

# MORE THAN JUST A SOCIAL COMMITTEE:

## The Many Responsibilities of a Community Association Board

Board members owe the community a fiduciary duty. The fiduciary duty encompasses the duty of loyalty, the duty of care, and the duty to act within the scope of one's authority. The duty of loyalty requires that a board member put the interests of the association above their own as an individual and as an owner.<sup>1</sup> The duty of care requires a board member make reasonable and informed decisions.<sup>2</sup> The duty to act within the scope of authority requires that a board member follow the association's governing documents.<sup>3</sup>

### Fiscal Responsibility

The board's fiduciary duty is the basis for how the board manages the community and is the foundation for the decisions the board makes. The board should think of the community as a business it is responsible for, and in order to keep a business running smoothly, it is important to understand its financial needs. A community's spending falls into multiple categories including the operating account, the reserve fund, and community projects. The operating account is meant to be used for the daily expenditures that come up such as landscaping, security, utilities, insurance, and management fees. The reserve fund should be based on longer term costs the community will incur for major repairs or for replacement costs, including unexpected expenses. Reasonable reserves may help prevent the need to levy special assessments. Finally, planning for community projects is important as well. There may be a need or desire to renovate or refurbish common areas or a desire to make general improvements. Planning for such projects should be part of the annual budget.<sup>4</sup>

### Preparing the Annual Budget

In preparing the budget the first step is to assess the current financial status of the community which includes identifying income sources and the status of current accounts. From there, the amount of money needed to fund the operating account to cover the daily costs should be accounted for. The amount needed to

properly fund the reserve account and which should be kept separately from the operating account, should be calculated. In determining the reserves needed, the board should look to the CC&Rs to see if they set forth a reserve funding requirement. The general rule and guideline is that the reserve fund should make up at least 70% of the annual budget. The association's CC&Rs may require a higher funding percentage. To determine the necessary funds for the reserve, the board may want to consider seeking the assistance of a financial advisor or reserve study specialist.<sup>5</sup> A reserve study is conducted by a licensed engineer or architect. This expert will survey the building structure and systems, estimate their remaining useful life, and determine any major repairs necessary to extend the life of these systems.<sup>6</sup> Reserve studies include a financial analysis of the association's financial health and current reserve funding status in addition to providing a physical analysis of the condition of the community's common areas. The reserve study will provide an estimated cost of repairing and replacing any of the components of the common areas that may be necessary.<sup>7</sup>

### State Requirements

Setting sufficient reserves is not only a good idea, but may be legally required by the state. Some states require reserve funds, and some have laws requiring the annual budget include a line item for repair or replacement reserves.<sup>8</sup> Some states have gone even further and designed laws for the purpose of protecting the structural integrity of condominiums and cooperatives which might require inspections to determine needed repair and maintenance. For example, New Jersey requires the primary load bearing system of housing structures and common areas to be inspected and mandates capital reserve studies be prepared.<sup>9</sup> Florida also enacted legislation requiring structural integrity reserves and setting reserve funding standards.<sup>10</sup> It is imperative that state specific requirements be followed. An attorney can help determine what is necessary to be in compliance with state law.

## Takeaways:

- The board is responsible for setting an annual budget
- An annual budget should include a plan to cover day to day operational costs, major repairs, future replacement costs and unexpected costs
- Reserving adequately today may help prevent the need for special assessments later
- Reserve studies can help determine the amount of money needed in reserve
- Seek the assistance of an attorney for guidance on state specific laws

Endorsed by:



Underwritten by:



Administered by:



<sup>1</sup> "What Are The Fiduciary Responsibilities Of HOA Board Members?", HOA Management (last visited March 19, 2024), <https://www.hoamanagement.com/fiduciary-responsibility-of-hoa-board-members/>

<sup>2</sup> *Smith v. Gorkom*, 488 A.2d 858 (Del. 1985), see <https://law.justia.com/cases/delaware/supreme-court/1985/488-a-2d-858-4.html>

<sup>3</sup> "What Are The Fiduciary Responsibilities Of HOA Board Members", *supra* note 1.

<sup>4</sup> "Creating the best HOA budget: A step-by-step guide", (November 2, 2023), <https://www.fsresidential.com/corporate/news-and-articles/articles/six-step-reference-guide-to-preparing-hoa-budgets/>

<sup>5</sup> David Bitton, "HOA Reserve Fund Accounting: Best Practices", (January 14, 2024), <https://www.doorloop.com/blog/hoa-reserve-fund-accounting-best-practices>

<sup>6</sup> A.J. Sidransky, "Capital Reserve Funds: How Much Do You Really Need?", THE COOPERATOR, (April 2019), <https://gumleyhaft.com/capital-reserve-funds-how-much-do-you-really-need/>

<sup>7</sup> "HOA Reserve Study 101: Does Your Community Need It?", HOA Management, <https://www.hoamanagement.com/hoa-reserve-study/>

<sup>8</sup> "Summary of State Reserve Fund Laws", Community Associations Institute, (October 2023), [https://www.caionline.org/Advocacy/Priorities/ReserveStudy/Documents/Summary%20of%20State%20Reserve%20Fund%20Laws%20\(Oct%202023\).pdf](https://www.caionline.org/Advocacy/Priorities/ReserveStudy/Documents/Summary%20of%20State%20Reserve%20Fund%20Laws%20(Oct%202023).pdf)

<sup>9</sup> Justine A. DelVecchio, Steven G. Mlenak, Steven Nudelman, "New Jersey Becomes Second State to Enact Legislation to Protect Structural Integrity of Residential Housing Structures Including Common Interest Communities", Greenbaum, Rowe, Smith & Davis LLP Client Alert, (January 16, 2024), <https://www.greenbaumlaw.com/insights-alerts-NJ-Becomes-Second-State-to-Enact-Legislation-to-Protect-Structural-Integrity-of-Residential-Housing-Structures-Including-Common-Interest-Communities.html>

<sup>10</sup> "Florida Structural Integrity Reserve Study and Funding Requirements: Frequently Asked Questions", Reserve Advisors, (2024), <https://www.reserveadvisors.com/resources/blog/florida-structural-integrity-reserve-study-and-funding-requirements-faq/>

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