

Hat Island Reserves

October 2014

The purpose of this edition of FAQs is to discuss the Hat Island Community (HIC) Reserves through September 2014. Please send additional questions to HICFAQs@gmail.com.

IMPORTANT: Please remember that the FC makes recommendations to the Board, but we DO NOT SET POLICY! Our goal is to hash through possibilities, weigh the pros and cons of each, and present what we think are the best alternatives for Board consideration. The ideas communicated from the FC are not approved as statements of fact until the Board makes its final decisions and/or revenue and expenses are realized. For example, HIC and the Board make decisions on funding sources and how they will be applied to Marina loan principal and interest.

Summary: The following FAQ is much more technical than usual. In fact, we've even included state law verbatim at the end of the FAQ for your reading enjoyment! However, we think it's important for everyone to have equal access to this information. Here is a general summary of the detail provided below:

1. The FC believes our capital reserves are significantly underfunded and clearly not adequate for our future needs.
2. State law now requires HOAs to obtain periodic capital reserve studies from independent valuation experts, unless certain exceptions are met.
3. HIC does not meet these exceptions.
4. HIC has not obtained an independent study, at least in recent memory. We are currently relying on an internal study that was done several years ago and updated annually.
5. The FC plans to include the cost of obtaining such a study in the proposed 2015 budget.
6. The FC is currently looking at known capital expenditures required in 2015 and will incorporate those expenses in the proposed budget in some way, shape or form!
7. Current timing calls for presenting the proposed budget to the Board in early November. Stay tuned for exact date.

FAQ #1: What is the current status of our reserves as of September 2014?

The September 30, 2014 Month End Financials state reserve balances as follows: (nine months into the year, based on unaudited financial records)

	<u>Sept 2014</u>	<u>Sept 2013</u>	<u>Change</u>
Cash Reserve	\$55,635.35	\$129,883.00	(\$74,247.65)
Insurance reserves	22,172.03	43,543.72	(21,371.69)
Capital Reserve	29,841.82	116,297.10	(86,455.28)
RO Water System money markets	3,244.15	57,187.45	(53,943.30)
Div H Slide Clean-up & Prevention	<u>43,575.94</u>	<u>0</u>	<u>43,575.94</u>
	\$154,469.29	\$346,911.27	(\$192,441.98)

FAQ 2: What is the difference between each Reserve Account?

The Financial Statements present five types of reserves. They are split between unrestricted, but designated cash reserves and those restricted by law:

Unrestricted Reserves

Cash Reserves – A buffer of three months operating cash held in reserve by policy for emergencies.

Insurance Reserves – A sinking fund used to pay the insurance which is due once a year.

Restricted Capital Reserves – (RCW 64.38.075 requirements)

Capital Reserves – Savings for forecasted infrequent and significant major maintenance, repair, and replacement costs.

Water System Capital Reserves – Capital Reserves for our reverse osmosis plant and water system.

Division H Road Capital Reserves – Capital Reserves for H Division Road.

FAQ 3: What is the Capital Reserve Study and why do we need it?

Capital reserves are for major maintenance, repair, and replacement costs. Steady reserve contributions smooth out property owner payments over time which helps avoid anxiety associated with special assessments.

Per RCW 64.38.065, unless doing so would impose an unreasonable hardship, an association with significant assets shall prepare and update a reserve study based upon a visual site inspection conducted by a reserve study professional every three years with updates annually. Hat Island does not qualify for any of the hardship exemptions under RCW 64.38.090.

A reserve study is supplemental to the association's operating and maintenance budget. In preparing a reserve study, the association shall estimate the anticipated major maintenance, repair, and replacement costs, whose infrequent and significant nature make them impractical to be included in an annual budget.

In the past, we performed our own reserve study based on the manager's proposal and review by the Finance Committee. The long term needs have not always been funded at the levels required by the new state law.

Being prepared through savings and reserves is a large part of the budgeting process. The best overall advice on budgeting? Cagianut & Company, CPA <http://hoacpa.com/assets/budgets-faq-03.html> is a local CPA firm active in community associations with invaluable online resources. They list four basic budgeting goals in their advice:

1. To protect, maintain, and enhance the value of the Association.
2. To determine and maintain a particular standard of living and/or lifestyle
3. To encourage a sense of community.
4. To use the least amount of resources to obtain maximum benefits.

FAQ 4: What is required in a reserve study?

The FC is on track to present the proposed 2015 budget to the Board at the November meeting.

A reserve study must include a component list for major maintenance, repair, or replacement that would cost more than one percent of the annual budget of the association, not including the reserve account. The study must also include estimates for the total and remaining useful life of each reserve component and cost estimates for current major maintenance, repair, or replacement for each reserve component;

The study must be dated, include a statement that the study meets the requirements of RCW 64.38, state the association's reserve account balance, the percentage funded, the status of special assessments, and discuss interest and inflation assumptions. A statement must be included on whether the reserve study was prepared with the assistance of a reserve study professional. A reserve study professional is certified by the Community Associations Institute. www.cai.com

The study must state the current and recommended contribution rates to achieve a full funding plan and baseline funding plan along with the recommended contribution rate from the reserve study professional. It includes a projected reserve account balance for thirty years and a funding plan to pay for projected costs from that reserve account balance without reliance on future unplanned special assessments.

FAQ 5: What is the current projection for funding the 2015 Capital Reserve?

The Capital Reserve balance is depleted and needs to be replenished.

Our recommendation for Capital Reserves is:

We recommend a 2015 contribution of \$140,000. We need a Capital Reserve balance of at least \$150,000 to meet our minimum future needs. This assumes we return to traditional contribution levels of \$80,000 per year next year and continue to increase this contribution for inflation. The current Capital Reserve balance is under \$30,000 and may still be committed to ferry repairs. We do not yet know if we will receive any insurance reimbursement for recent ferry repairs.

FAQ 6: What happens when we need to spend Capital Reserves?

The Board votes to approve expenditures of reserves on qualifying expenditures and unrelated expenditures. Unrelated withdrawals require written notice to owners and a 24 month repayment plan per RCW 64.38.075.

Reserves are expressly reserved for maintenance, repair, or replacement of specific assets, called reserve components, which are identified by the reserve study. Any use of reserve funds for anything other than designated reserve components must meet additional requirements.

An association may withdraw funds from its reserve account to pay for unforeseen or unbudgeted costs that are unrelated to maintenance, repair, or replacement of the reserve components. The board of directors shall record any such withdrawal in the board minutes, notify each owner of any such withdrawal by hand delivery or by first-class United States mail, and adopt a repayment schedule not to exceed twenty-four months unless it determines that repayment within twenty-four months would impose an unreasonable burden on the owners.

FAQ 7: What if we don't want all that money sitting in the bank?

The purpose is to save in advance of our needs to smooth out major expenses and avoid special assessments and fluctuations in general assessment amounts.

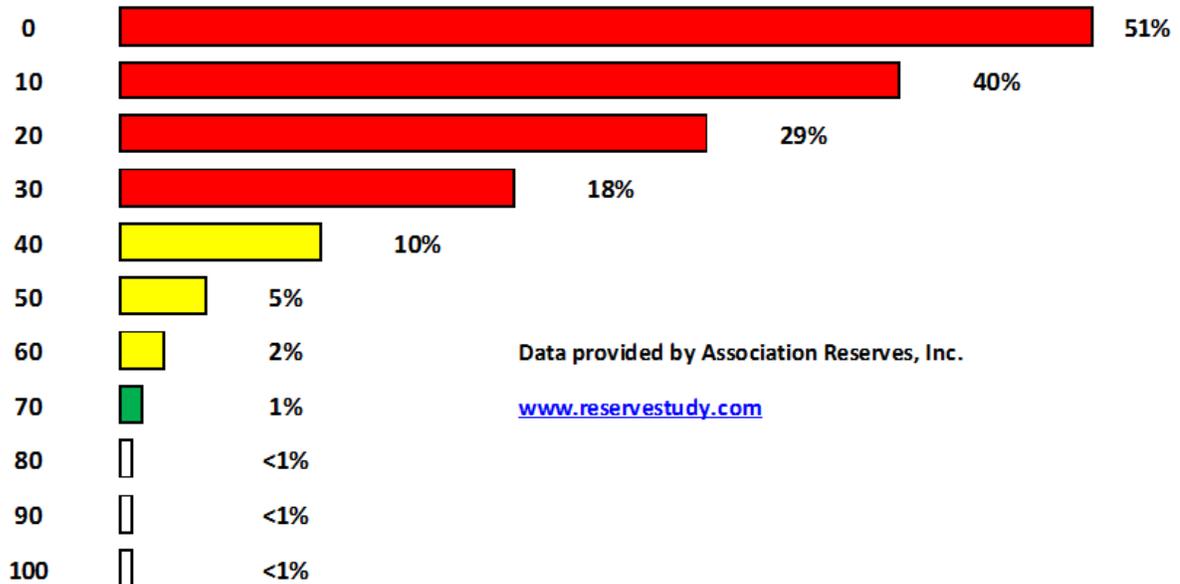
The money in the bank is what keeps the island from being surprised by large bills. It is evidence of planning and the savings are earmarked for major reserve component maintenance, repair, or replacement. Transferring this money to another objective only robs Peter to pay Paul since the future reserve obligation remains. The reserves are protected from diversion. Also, the funds can be invested, but not in a manner that places the principle at risk.

Association Reserves, Inc. (www.reservestudy.com) identified a strong link between special assessments and law suits. Community Associations with few special assessments have almost no litigation. Community Associations that wait to react to their needs have a 51% chance of litigation. Save consistently or pay the lawyers. It's your choice.

Some Statistics

Risk of a Special Assessment

% Funded



Data provided by Association Reserves, Inc.

www.reservestudy.com

FAQ 8: How do I get my questions to you so they can be addressed in future editions of the FAQs?

Please send your inquiries to HICFAQs@gmail.com, and be sure to tell us how to contact you if we don't understand your question. Please do NOT send any FAQ requests to any of our personal or business e-mail addresses.

State Law discussed above:

RCW 64.38.025

Home Owners Associations:

(4) As part of the summary of the budget provided to all owners, the board of directors shall disclose to the owners:

(a) The current amount of regular assessments budgeted for contribution to the reserve account, the recommended contribution rate from the reserve study, and the funding plan upon which the recommended contribution rate is based;

(b) If additional regular or special assessments are scheduled to be imposed, the date the assessments are due, the amount of the assessments per each owner per month or year, and the purpose of the assessments;

(c) Based upon the most recent reserve study and other information, whether currently projected reserve account balances will be sufficient at the end of each year to meet the association's obligation for major maintenance, repair, or replacement of reserve components during the next thirty years;

(d) If reserve account balances are not projected to be sufficient, what additional assessments may be necessary to ensure that sufficient reserve account funds will be available each year during the next thirty years, the approximate dates assessments may be due, and the amount of the assessments per owner per month or year;

(e) The estimated amount recommended in the reserve account at the end of the current fiscal year based on the most recent reserve study, the projected reserve account cash balance at the end of the current fiscal year, and the percent funded at the date of the latest reserve study;

(f) The estimated amount recommended in the reserve account based upon the most recent reserve study at the end of each of the next five budget years, the projected reserve account cash balance in each of those years, and the projected percent funded for each of those years; and

(g) If the funding plan approved by the association is implemented, the projected reserve account cash balance in each of the next five budget years and the percent funded for each of those years.

**RCW 64.38.065,
Reserve account and study.**

(2) Unless doing so would impose an unreasonable hardship, an association with significant assets shall prepare and update a reserve study, in accordance with the association's governing documents and this chapter. The initial reserve study must be based upon a visual site inspection conducted by a reserve study professional.

(3) Unless doing so would impose an unreasonable hardship, the association shall update the reserve study annually. At least every three years, an updated reserve study must be prepared and based upon a visual site inspection conducted by a reserve study professional.

(4) The decisions relating to the preparation and updating of a reserve study must be made by the board of directors in the exercise of the reasonable discretion of the board. The decisions must include whether a reserve study will be prepared or updated, and whether the assistance of a reserve study professional will be utilized.

**64.38.070
Reserve study — Requirements.**

(1) A reserve study as described in RCW 64.38.065 is supplemental to the association's operating and maintenance budget. In preparing a reserve study, the association shall estimate the anticipated major maintenance, repair, and replacement costs, whose infrequent and significant nature make them impractical to be included in an annual budget.

(2) A reserve study must include:

(a) A reserve component list, including any reserve component that would cost more than one percent of the annual budget of the association, not including the reserve account, for major maintenance, repair, or replacement. If one of these reserve components is not included in the reserve study, the study should provide commentary explaining the basis for its exclusion. The study must also include quantities and estimates for the useful life of each reserve component, remaining useful life of each reserve component, and current major maintenance, repair, or replacement cost for each reserve component;

(b) The date of the study, and a statement that the study meets the requirements of this section;

(c) The following level of reserve study performed:

(i) Level I: Full reserve study funding analysis and plan;

(ii) Level II: Update with visual site inspection; or

(iii) Level III: Update with no visual site inspection;

(d) The association's reserve account balance;

(e) The percentage of the fully funded balance that the reserve account is funded;

(f) Special assessments already implemented or planned;

(g) Interest and inflation assumptions;

(h) Current reserve account contribution rates for a full funding plan and baseline funding plan;

(i) A recommended reserve account contribution rate, a contribution rate for a full funding plan to achieve one hundred percent fully funded reserves by the end of the thirty-year study period, a baseline funding plan to maintain the reserve balance above zero throughout the thirty-year study period without special assessments, and a contribution rate recommended by the reserve study professional;

(j) A projected reserve account balance for thirty years and a funding plan to pay for projected costs from that reserve account balance without reliance on future unplanned special assessments; and

(k) A statement on whether the reserve study was prepared with the assistance of a reserve study professional.

(3) A reserve study must also include the following disclosure: "This reserve study should be reviewed carefully. It may not include all common and limited common element components that will require major maintenance, repair, or replacement in future years, and may not include regular contributions to a reserve account for the cost of such maintenance, repair, or replacement. The failure to include a component in a reserve study, or to provide contributions to a reserve account for a component, may, under some circumstances, require you to pay on demand as a special assessment your share of common expenses for the cost of major maintenance, repair, or replacement of a reserve component."

RCW 64.38.075

Reserve account — Withdrawals.

An association may withdraw funds from its reserve account to pay for unforeseen or unbudgeted costs that are unrelated to maintenance, repair, or replacement of the reserve components. The board of directors shall record any such withdrawal in the minute books of the association, cause notice of any such withdrawal to be hand delivered or sent prepaid by first-class United States mail to the mailing address of each owner or to any other mailing address designated in writing by the owner, and adopt a repayment schedule not to exceed twenty-four months unless it determines that repayment within twenty-four months would impose an unreasonable burden on the owners. Payment for major maintenance, repair, or replacement of the reserve components out of cycle with the reserve study projections or not included in the reserve study may be made from the reserve account without meeting the notification or repayment requirements under this section.

64.38.090

Reserve study — Exemptions.

An association is not required to follow the reserve study requirements under RCW 64.38.025 and RCW 64.38.065 through 64.38.085 if the cost of the reserve study exceeds five percent of the association's annual budget, the association does not have significant assets, or there are ten or fewer homes in the association.