

HOUSE BILL REPORT

HB 2541

As Reported by House Committee On:
Judiciary

Title: An act relating to reserve accounts and studies for condominium associations.

Brief Description: Concerning reserve accounts and studies for condominium associations.

Sponsors: Representatives Kelley, McCune, Springer, Williams, Miloscia and Campbell.

Brief History:

Committee Activity:

Judiciary: 1/22/08, 2/4/08 [DPS].

Brief Summary of Substitute Bill

- Requires a residential condominium association, unless doing so would impose an unreasonable hardship, to (1) prepare an initial reserve study based upon a visual site inspection conducted by a reserve study professional; (2) update the study annually; and (3) arrange for a visual site inspection every three years by a reserve study professional.
- Encourages, but does not require, a residential condominium association to establish a reserve account, supplemental to the association's annual operating budget, to fund major maintenance, repair, and replacement of common elements.
- Requires a condominium public offering statement or resale certificate to include (1) a copy of the current reserve study, or (2) a disclosure to the potential buyer stating that the association does not have a reserve study.

HOUSE COMMITTEE ON JUDICIARY

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 11 members: Representatives Lantz, Chair; Goodman, Vice Chair; Rodne, Ranking Minority Member; Warnick, Assistant Ranking Minority Member; Ahern, Flannigan, Kirby, Moeller, Pedersen, Ross and Williams.

Staff: Lara Zarowsky (786-7123).

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Background:

The Condominium Act governs the management of all residential condominiums built in Washington after July 1, 1990. The Horizontal Property Regimes Act governs those built before July 1, 1990. Neither statute requires condominium associations (associations) to maintain particular levels of funding to pay for repairs or replacement of common elements.

Associations must prepare an annual financial statement, using standard accounting procedures, which may include cost projections for future costs related to common elements. Associations have the authority to adopt and amend annual budgets, and to impose assessments on unit owners. Governing documents may include a provision requiring the association to maintain adequate reserves. Condominium resale certificates must contain a statement of the amount of any reserves for repair and replacement and the portion of those reserves currently designated for any specific project.

A **reserve account** consists of funds contributed by condominium owners, supplemental to the association's annual operating budget, which are used to fund major maintenance, repair, and replacement of common elements that will be required in the next 20 to 30 years. Examples of common elements include a condominium's lobby, roof, parking lot, recreational areas, roads, and sidewalks. The purpose of the reserve account is to offset the financial burden of necessary future renovations that, in the absence of a reserve account, would require the owners to incur a substantial special assessment.

A **reserve study** identifies the major maintenance, repair, and replacement expenses that an association will incur over time that are not practical to include in an annual budget. The purpose of a reserve study is not to inspect for defects, but to evaluate the expected cost of future repair and maintenance of common elements

A reserve study is performed by a **reserve study professional**, an independent person suitably qualified by knowledge, skill, experience, training or education to prepare a reserve study.

A **reserve disclosure** is a statement on a unit's resale certificate or public offering statement indicating that the association lacks a reserve study, which may pose certain risks to the purchaser.

Summary of Substitute Bill:

Authorizes and requires associations to conduct an initial reserve study by a reserve study professional, updated annually with a visual site inspection every three years, unless doing so would impose an unreasonable hardship.

Requires a reserve study to include:

- a reserve component list;
- the date of the study;
- the level of study performed;
- the balance of the association's reserve account balance;

- the percentage of the fully funded balance that the reserve account is funded;
- special assessments already implemented or planned;
- interest and inflation assumptions;
- current and recommended reserve account contribution rates; and
- the projected reserve account balance for a minimum of 30 years, and a funding plan to pay for projected expenses without reliance on future unplanned special assessments.

Authorizes and encourages associations to establish reserve accounts independent of the association's annual operating budget, administered by the board of directors, to fund the maintenance, repair, and replacement of common elements.

Bars the award of monetary damages or any other liability against the association, the officers, or board of directors, or those who may have provided advice or assistance to the association for failure to: (1) establish a reserve account, (2) have a reserve study prepared or updated, or (3) make reserve disclosures.

Requires a copy of the current reserve study, or disclosure if the association does not have a reserve study, to be included in the public offering statement or resale certificate.

Defines: contribution rate; fully funded balance; replacement cost; reserve component; reserve study professional; and useful life.

Substitute Bill Compared to Original Bill:

The legislative findings section is removed from the substitute bill. The term "expense" is replaced by the word "cost" throughout the bill. Definitions for "replacement cost" (formerly "replacement expense"), "contribution rate," "useful life," and "fully funded balance" are reworded for clarification. Provides that the purpose of a reserve account is to fund components in need of repair or replacement within 30 years.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date of Substitute Bill: The bill takes effect 90 days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony:

(In support) The purpose of this legislation is to avoid surprise. A person moving into a condo may budget for monthly expenses and know just what they can afford, and then get hit with a huge special assessment that the association wasn't prepared for.

Reserve legislation already exists in some states including California and Oregon. Fifty percent of all condos are subject to some kind of reserve study legislation. An increasing number of communities are torn apart due to foreclosures or incomplete sales. Owners find out too late that there are urgent capital expenses with no savings. Reserve study

professionals first evaluate what the association should be reserving for, e.g. lobbies, roofing, elevators, pools, tennis courts - things that by themselves would kill the operational budget and force the association into a special assessment. Second, the association's current reserve fund is evaluated. Third, the amount that should be set aside is identified.

Typical reserve contributions range from 10 - 40 percent of an association's annual budget. The budget of an association should be evaluated annually. The cost of a reserve study in Washington averages just under \$2,500, close to one percent of the average association's operating budget. In California, they average \$1,500, because it is a more mature market and most studies done every year are updates (rather than initial reserve studies). There is an inverse relationship between the strength of a reserve fund and the likelihood of a special assessment. Reserve statements are about disclosure, allow market forces to work, and units with a reserve account will command a stronger selling price because potential buyers will know they won't be hit with a special assessment.

Reserve studies prevent future financial hardship and should be encouraged. A reserve study is a plan for protection of capital assets over time. Senior communities include many people on fixed budgets who need adequate planning to avoid special assessments. An outside consultant gives the assessment credibility, has access to the expertise of the vendors, and may have computer programs that make estimated costs readily available and easily updated.

(Opposed) None.

Persons Testifying: Representative Kelley, prime sponsor; Brian McLean and Robert Narlund, Community Association Institute; Kris Gyllameti, Community Association Banc; Janet Richardson, Jubelee Community Association; and Marilyn Lewis, Willow Creek Owner's Association.

Persons Signed In To Testify But Not Testifying: None.