

S H E L T O N L E E



HOW TO SELF MANAGE YOUR HOA

*10 Simple Secrets to Transform
Your Community Association*



How To Self Manage Your HOA

10 Simple Secrets to Transform Your Community Association

Shelton Lee

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First Edition

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Table of Contents

[Foreword](#)

[HOA Board of Director's Best Practices](#)

[Section One](#)

[Secret # 1](#) — Hire the Right Type of Attorney

[Secret # 2](#) — How our HOA CC&Rs Take You from “Weak and Powerless... to Being able to Dissolve Tall Arguments in a Single Bound!”

[Section Two](#)

[Secret # 3](#) — A/R Management or “How to reduce high Account Receivables... and keep them that way”

[Secret # 4](#) — Lockbox Services or “How to receive funds instantly and accurately with the highest security.”

[Section Three](#)

[Secret # 5](#) — Your Local Banking Relationship

[Secret # 6](#) — Have a Bookkeeper – And a CPA

[Section Four](#)

[Secret # 7](#) — Insurance is the Board's Safety Net – and its Armor.

[Secret # 8](#) — Reserve Study – How Planning Helps Assure a Bright Future.

[Section Five](#)

[Secret # 9](#) — Association Website or “The World's Window into Your Association”.

[Secret # 10](#) — Making sure Members can Reach You – Without Giving Out Your Personal Information.

Foreword

Shelton Lee is a man of unusual fiber. On April 19, 1995 Timothy McVeigh parked his bomb laden truck right in Shelton's usual UPS truck parking spot in front of the Murrah Federal Building in Oklahoma City. "That was the day I lost 168 of my closest friends" Shelton recalls. An argument with his boss having been the grace saving Shelton from being there on time that day.

But Shelton would never tell you about that day. That's not his style.

Rarely do you see care and compassion ignite a soul to so freely put oneself on the line in service to their Community, as you do in Shelton Lee.

Mr. Lee is a client on mine, and though we've never actually met, we've spent countless time on the phone over the years. I'm in awe of his ability to patiently listen to, and then bring to a point of reason, even the most cantankerous of community members. I've come to recognize and respect a certain 'statesmanship' quality in Mr. Lee, a quality one rarely witnesses today. It's an attribute of heart which can only be borne of years of overcoming personal frustrations... in order to better serve, the needs of others.

I consider Shelton Lee an American Hero. The quiet kind you never hear about. The kind who has assayed a quality of grace... somehow woven into the heart of a lion. That... is Shelton Lee.

I suggest you listen to him.

Richard Slater

National Marketing Director

RecoverHoaDues.com

Hello. My name is Shelton Lee.

As a homeowner I was kicked out of my first HOA Board meeting. At the following meeting, I was greeted by a police officer who barred me from entering. Today, I'm Treasurer of that same Board.

My crime at that first meeting had been to first ask the Board, and then demand to know, when the HOA's financials had last been audited. After getting kicked out and barred, I knew there was only one thing to do. I ran for a seat on the Board and won. After getting on the Board we audited the last two years of HOA financials and discovered that \$40,800 was not accounted for. *In two years.* Our HOA management company at the time had been managing us for eight years. When pressed, the company coughed up some different numbers that made them look slightly better – but it was clear that the HOA would never be able to account for several tens of thousands of dollars.

I knew I never wanted this to happen again. But in the beginning, I was lost. I thought "I don't even know what I don't know... How do I start...? Where do I begin...?" I was so confused and uncertain that I couldn't look my family and neighbors in the eye, thinking I might let them down.

In my seven years on the Board since, I've learned a lot. In addition to the routine complaints and disputes with our homeowners, I've had to deal with unscrupulous property managers, bribe offers from vendors, and self-interested bankers and lawyers who weren't necessarily protecting the interests of our HOA. I've had to learn how to discern quality vendors, how to protect our board and community, and how to assess and acquire advisers I could trust. I've had to learn simple steps to prevent fraud, waste, and graft. And now I want you to have the benefit of my experience... without all the pain I had to go through.

In a nutshell, I'm sick and tired of being taken advantage of by persons we pay to serve the HOA! That's why I have started HoasBoard.org – so board members can freely share information and managerial experience with one another in an environment free from vendor influence. I want board members to have the freedom to serve and do

what's best for their community, with a clear understanding of systems and resources easily available to them, the major elements of which are the basis of this brief.

What you'll find in this brief is the distilled knowledge, secrets and insight from over seven years of pain and struggle in solving the mysteries of self-management. And whether you want to self-manage, or simply supervise your hired property manager, there's one thing I can absolutely assure you of – *knowledge is power!* Power to assure you're able to fulfill your responsibilities. Power to do what's in your community's best interest. And power to ensure that those who want to take advantage of you can't.

It's my desire to energize you with the confidence necessary to handle your responsibilities – a confidence that you may never have had before! So let's begin to unravel your uncertainties. Prepare yourself to wrest back control of your association – *perhaps for the very first time*. You'll find it's easier than you may think. And remember – if you have any questions, I'm here for you.

Best Regards,

Shelton Lee

member@hoaboard.org

PLEASE NOTE

I'm not an attorney and this is not legal advice. For that you need an attorney — and herein you'll find out *exactly what kind you need.*

HOA Board of Director's Best Practices

Most new board members do not have the necessary time, experience, or knowledge of association covenants and bylaws to properly govern an association. As a result, most HOA Boards are compelled to trust various professional advisers – management companies, attorneys, bankers, financial advisers, etc. – to properly collect and account for HOA funds, to enforce HOA rules and regulations, and to keep abreast of with the constant changes in HOA and corporation law.

However, even though you may have hired a respected HOA management company, you must never lose sight of the fact that one misstep by your manager could put the HOA and all its members at risk of substantial financial liability. With all due respect to property managers, don't be fooled: only a few states require property management licensing, and even fewer states provide or require any training before a property manager hangs out a shingle. In too many instances, associations find out the hard way that their management company is inexperienced, unknowledgeable, unprofessional, or worse, dishonest. And unlike certified professional fields such as accounting or law, many times there is no mechanism or agency to assure oversight, compliance, or accountability.

Even when the HOA delegates its responsibilities to a property manager, the HOA always remains ultimately responsible – and liable. Thus there are two things which are critical prerequisites to efficiently managing a homeowner's association. We'll cover those first.

Section One

Secret # 1 — **Hire the Right Type of Attorney** (the kind of counsel you need may surprise you)

You just made one of the largest and most important purchases in your life: a new home! Shortly thereafter, you received a notice announcing a community meeting. The next thing you know, you are asked to run for the Board. You want to do the right thing, to get involved in the community, to serve your new neighbors; and so you're elected as a board member. At this point, you don't yet wonder why no one else ran for that seat, why the new guy on the block ended up on the Board. Everyone congratulates you. The property manager quietly assures you they'll take care of everything, no worries.

Does any of this sound familiar? When you became a board member, do you remember receiving some assurance that your property manager would 'take care of the important things'? Did anyone convey (verbally or otherwise) that the property manager was the expert? Did you feel that you could rely on that expert to take care of the big issues?

What most property managers fail to tell you is that irrespective of whom your board's advisers are, the Board remains 100% *responsible* for all HOA decisions. An HOA is a non-profit corporation, and because you are now a corporate officer, you are exposed to certain legal liabilities through a legal concept known as *fiduciary duty*.

A fiduciary duty arises from a relationship similar to that between a trustee and a beneficiary. The Board is the trustee, the homeowners are the beneficiaries. The HOA has a fiduciary duty to its members (homeowners) to put the interests of the members before its own interests, and to act at all times in good faith and with reasonable diligence and prudence. If something goes wrong, and legal liability arises, the law always looks to the Board first — not its advisers! That's kind of important to know, don't you think?

First, a short primer on HOA governing documents: In most states, including North Carolina where I live, the law requires that an HOA organize itself as a non-profit corporation. Because it is a corporation, it must have bylaws, and if it does not adopt a set of bylaws, the state nonprofit corporation statute will operate as the “*de jure*” bylaws. Bylaws are simply the rules for self governing the *corporation* (as opposed to the community) – how to elect, and the length of terms of, directors and officers; how many members must be present at meetings to have a quorum, when must meetings be held, how many members must vote to pass a resolution, etc. These are the types of things covered in bylaws.

The *community* (as opposed to the corporation) will be governed by a set of covenants, or promises made between the members of the community, usually called “the Declaration” or “the Conditions, Covenants & Restrictions” (the “CC&Rs”). Most HOA professionals simply refer to all these governing documents as the CC&Rs, but to be precise, bylaws and CC&Rs are usually two different documents with two different purposes. Sometimes bylaws are appended to CC&Rs, and sometimes there is a great deal of overlap, so it can be confusing to the uninitiated. Review your CC&Rs and Bylaws to make sure you understand your particular documents. It's important to remember they relate to two different areas of responsibility: running your non-profit corporation, and overseeing your community.

In addition to its governing documents, the typical HOA is also subject to state statutes governing nonprofit corporations as well as statutes governing planned communities or condominiums. The various statutes and regulations place the HOA in a complex legal environment involving corporate law, real estate law, and tort law to name a few, requiring that the HOA routinely seek legal counsel. Having the right attorney is a critical necessity. And hiring that attorney directly, is of equally critical importance (more on that in a moment).

A lot of HOAs rely on a lawyer recommended by their management company, usually a real estate specialist with an HOA subspecialty. This type of lawyer is competent to handle routine collection actions and routine property transactions such as filing liens and foreclosure proceedings. However, this lawyer has a “built-in” conflict of interest in

that the more liens he files and the more collection letters he sends, the more foreclosures he processes, the more fees he generates. Liens and foreclosures are sometimes necessary, and the typical HOA will need this type of lawyer on occasion – but liens and foreclosures should be a rare last resort. Unfortunately, a lawyer whose office is set up to handle only these transactions is like a carpenter who only owns a hammer. And as the old adage goes, when all you have is a hammer, everything looks like a nail. (As you’ll soon see...)

An HOA should always have a relationship with a trusted attorney separate and apart from its management company. Specifically, an attorney *whose specialty is corporate law*. For reasons of time and efficiency, you may want to utilize the management company’s attorney for routine matters, but from time to time you need independent legal advice. Legal advice you hire directly. Do you want to establish a relationship with a new and unknown attorney every time the HOA decides to contract with a new HOA management company? Hiring a corporate attorney directly assures continuity of competence.

Now you probably wouldn’t let your family doctor perform brain surgery on your family, so, why would a non-profit corporation go to a real estate attorney to advise it on running a corporation? Find an attorney knowledgeable in corporate law, preferably with litigation experience (just in case). That’s what we do, and we’ve found it works best by far. *Bear in mind*, you’re not some neighborhood activities director. You are a corporate officer managing a nonprofit corporation with fiduciary responsibilities to the shareholders (members). A corporate attorney will advise you how to navigate the legal regulatory thicket, and advise you on how best to govern your non-profit corporation. They also have no “built-in” conflict of interest.

No matter what anyone else says – *you owe it to your members – and yourself* – to interview at least one attorney whose practice focuses on corporation law. Often a first consultation is gratis anyway, so you can find out what you’ve been missing for free.

[Secret # 2](#) — How Your HOA CC&Rs Take You from “Weak and Powerless... to Being able to Dissolve Tall Arguments in a Single Bound!”

Okay – maybe you won't become "Super Board Member", but after seven years of experience, I can honestly tell you that knowing your CC&Rs (covenants and bylaws) will help you solve almost any problem involving your neighbors, and will help maintain decorum in the most outrageous of board meetings.

I realized after a while that all I needed to do was *one simple thing*... and once I accomplished this one thing, everything changed. And what was this one thing? It turns out that all I had to do was get discontent homeowners to agree with me that "*We must follow our HOA rules and regulations (CC&Rs)*". Once I started getting that simple accord, everything became smoother for all parties concerned. Let me explain why.

Knowing and thoroughly understanding your CC&Rs allows you to draw a connection between these community 'rules', and the specific actions taken by your Board. When you connect actions to rules you make your job easier, and also *reinforce* those rules that all homeowners agreed to when they joined the community. If a homeowner (or group of homeowners) doesn't like the board's actions, the onus is on them to either offer alternate actions – which must comply with the CC&Rs – or take on the responsibility for changing them. Get it? This puts the pressure where it properly belongs, on the CC&Rs... and removes the pressure from you.

This gives you authority to essentially say, 'It's my responsibility to uphold the CC&Rs whether I agree with them or not – and I'm bound by law to do so. If you don't like it, you are welcome to offer alternative suggestions that comply with the CC&Rs, or you can try to convince your neighbors to change the CC&Rs; or you can take my place on the board, and risk any liability for breaking these laws yourself.'

Take the time to read your CC&Rs *in their entirety*, and incorporate them where appropriate in your communications with homeowners. Take the time to tab them for those provisions that are repeatedly referenced. (The same problems always pop up over and over again). This puts the pressure on CC&Rs, and not on you. It's a kind of judo for board members. It's like saying, "If you don't like the fact that you keep running into this wall, move the wall. But it's not my job to ignore the wall or move it for you."

Your covenants and bylaws are your best means for dealing with most unruly and argumentative association members. Always remember: a community association exists to benefit its homeowners *overall*. Its rules and regulations are in place to enhance the quality of life and to preserve the property values of all members – not just a few. If you bend a rule to benefit one member, I can assure you another member is going to be unhappy about it. The only way to avoid this trap is to follow the CC&Rs. As a Board member, it is not your responsibility to please every single member. It is, however, your responsibility to honor your fiduciary duties to the community at large and enforce the CC&Rs uniformly.

In summary, once you become more familiar with your association's CC&Rs and have consulted with the right attorney, you'll have far more confidence, as well as knowledge, to effectively participate as a board member. In my experience, these simple steps also help retain more seasoned board members, simply because they soothe your progression toward working together as a cohesive unit.

In the next section we'll talk about money – *the life blood of your Community Association*.

Section Two

When I was a kid I used to love to play ‘crack the whip’. You know, that’s when kids hold hands in a long line and the leader runs off taking everyone through a jumble of twists, turns, and circles. It was fun feeling a bit out of control and at the mercy of being recklessly drug around by others. But there’s no joy in feeling that way as an association board member.

Getting on top of your association’s finances removes much of that dizzying feeling. We’ll now discuss two subjects which will put you in near total control of your finances – and do so for less money than you’re currently spending. Those two subjects are accounts receivable management, and lockboxes.

Secret # 3 — **A/R Management** or “How to reduce high Account Receivables... and *keep them that way*”

First, let’s define accounts receivables (A/R) as it relates to associations. Accounts receivables are simply assessments owed to the association by its homeowners. If money is owed to the association and not paid when due, the association may not be able to pay their bills on time, or provide the services which maintain the community’s safety and property values. Keeping you’re A/R under control simply takes diligence in following consistent steps. You must have a specific, written collection policy. Where the CC&Rs do not already contain collection policies and procedures, most CC&Rs empower the HOA Board to adopt a set.

Prompt payment of assessments is essential to the financial health of your association. Late payments adversely impact cash flow, and payments not received in a budget year often makes it necessary to tap into reserve funds. As a result, fair and uniform enforcement of your collection procedures keep costs down, as you’ll see shortly. And the less money you spend collecting delinquent assessments, the more money you can put back into your association. In fact, some associations have been able to actually

reduce assessments after getting on top of their accounts receivable delinquencies. An added benefit is that your board will get greater respect from homeowners throughout your community... both for being on top of the finances, and for motivating non-paying members to get current.

Don't get me wrong. I know these are your neighbors, and getting all of them to pay the dues they contracted to pay when they bought their home can be a sensitive issue. I simply want you to know that there are some easy, effective ways to encourage neighbors to pay any delinquent dues, and to stay current, that don't involve lawyers, litigation, or heavy expense. We rarely if ever have to resort to liens or foreclosure to get our assessments collected, and that's what we want to discuss here.

Let's look at the anatomy of an HOA's accounts receivables. Homeowners tend to be in three categories:

- Homeowners who pay on time.
- Homeowners who pay late (considered to be chronic 'slow payers').
- Homeowners who don't pay in the budget year.

Without a sustainable A/R collection system, homeowners who pay on time become homeowners who pay late. Homeowners who pay late can become homeowners who don't pay. Many homeowners seem to slide down one notch in the A/R scale when there's no viable, effective way to get assessments current and keep them there. Without a viable sustainable process, many homeowners associations end up with a handful of responsible homeowners on one side – and a handful of excuses on the other. That's been my experience over the years – but it's easily resolved.

Property managers (and *their* attorneys) will typically advise a board to file a lien and then foreclose on delinquent homeowners — and they'll usually tell you to do so as soon as legally possible. This is the old “when you only have a hammer everything looks like a nail” mindset I warned you about earlier. Or they'll tell you to simply put a lien on the property, and wait until the home is sold to collect your delinquent dues.

Yes, foreclosure has its place in the collection of association accounts receivables, but it's not a feasible or cost effective solution for *managing* your accounts receivables. Once you start the legal process by placing a lien on the property, you not only haven't collected the needed assessment, but you've also incurred legal expenses. So effectively you're throwing good money after bad, and you're getting further behind financially. This tends to add to the board's financial frustrations, which adds fuel to the fire that leads to foreclosing on neighbors. If the lien and foreclosure route is your only tool, you'll likely go broke before you're able to get delinquent accounts under control, and may end up with a bunch of foreclosures, which is terrible for the property values of the remaining homeowners.

The foreclosure procedure takes time and money. Let's say you have a budget of \$100,000 a year and the property manager tells you you'll need to budget ten percent (\$10,000) for lawyer fees for collection of delinquent assessments. Many property managers will tell you not to worry, the CC&Rs require the delinquent homeowner to reimburse attorney fees so you'll get that money back. Maybe, maybe not. It depends on the reasons for the delinquency. In a recession economy, sometimes it's hard to squeeze blood from a turnip, especially in the fiscal year you need it. So if you spend \$10,000 on legal expenses, collect the assessment but get reimbursed for \$5,000 of your legal expenses in that budget year, your property manager will direct you to transfer \$5,000 from the reserve account to fill-in the gap in your budget and finish out that year. Now this is assuming that the liens actually motivated some homeowners to get current, which is not always the case.

In this scenario (which has happened to me) the following year you have to find a way to cut \$5,000 from that year's budget, in order to pay back the loan to the reserve account. Then, you still have to budget an additional \$10,000 in annual lawyer fees to follow this failed formula again the next year.

This progression means you'll be forced to cut back on services your community needs, or raise assessments, or borrow more money from reserves year after year – or all three. Those reserve funds are intended for long-term capital expenditures, like paying for the maintenance of community facilities, including pools, parking lots, and roofing,

and all the other things which cost tens or hundreds of thousands of dollars to replace or repair. *And sooner or later, they will need repairing.* The good news is you can relax in the knowledge that the brief you're reading will help you address all these needs, and prevent you from falling into this same trap, thus avoiding this endless pitfall of legal fees.

When that old "No-Worry A/R Management" system (that leans on lien and foreclosure to fix everything) inevitably results in your not being able to pay for services, or instead facing a depleted reserve account, again your advisers will have a ready-made 'no problem' answer. "Just raise your assessments." Do you see how this vicious cycle can be (and has been) the ruin of more than one association?

Foreclosure as an A/R management strategy is a failure for many associations, and can lead to a breach of your fiduciary duty. For instance, all HOA CC&Rs obligate the Board to maintain certain required services, like carrying all the right insurance. When required association services are cut due to budgetary mismanagement, you are failing your homeowner constituents and exposure to legal liability arises. On the other hand, if you implement sound policies and procedures, you'll be on safe ground. I recommend the following:

Begin managing accounts receivables the day they become due. The dates can be found in your CC&Rs, along with any grace period. It does not matter if your CC&Rs require monthly, annual, or semi-annual assessments, the most efficient and cost effective way to manage an association's accounts receivable includes the following steps. We adhere to them faithfully.

- 10 days after the due date: send a late notice and charge a reasonable late fee.

- 30 days after the due date:

- A. Submit accounts to a recovery service (collection agency). We use RecoverHoaDues.com. They perform skip tracing, a letter and phone campaign, and (after a period of time) will credit report anyone who doesn't contact our

board and show a willingness to work with us. You shouldn't pay more than \$20 per delinquent account for this kind of service. Important Caveat: Always retain complete control of the accounts. *Never* sell, pledge, or assign your accounts to the collection agency. Another key is to make sure the service you use doesn't credit report until the end of their process. That way, only the homeowners who don't cooperate get credit reported. Some agencies start off by credit reporting all the accounts you give them. That's bad strategy. It hurts tight-knit communities like HOAs. And, you lose all your leverage in motivating homeowners to get current.

B. Where your CC&Rs allow it (most do), suspend all community privileges. Do this only after properly notifying the homeowner that they'll be given an opportunity to be heard at the next board meeting. Read your CC&Rs for specific procedures in this regard.

C. Send any 15-day statutory Pre-Lien Notice (if your state requires one), which you can do yourself.

D. Always keep lines of communication open and be prepared to help homeowners who are delinquent, especially if there's a hardship.

We have found that following this procedure leads to a collection rate of 80% to 90% of your accounts within 90 to 120 days. Some pay quicker, some take a little longer, but the vast majority eventually get current. Any delinquent accounts remaining after these steps are usually homeowners who are either going through a bank foreclosure, bankruptcy, or who have just walked away from their home. Either way, you should put a lien on any remaining properties to secure the debt, if you haven't done so already. Just remember, while placing a lien earlier in the process may secure the debt, it also increases the balance owed; thus making it that much harder for your homeowners to get current.

There are those few stubborn homeowners who just won't pay for no good reason. These are the homeowners for which foreclosure is the final resort *if your board thinks*

it's best. Remember: foreclosure hurts everyone in your community – not just the delinquent property owners. So it should only be done as a last resort.

Key Points:

Good accounts receivable management means collecting the highest possible percentage of delinquent assessments, at the lowest possible cost for your HOA and your paying and non-paying homeowners, all while keeping peace in the community and preserving your members' property values.

Good accounts receivable management is directly tied to good budgetary preparation, and not spending money unnecessarily. Your collection policy should be transparent, unwavering, and uniformly applied. Discuss these suggestions with your corporate attorney for their input. They will fully understand the importance of leaving foreclosure as a last resort.

As a final note on collecting receivables: **Always recognize the potential conflicts of interest of the entities involved in advising or managing your association.** Some actions are necessary even where a conflict of interest might be implicated. There is no need to become suspicious or paranoid about every piece of advice. But if someone is always pushing you to use services they provide over options you're more comfortable with, that should be a red flag to you. No matter how good advisers claim to be, or how nice they are, as professionals they should always subordinate their interests to your association's interests, and they should always acquiesce to your authority and respect your position as fiduciary agent... or they need to be replaced. It's that simple.

[Secret # 4](#) — **Lockbox Services** or "How to receive funds instantly and accurately with the highest security."

Another key component of good revenue management is the use of a lockbox service. Many management firms use lockbox services, and charge for it, without ever telling you that's what they're doing. There's nothing wrong with that in and of itself, however you can do it yourself and avoid paying the management firm a surcharge. Here's how a lockbox service works:

A bank assigns a mailbox address to your HOA. Homeowners mail their payments to the lockbox address. Bank employees instantly deposit the checks into your HOA's bank account, but also scan and make any accompanying documents available for your Board through their secure website. Companies with high incoming receivables use lockbox services all the time expressly for their security, speed, accuracy, and ease of use.

When management firms use lockboxes, and then charge you a surcharge for this service, you're paying extra, while *actually reducing* their labor costs. Essentially, they're charging you for the convenience of their not having to touch your member's checks. On the other hand, if your property management firm doesn't offer a lock box service, and relies on their in-house staff to process your incoming receivables, they are operating inefficiently and the HOA's cash flow, accuracy, and security could be at risk.

Also, a lockbox service protects the HOA when (not if) you part ways with your present management firm. Not knowing how your receivables are being processed can put the HOA in a real bind when you change companies. With a lockbox service, this is not a problem because *you're in control*. You simply provide the new company with the appropriate lockbox information and everything continues on seamlessly, albeit under new management. Call it sound fiduciary responsibility...or just good common horse sense.

Most major banks offer lockbox services. There are some banks that only offer their lockbox services through management companies, or only offer their services to large HOAs. [BB&T Bank](#) offers exceptional lockbox services without restrictions or any volume requirements. They cater to self-managed HOAs. You can also find several other stand-alone companies who provide lockbox services simply by doing a Google search for 'lockbox services'.

Section Three

As a board member, you're only as good as your team of advisers. Every adviser's input is a key element within their area of expertise. Some advisers may seem to perform secondary roles. However think of their input as having a 'stabilizing' effect, one which augments and adds to the association's overall strength. In this section we'll consider some obvious and some not-so-obvious relationships that add vision and perspective, as they contribute in ways you may not have imagined.

Secret # 5 — **Your Local Banking Relationship**

If your HOA decides to contract with an HOA property management company, the company will use its bank and run all your HOA accounts through its accounts. It will have total control over the accounts, and will have a relationship with its banker *to the exclusion or detriment of your HOA* when push comes to shove. If your Board decides to use a property manager, *safeguard your accounts*. Ultimately you never want to give up control of your accounts to a third party.

Boards of directors are responsible to keep, or cause to be kept, the financial books of their associations, and to faithfully account for all association funds and financial assets. To better do this, you must develop a relationship with your association's local banker – preferably the branch manager. Knowing the name of your banker, and having a business relation with them is the first step in protecting the association's assets.

How many corporate officers do you suppose neglect having a close and active business relation with their banker? Remember, your finances are the *life-blood* of your non-profit corporation, and finances lie at the heart of your fiduciary duty. Hiring a property manager and relying on them to deal with a bank does not relieve you of any responsibility in this area. In fact, it may even imperil your ability to comply with your fiduciary responsibility.

Directors should have a strong banking resolution and adhere to that policy faithfully. To the extent that your CC&Rs do not state otherwise:

- All financial accounts should be opened in the name of the association.
- Only Directors (board members) should be signatories on the accounts, and no single director should be the sole signatory. Two signatures protects everyone.
- Property managers should only have limited access to the accounts, or limited amounts to which they can authorize checks – *if any at all*.

I can tell you real stories where HOAs have had all their accounts entirely drained of funds, and wiped out because of misbehavior by a property manager who had authority via the bank's signature cards. It is not a fun scenario, nor do you need to waste the full day trying to get access to your own corporation's funds.

An association should have two open accounts: one for operating expenses, and one for capital reserves. Property managers should at best have limited access to the operating account, and if you grant them access, it should only be for sums under a specific dollar amount. Anything over that amount should require the signature of at least one board member. The reserves account should only have directors as signatories. I'll talk more about why this is necessary later when we discuss your reserve study.

This is very important: all banks statements should only be mailed directly from the bank to a specified board member, or board mailing address, such as a Post Office Box. Having all of the original monthly bank statements delivered first to the possession of the Board is the best way to account for, audit, and safeguard HOA funds.

In summary, a prudent director will have complete control over all finances, have a working relationship with their banker, establish a strong banking resolution, and limit the property manager's access to the accounts. Even if you are currently under a property manager, make it your business to reach out to your bank. Introduce yourself as a Director of your HOA, and make sure your banker understands your banking

policy, and helps assure it's being adhered to. Talk to your local banker about ways to help increase your cash flow and protect your receivables.

On the other hand, if the banker gives you any indication they are less than 'interested' in you, or treats you as being less important than the property manager, then you have a problem. Your property manager probably manages multiple HOAs and has multiple accounts, and may be a more fruitful and therefore important customer to *his* bank. Nevertheless – and this bears repeating – all HOA accounts should be owned by, and in the name of, your HOA – without exception. Property managers *should never own, or have unfettered control of, your accounts.* They should have very limited access to your funds – if any at all. Also property managers should have very limited check writing authority – if any at all.

Secret # 6 — **Have a Bookkeeper – And a CPA**

The number one reason why you should separate your HOA bookkeeping duties from your property manager is because most state HOA property management companies are not regulated by the state and have very little (if any) accountability. You can contact your state legislator to find out if your HOA management company has any governmental or supervisory oversight, and if the state requires any licensing or training for its property managers. The less oversight, accountability, or licensing and training, the more concerned you should be.

In my experience, most people who volunteer to sit on HOA Boards are good hearted people, trying to effect positive change in their community, or simply willing to take on the responsibilities that no one else is able to fit into their schedule. The issue is that many board members and directors have little or no experience in all the verities of running a non-profit corporation. So entrusting a budget of tens or hundreds of thousands of dollars to a potentially non-licensed property manager, with little to no agency supervision to provide oversight and accountability, may be easier – but can also be a recipe for disaster. You may think it absurd, but that's an exact description of the conditions in my state.

In some states property managers handle over a billion dollars in HOA funds. And there seems to be an uptick in more new reports of property managers embezzling hundreds of thousands of dollars from HOAs. Can you guess the only thing that's sadder than these thefts? It's the fact that most of these HOAs didn't have proper insurance to cover these types of losses, or were under-insured to cover their claim properly.

We'll go over more on proper insurance coverage in a moment. Just remember that without government oversight and licensing, property managers (and their accounting departments) are not held to the same standards and accountability as accountants or CPA firms. In-house accounting departments can represent a conflict of interest. Clearly defined lanes of responsibility helps ensure you are complying with your fiduciary obligations. That includes using one entity for helping you plan your budget – and a separate one for doing your books.

Fair and accurate financial reports from your accountant are vital to the success of your HOA. Accounting records serve directors in controlling current operational costs, and successfully planning future operations. Accuracy in your records is key.

Let me give you an example from personal experience. When expenses or income are not properly categorized, it can render your entire accounting system useless. As a newly elected board member, I had first-hand experience with how poorly prepared undocumented financial reports can be a blanket covering error. Our board ordered a financial audit – this after 8 years without any audit. Over *forty thousand dollars* could not be immediately (or subsequently) accounted for, due to inaccurate financial statements. The management firm was not held responsible for submitting inaccurate reports to our board. But we were able to go after the previous board members, who were found accountable. The management firm walked away scot-free. This even though it was the management firm who performed the poor record keeping.

Conclusion:

1. Try to enlist a board member with some accounting, or at least bookkeeping, experience. If not, hire a part time bookkeeper for a few hours a month to do the basic record keeping.
2. Book some time with a Certified Public Accountant familiar with the financial demands of an HOA.
3. Never be timid to ask questions. A good CPA will help you understand the role of your Treasurer.
4. Make sure you know what kind of accounting method your association uses: cash or accrual.
5. Review your monthly bank statement. And do so every month.
6. Read and understand the monthly financial reports your accountant or bookkeeper provides.
7. Read your association's budget on a month-to-month basis. Keep this component fresh in your mind.
8. Make sure your board, and your accountant, both have "fidelity bond" coverage.
9. Never commingle association funds (keep operating funds in a separate account from reserve funds).
10. Final point: adopt a strong 'checks and balances' financial resolution, including a full annual audit. A yearly audit is the highest level of scrutiny and transparency you can have. Make sure that your bookkeeping agent follows the auditing standards put in place by the Generally Accepted Accounting Principles (GAAP). (While an annual audit clearly demonstrates your respect for fiduciary duty, audits can be expensive. At minimum, do one every 3-5 years, depending on how often the entire board membership changes, or rotates out).

The important thing to remember here is: **you're eliminating headaches**. These are the steps necessary to alleviate potential misconduct, and to assure you – as a corporate officer – are in full control of your organization. You see, maintaining a high level of professionalism, and surrounding yourself with unbiased expert advisers, enables you to focus your attention on things that don't cause a loss of sleep.

Next we'll discuss proper insurance coverage, and your reserve study...

Section Four

Secret # 7 — Insurance is the Board's Safety Net – and its Armor.

When a new Board convenes, one of its first tasks should be to review the HOA's insurance policies. To do this properly, you must first review your CC&Rs to determine what they require in the way of insurance coverage. Because there are a lot of insurance terms which can be confusing, you probably want to confer with an insurance agent who specializes in serving HOAs when undergoing this review. Insurance coverage review is especially critical for the first, newly elected board after the community developer turns the community over to the association. In some cases this may be the most important step you can take as a Director. I'll explain why shortly, but for now just remember that your insurance protects more than just property. When properly placed, it protects the community – *and its board* – from liability.

HOA insurance policies usually have a "property and casualty" (P&C) provision that protects HOA property from things like lightning damage, hail, vandalism, etc. The policy will also usually have a "liability" provision that protects the association from third party claims for personal injury and property damage. State law and your CC&Rs usually have a minimum coverage requirement, such as \$1,000,000. Make sure your policy complies with your state law and your CC&Rs. With insurance, more is usually (if not always) better, and the cost is usually a bargain as the limits increase.

Non-profit corporation statutes and your CC&Rs also usually require that the HOA insure its Board members against individual claims. This is called "Director's and Officer's" (D&O) coverage. But depending on your state, there may be a wide range of coverages offered, some more comprehensive than others. Don't just take your manager's word that "you're OK, you have D&O coverage." Confirm all coverages, what conduct is covered and what is not, and confirm the limits of the coverage with an

insurance professional. When it comes to D&O coverage, it's *your* butt on the line. Make sure you're covered.

The most common D&O insurance claims facing HOAs today are claims brought, not by outsiders or third parties, but by members of the HOA – i.e., your neighbors suing you. These are either (1) claims that the Board is showing favoritism; or (2) claims that the Board is not enforcing the bylaws or the CC&RS.

I'm sure you can imagine getting this question: "My neighbor has a shed in their backyard – why has my architectural control request for a shed in my backyard been denied?" What you may not imagine is how easily such a question can lead to a law suit today. Legal defense costs can be substantial – much higher than the cost of the shed – and without proper insurance coverage, homeowners are left with the tab. All because someone was granted permission to do something, and someone else wasn't.

The second types of claims are for (a) failure to enforce the restrictions or rules; or (b) failure to comply with the governing documents and laws in connection with the election of directors; or (c) a failure to provide documents or records in accordance with the governing documents and laws. These kinds of non-monetary claims *are usually not covered by D&O insurance*, which means the Board's failure to properly enforce all the rules can cost the HOA thousands, or even tens of thousands of dollars in legal fees alone.

Now I'm sure you can see plenty of opportunity for such lawsuits to fly – especially when an association has an unprofessional bookkeeper or accountant providing subpar reports and records. When this happened to us, we had no recourse on the property manager... only on the former board members. Was it fair? No. Was it the law? Yes. Which side of the law do you want to be on?

Now be careful because your current insurance agent, or the developer transition agent, may not be the professional consultant you want them to be. HOA insurance is not exactly a high demand product. A lot of insurance agents cannot competently discuss these policies with you. *Find a professional insurance agent specializing in HOA and D&O insurance.* Such a specialized insurance agent will be able to perform a free

insurance audit on your current policies. This audit helps assure you have the appropriate protection, and without any gaps in coverage.

Having the appropriate D&O liability coverage helps Board members do their job, and improves retention of good board members. The proper coverage allows board members to make decisions without having to worry about being personally sued or unduly costing their community money. It's easier to make decisions when you know that if a decision sparks a lawsuit, your D&O liability policy is going to defend you, your community, and your family. This insurance may not be the least expensive; however it enables you to function properly, and should easily be covered by the savings you receive from lowering your legal costs in the accounts receivables area.

Typically, it isn't that an association doesn't have the money to run at a top notch level – it's more likely that the funds they do have to run effectively may be getting misallocated or improperly managed. For instance, it's cheaper to pay even enhanced insurance premiums than it is to pay an attorney to defend a lawsuit, even a lawsuit in which your HOA wins. So now you're getting a better view on how to remedy areas where improvements can be put into practice, by realigning your resources to be more properly allocated.

Secret # 8 — Reserve Study – How Planning Helps Assure a Bright Future.

If your association has a reserve study, keep it updated and fully funded. Nowadays it's not uncommon for lenders (like Fannie Mae and FHA) to have regulation requirements setting the minimum adequate reserve funds for condominium communities in order to lend into that community. The same requirement may not be far behind for communities with single family dwellings. In other words, if your HOA doesn't comply with industry standard reserve fund requirements, you may have a hard time selling your condo or single family home because potential buyers cannot find financing. Imagine the potential for lawsuits if this happens.

In addition, prudent prospective buyers may request a copy of a community's reserve study in order to avoid buying into a community that's under-funded (and may be only

one step away from a special assessment). Who wants to buy into such a community when they can buy somewhere else.

Some key things to remember about a Reserve Study:

- Only Professional Reserve Analysts that hold the highest credentials in their industry should be retained to perform a reserve study. There are a lot of well-meaning board members who think they can save their HOA money if they perform the study themselves. Some property managers will even claim they can perform the reserve study. But the best practice, by far, is to hire and pay a skilled professional. The Reserve study ensures the HOA has sufficient funds for long-term, periodic capital expenditure requirements. Properly performed, this report requires a thorough structured analysis, with timeline and cost estimates, using historical information, a network of contractors, and RS Means Construction Cost Data. This is not something for amateurs!
- Once you have your reserve study, keep it funded. Open a separate savings account. And if you contribute a portion of each assessment collected, the homeowners will only pay for the time of their ownership. No unexpected special assessment should ever be required.
- Even a professional reserve study needs to be updated. Make sure you update your study when required. Usually every two to three years should suffice.
- The Board should adopt a written resolution defining your Reserve Planning and Funding Policy. This is a resolution that *commits* the HOA and board to the reserve planning process *and holds future boards to these standards*. Without it, a future well-meaning board member might decide to set your plan aside, or worse, spend reserve funds on something they were never intended for.

A properly performed reserve study with a well-credentialed reserve study analyst, and maintaining our Funding Policy, meant our HOA's recent need for upgrades and upkeep to our pool came in under budget, and without a hitch. And the power of a reserve study just enabled us to negotiate another repair bid from \$30,000 down to \$12,000 – all

because the contractors came to realize that, armed with the facts and figures documented in our reserve study, they couldn't dupe us with over-inflated bids. And now this coming spring our members will walk into our beautiful newly renovated pool and spa area, and enjoy walks along well-manicured hiking trails through our forests, all without ever having had a hint of a special assessment! The power of a professionally performed reserve study is essential to keeping costs in line.

Conclusion:

Planning for future repairs and replacements is one of the most crucial aspects of managing your HOA. Conduct a professional reserve study even if your state or governing documents don't mandate having one. Governing documents obligate board members to maintain, operate, repair and replace the common areas in the development. And doing a reserve study means you're meeting your financial requirements in a fair and just way, without increasing service fees above the cost of inflation, or having to borrow reserve funds, or levying any special assessments on homeowners. A reserve study and funding policy are the only way to keep your pools, spas, clubhouses, entrance gates, parks, ponds, and fountains beautiful... and welcoming for your community.

Section Five

Communication is a vital key for any association. And assuring you're in control of your primary aspects of communication is of vital importance. One thing you want to remember is: If someone else is in control of how the world and your members get in touch with you, you're at a serious disadvantage – as you'll see.

Secret # 9 — **Association Website** or “The World’s Window into Your Association”.

Most management companies will offer an association the use of a website as part of the management contract. Up front, this seems like a great deal to board members – “Hey, we get a free website!” And having a professional website allows board members to communicate with homeowners, send alerts, and allows members to view their account information, board minutes, and to pay their dues. But what happens if all that communication suddenly gets shut off? Well, that’s exactly what happens when your association changes management firms, and the one you’re leaving is in control of your website. Oops! Now what?

An HOA's ownership of its own website means more than simply owning the site itself – it means owning the *domain name*. A domain name is the phrase that is to the left of “.com” (or “.net”, “.org”, and so on). So when you go to Hoaboard.org to share insight with other board members, the phrase “hoaboard.org” (without quotation marks) that you type into the URL bar of your computer’s web browser is that site’s ‘domain name’.

If you're the Brookside HOA, domain names such as “brooksidehoa.com” or “brookside-hoa.com” might be domain names you would choose. You can secure a domain name very inexpensively at GoDaddy.com. However actually building the website should be done with a firm whose expertise is specifically HOA websites.

The key here is that once you own that domain name no one else can have it, use it, or take it away from you. It belongs to you (or your association). All you have to do is pay a small annual fee (usually under \$20) to maintain your rights to that name, and it's yours.

So when you change management firms, nothing on that vital communication channel changes.

Think of it like this: you wouldn't give someone else control over your home or cell phone number. You wouldn't give someone else control over your physical or mailing address. Why on earth would you risk giving someone else control over your virtual address? This 'virtual address' is the world's window into your association, it gives members access to important data, and allows quality vendors to find you (if you so choose).

When a management firm has control of your website, guess who the only contact point on that site tends to be? You guessed it – the property manager. So you literally *cut yourself off* from any and all potential service providers who may have a great opportunity for you. Believe it or not, there are property managers who would actually steer you to using their vendors – and cut off what might be even better vendors – simply because of 'sweetheart' deals they may have with their friends, cronies, or "pre-selected" vendors. I don't mean to shock you, but when there are hundreds of thousands of dollars in annual budget to dole out, the scent of all that money might just attract a few vultures. By having your own domain name and website, along with utilizing some simple communication technology we'll cover in the next section, you'll have all your options open.

The biggest problem I've found though, with using a free property management website, is when homeowners pay their dues online. There is a clear potential for commingling of your HOA funds with other HOA funds. When that happens, *the Board has breached its fiduciary duty*, even if it's the HOA management company's fault.

Here's how it can happen. Commingling can occur when homeowners pay their dues through a property manager's website, and all its HOA customer accounts are first processed into a single management account. Theoretically, and ethically, the property

manager is then supposed to move the payments to the appropriate HOA account. But mistakes (and worse) do happen.

If your HOA must use a management company's 'free' website to pay dues, insist that all payments are directly deposited into your HOA's account – without passing through the manager's account first. These problems are alleviated when you use a lockbox, as we discussed earlier. Having your own site, coupled with your lockbox capabilities, solves many potential problems and keeps things running cleanly.

So, here are some of the problems with a property management-owned website:

- You can lose your website if you change management firms or they go out of business.
- If you lose the site, you lose all your data and records associated with your site.
- Getting even small changes done – or vital updates posted – can take forever.
- Websites are a vital marketing opportunity, and how potential home buyers initially shop your area.
- You have little or no control over what your site looks like or how it functions and what it provides.
- You close yourself off from potentially meeting some very good vendors and service providers.
- And most importantly, everything, including member dues, goes through the filter of your manager.

If all this sounds complicated – don't worry. We'll cover an exceptional site provider in a moment who can handle all this for you, inexpensively and expertly. However *you still want to buy your own domain name*, and make sure the firm that builds your website anchors that site to the domain name you own!

It's always best to have the board members control how the world sees your website, and thus your community – without any property manager advertising, or any other

unwanted content. And the truth is their websites are not free. For instance, you can help reduce delinquent accounts receivables by offering online payments, and do so at no additional cost to the homeowners (saving them \$10 to \$15 in processing fees). And any risk of commingling funds (and the associated exposure to your board) would no longer be an issue.

Conclusion

HOA websites are a critical component of community communications. Communities are more involved when you share, educate, and inform. Today websites provide essential tools and functionality for board members in managing their community, announcing updates and events, and posting meeting minutes, bylaws, and information essential to resident's safety. We've been very happy with using AtHomeNet.com for our website, though a quick Google search for "HOA websites" will bring up several providers. No matter who you use, be in control of this vital communication avenue.

Secret # 10 — Making sure Members can Reach You – *Without Giving Out Your Personal Information.*

On this final note, in today's era of software and web-based electronics, making yourself and other board members readily available to your members (and important contacts) is easy, confidential, and inexpensive.

While improving communication by hiring a 24-hour answering service to serve as your board's hotline is easily available, there are also a myriad of options available for even the tightest budget, or smallest HOA.

One service is line2.com. It provides you with a virtual PBX phone system for \$10 a month (under their 'personal plan'). In this system, you get to choose a virtual phone number from within your area code. And there are so many features for such a small cost. For instance, when members call your number, you can have it forward straight

through to a given line, or have an automated assistant offer various options (“press 1 to leave a message, press 2 for...”).

You can also have extensions for board members. When homeowners call a given extension during business hours it will forward to up to three phone numbers (your home, cell, and office, if you choose) simultaneously. Caller ID indicates the call is from the association’s phone system, so you can decide to take the call, or pass it onto the system’s voicemail.

When you choose not to take a call, the member can leave a message, which is recorded. Then the recording is emailed to you as an attachment, so you can listen to it when you have time. And during night hours, the system can just forward everything to a general voicemail box, which will email any messages as attachments to whatever email address you choose, so you can pick them up the next morning. You can also have options to forward member’s calls to your local police or fire departments, or other important services. And you can have recorded answers to provide the association's mailing address, or answers to other common questions.

These are just a sampling of the features you can get from such a service, which allows you to maximize access, without giving up privacy, because you maintain control by gaining the ability to filter and manage communications.

Conclusion:

Giving members access is imperative – and you don’t have to give up your personal privacy to do so.

Here’s my hope:

It’s my hope that after reading this you’re energized with a confidence and peace in your ability to handle your responsibility that you never had before! I know some will read this and say, “Thank you Mr. Lee, this is exactly what I needed to know. I got it... and

I'm on it!" And to those of you who feel that way, I truly am delighted! I want fellow directors to have a sense of mastery, and to absorb confidence from my experience.

And yet I know there are those who read this and say, "I know this makes sense, and I got a lot from it – I'm just not sure how well we can do all this for ourselves... we may need *help*." If you do, you're welcome to reach out to me. If I can answer simple questions, I most certainly will. And if you want to join HoasBoard.org (which is free) to get input from other board members – that's readily available. However if you're in a real quandary (or perhaps a serious mess) call me. I'm also available to consult and help you get your association turned around and on the right track. I can help you interview vendors (remotely), set-up your budget, implement any of the details in this brief, and help you *break free* as a self-managed association.

Either way, reach out... I always welcome fellow board member's calls. You can reach me directly at (800) 810-0015 or simply email me at member@hoasboard.org. Let's start a simple conversation, and see where we can go together....

God bless you,

Shelton Lee