to using the wrong products or failing to meet building codes. An example of this is a property replacing rails on elevated walkways (3 stories) high. They were removed and replaced by the on-site manager. The spacing between the slats was too wide, the wrong top cap was used, and they used substandard screws and material to attach the rails to the building supports. I could literally break the rails by kicking them. Talk about a future liability claim. The end result was taking the rails down and hiring a contractor to build new rails that met code. They also look a lot better.

Not all problems are related to maintenance and money. Often self-managed properties require a few key individuals to step forward to deal with the day to day administrative business. Who do the owners call to report a problem, who handles emergencies during the day and in the middle of the night, who fills out lender forms and responds to escrow payoff figures? Do they outsource the bookkeeping or keep it in house? These are the same people that usually end up enforcing the house rules and get ugly stares and a cold

shoulder from the violators. What happens if these people move or stop doing these things, who steps in to do it?

Governance/Legal

This next section covers potential legal pitfalls, and as much as one may desire to gloss over this segment because it is written by an attorney, the following sentence should keep the reader's attention: An association board or individual board member may be held legally liable for failure to follow Washington statutes or to act in good faith based upon a reasonable basis.¹ Self-managed homeowner association board members often do not have the background, training or experience to recognize potential legal hazards; nevertheless, to act in strict compliance with specific statutes or general laws. All too often, an association board may act in good faith, but in contravention of one or more laws or standards. Unfortunately, determination of whether that action or omission was reasonable is sometimes left for a jury to decide. Common missteps involve an association board that asserts itself into the unit rental process, neglects to properly file governing documents and amendments, fails to file annual corporate or renewal documents or neglects to follow Washington's corporate legal governance requirements.

In Washington, community associations are created by a developer ("declarant" for condominium associations) who drafts and files original corporate and governance documents. The developer retains control of the association until turnover to the owners, which takes place many months or years later. Accordingly, a homeowner association has absolutely no input into creation of its corporation or preparation of its governing documents. Though declarants ordinarily are experienced and sophisticated entities, sometimes issues slip through the cracks or governing documents are written in such a manner as to limit an association's ability to conduct business and preserve the property. A self-managed association board often lacks experience to identify these potential dangers. The situation is not unlike new parents who are escorted to the hospital parking lot by hospital staff with a newborn baby in their arms. The parents are given a blanket, bottle and basic care instructions, but after a day or two of the hospital attending to every need, the parents are now alone and independently need to care for the child. First-time parents usually rely on a network of family and friends to assist them on the first years of the newborn's life. The same holds true for homeowner association boards trying to avoid "ER" or 911 calls. Well qualified property managers are the experts to whom a board can rely upon to appropriately and reasonably help manage a homeowner association.

Other than the specific missteps noted above, other examples of self-managed association pitfalls include imposing improper limitations on satellite TV dishes (in violation of the Federal Telecommunications Act), denial of certain rental leases (in violation of the Fair Housing Act), failure to properly follow corporate governance (in violation of the Washington Nonprofit Corporation Act), failure to respond properly to homeowner disputes (in violation of ordinary and reasonable care) and failure to update and provide resale certificates (in violation of the Washington Condominium Act), to

¹ There is a common misperception that a condominium association board other than a board run by a declarant has a fiduciary duty to its homeowner members. This is not accurate. The proper duty is defined as "ordinary and reasonable care," as codified in RCW 64.34.308(1).

name but a few. In order to avoid unnecessary risks, an association board may wish to explore the ordinary and reasonable step of hiring an experienced association management company to help guide them through the sometimes precarious, yet always eventful, experience of community association governance and management.

Kevin Ducotey, CMCA, AMS is the Director of Condominium Management, a management firm serving clients in the greater Puget Sound area.

Sherrie Moore, CMCA, AMS is the founder of Compass Management, a management firm serving clients in the greater Puget Sound area.

Daniel Zimberoff is a Shareholder of Barker Martin, P.S., a law firm with offices in Seattle and Portland that limits its practice to construction defect and homeowner association representation.