



Hawaii Condominium Bulletin

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What is the Association's Reserve Fund Condition?

By Mike Price RS



This is a now a frequent question of lenders and prospective astute buyers. It should be the question of every owner. As we slowly climb back from the longest recession and real estate market decline in recent history, whether an association is adequately funded is a deal maker or breaker in the real estate market. Lenders do not want mortgage payment delinquency and resulting foreclosure losses due to surprise loans and special assessments impacting mortgagees' ability to make monthly payments. No lender or owner is happy with deferred maintenance due to inadequate funding. Foreclosures and delinquencies result in financial shortfalls, placing higher maintenance fees and special assessment payments on future owners. Loss of property value and investment is another result of inadequate funding.

A current Reserve Study by a reserve professional is more and more a necessary requirement of mortgage applications. Lenders look for strong funding and a complete component list of major assets requiring replacement by Reserve funding. Adequate funding begins with an accurate Reserve Component List.

A Reserve Study prepared according to National Reserve Study Standards (NRSS) defines the Reserve Component List: a clear description of the major assets maintained by the association with limited, predictable life expectancies. There is a 4 Part Test qualifying an expense as a Reserve Component:

1. Component must be the Association's maintenance responsibility.
2. Component must have a limited Useful Life (UL).
3. Component must have a predictable Remaining Useful Life (RUL).
4. Component must be above a minimum Threshold cost.

All parts of the test must be met for an expense to qualify as a NRSS Reserve Component and all qualifying components must be included and adequately funded.

The Component List is the foundation of the Reserve Study Report and calculation of Reserve Fund strength. The Board of Directors has the fiduciary responsibility for insuring that the Component List includes all assets

(continued page 4)

Message from the Chair



Happy Holidays Everyone,

Well it's that time of year where the holidays are bearing down upon us and it's hard to fathom that 2014 is nearly over. What does that mean for condominium associations? Annual meeting season will be popping up soon. This is the one time in the year that an AOOU owner has a voice in the previous year's actions and the upcoming year's events (I am speaking of course for those AOOU's that are on a calendar year).

One of the issues that come up during the annual meeting season is the annual audit. Condo associations of 20 units or more are required by statute to have an independent annual audit done; the results of the audit are usually presented at the annual meeting. Recently I was asked by a fiscal manager if an association could do the accounting by cash method as opposed to accrual method, and the answer is yes....with caution. Although the statute allows for accounting of the AOOU's funds to be done by either the accrual or cash method, most CPA's, fiscal managers and auditors prefer the accrual method as it provides a much clearer idea of the associations' funds, whereas the cash method may show a great financial statement, but doesn't show what has not been paid. This makes it more difficult for the auditor, and usually after the audit it may appear that the AOOU is not in as good a shape as it thought.

§514B-148 Association fiscal matters; budgets and reserves. (a) The budget required under section 514B-144 (a) shall include at least the following:

- (1) The estimated revenues and operating expenses of the association;
- (2) Information as to whether the budget has been prepared on a cash or accrual basis;
- ...

§514B-150 Association fiscal matters; audits, audited financial statement. (a) The association shall require an annual audit of the association financial accounts and no less than one annual unannounced verification of the association's cash balance by a public accountant; provided that if the association is comprised of less than twenty units, the annual audit and the annual unannounced cash balance verification may be waived at an association meeting by a vote of a majority of the unit owners.

(b) The board shall make available a copy of the annual audit to each unit owner at least thirty days prior to the annual meeting which follows the end of the fiscal year. The board shall not be required to submit a copy of the annual audit report to an owner if the proxy form issued pursuant to section 514B-123(d) is not marked to indicate that the owner wishes to obtain a copy of the report. If the annual audit has not been completed by that date, the board shall make available:

- (1) An unaudited year end financial statement for the fiscal year to each unit owner at least thirty days prior to the annual meeting; and
 - (2) The annual audit to all owners at the annual meeting, or as soon as the audit is completed, but not later than six months after the annual meeting.
- (c) If the association's fiscal year ends less than two months prior to the convening of the annual meeting, the year-to-date unaudited financial statement may cover the period from the beginning of the association's fiscal year to the end of the month preceding the date on which notice of the annual meeting is mailed

Until next Year, Happy Holidays and a Happy Prosperous New Year.

Aloha

Scott A. Sherley

Almost Free Legal Advice 2014

On November 13, 2014, the Hawaii Council of Community Associations held its “Almost Free Legal Advice 2014” workshop. This popular workshop is held every year and offers condominium owners the opportunity to get the answers to legal questions “almost free” from legal practitioners representing condominium associations.

The Office of Consumer Protection Executive Director Bruce Kim, Esq. talked about his office’s role in protecting and enforcing the consumer protection laws in Hawaii and noted some current scams affecting consumers. Ann Anderson, Esq. offered advice for safely contracting for association services and dealing with difficult residents.

John Knorek, Esq., an employment law specialist discussed hiring practices and gave tips on staying within federal and Hawaii state law. He also gave advice about maintaining employees in a healthy work environment and when necessary, terminating employees and how best to do so.

Phyllis Okada Kacher, Senior Vice President of Hawaiiana Management Company moderated the speakers and audience discussion.

Posting Association Protocols For Owner Inquiries

Where do you go for answers when you have questions concerning your condominium association? What are the protocols for communicating with board members or the condominium managing agent?

Every association has different procedures for communicating with its owners. Do you know what they are? Chances are you may not; board members may even be unsure of the protocol for communicating information to owners. Does it come directly from the board members? Or is it the duty of the resident manager or condominium managing agent to respond to owner inquiries? How do owners obtain meeting minutes, a current copy of the association’s declaration or a list of unit owners?

Every condominium association should document the procedures and chain of communication for owners seeking information and post these in a prominent place within the association common area. It could be posted on a bulletin board in a common area or lacking space for posting, a notice sent out to all owners listing the protocols.

For owners, follow the protocol for obtaining information and be precise in your requests. Instead of requesting “meeting minutes”, be specific and ask for minutes for all board meetings for the year 2013, for example. Managing agents often don’t keep records for more than a year at a time; records may be removed to storage sites. A clear request will save them time and get the documents to you in a more timely fashion. Moreover, a request describing the documents you are seeking and a time frame, e.g., information related to plumbing work done in the association in 2012, will assist those who are responsible for getting the documents to you and save you the frustration of having to clarify your request at a later time.

Clear procedures for obtaining information is a first step in maintaining a harmonious living environment.

What is the Association's Reserve Fund Condition?

(cont. from page 1)

requiring Reserve Funding. The reserve study or reserve study update process can be delegated to the management agent or professional reserve provider, but their report recommendation has to be approved by the Board of Directors after their review for completeness. Checking completeness of the Component List is not difficult and NRSS provides a handy checklist to assist with this review at www.caionline.org.

A Reserve Study prepared according to National Reserve Study Standards (NRSS) includes a bench mark calculation of Reserve Fund Strength based on dividing the current Fiscal Year (of the Reserve Study Report) Starting Reserve Fund Balance by the Current Total Deteriorated Value of all Reserve Components. This Current Total Deteriorated Value is labeled the "Fully Funded Balance" in the Reserve Study Report. No matter what funding objective is selected: Full Funding, 50% Hawaii Funding (Threshold Funding per NRSS), or Hawaii Cash Flow Method funding (Baseline Funding per NRSS) this benchmark measure of Reserve Fund Strength should be transparent in the Reserve Study Report. The calculation is stated as **Percent Funded**. An association's Percent Funded evaluation is not the same as "100% Replacement Reserve" for the current year. Percent Funded is also not a comparison of current Reserve cash to the total replacement cost of all Reserve assets.

The NRSS Percent Funded strength is a measure of future risk of cash flow problems for the association. Percent Funded indicates the strength and adequacy of the reserve fund. A Percent Funded between 70% and 130% is considered strong because the association has Reserve cash on-hand roughly equivalent to the deterioration of its Reserve components, with the result that Reserve cash flow problems (special assessments and deferred maintenance) are extremely rare in this range. **A Percent Funded between 30% and 70% is considered fair**, as there is typically enough Reserve cash on hand in this range to manage the necessary Reserve projects without running into a cash flow problem when projects inevitably happen earlier or more expensive than anticipated. **A Percent Funded below 30% is considered weak** because Reserve cash flow problems are common, since there is little to no margin for the association to manage projects that happen earlier or more expensive than anticipated. Note: when all goes according to plan, there are no problems. But because reality rarely goes exactly according to plan, associations need some "margin" to avoid cash flow problems. **A below 30% funding objective has the highest risk of cash problems.**

In closing, adequate funding of Reserves is responsible, required by lenders, and fair to all owners now and in the future. Please make wise reserve study decisions.

About the Author: Mike Price – CAI Reserve Specialist #164 has provided independent third party comprehensive reserve studies for all Islands in the past. Mr. Price has a BA degree from Eastern Washington University and over 30 years' experience in construction and project management. Mr. Price can be contacted at mike.arhllc@gmail.com or 808 936-4789.

Condominium Association Biennial Registration 2015 - 2017

Registration for the 2015-2017 condominium association biennial registration will begin in April of 2015. Deadline for completed registrations is May 30, 2015; the deadline for applications for a fidelity bond exemption is April 30, 2015. The registration period runs from July 1, 2015 to June 30, 2017.

Two fee increases will impact condominium associations in the upcoming registration period. Act 187 (2013) added "[s]upport for mediation of condominium related disputes" as an educational purpose of the Condominium Education Trust Fund ("CETF") (HRS § 514B-71) and requires the Real Estate Commission to ensure that adequate funds are available for the mediation of condominium disputes. To that end, HRS § 514B-72 was amended by Act 187 to increase the biennial CETF fee by \$1.50 per unit, from \$3.50 per year to \$5 per year. The result is an increase to \$10 (from \$7) per unit per biennial registration.

The second fee increase is a department wide increase on all licensing and Consumer Resource Fund fees; it is the first department fee increase since 1982. As it affects condominium association registration, the registration fee will increase to \$60, from \$50. This fee increase took effect on October 20, 2014.

Watch for reminder cards to be sent out in April of 2015. If contact information has changed since the last association registration, complete and submit a Condominium Association Information Update Form available on the Real Estate Branch website, www.hawaii.gov/hirec. (Click on the "Forms" link.)

Ask the Condominium Specialist

Q: I live in a small self-managed condominium association. We are having our annual meeting soon and I would like to know where I can take our proposed proxy ballot to confirm that it is legal under the condominium law. Where may I take it to have someone review it for validity?

A: Hawaii Revised Statutes § 514B-123 (d) governs proxies. It is one of the self-enforcing provisions of the Hawaii condominium law. This section sets forth the minimum requirements necessary for a proxy ballot to be valid. There is no agency of the government, including the Real Estate Branch that has the jurisdiction to review and comment on your document. You may, however, have the form reviewed by an attorney familiar with the condominium law to assure the proxy form's compliance with the statutory requirements.

Q: I have concerns about the managing agent managing my condominium association and the employees working for him. One in particular does not have any real estate license. I thought it was a requirement that employees of a condominium managing agent must hold a real estate license? Where may I go to file a complaint about this?

A: There is no requirement that employees of a condominium managing agent must have a real estate license. Hawaii Revised Statutes § 467-1 defines "real estate broker" and "real estate salesperson" and gives examples of activities that constitute real estate activity for which a person must have a license. A managing agent may hire employees for work that falls well outside of these areas, for example as an office manager or payroll clerk where no real estate license is necessary to perform the work.

Complaints against real estate licensees alleging a violation of the real estate licensing law, HRS Chapter 467, are the jurisdiction of the Regulated Industries Complaints Office. That office's complaints telephone number is (808) 586-2653.

The information provided herein is informal and intended for general informational purposes only. Consult with an attorney familiar with the Hawaii condominium law for specific legal advice regarding a particular situation.

Condominium Hotel Operator Re-registration

Reregistration for all 28 registered condominium hotel operators (CHO) was conducted from October 20, 2014 to November 30, 2014. All registered CHOs that do not reregister by December 31, 2014 will be terminated and may not conduct any further activities related to the CHO. To continue conducting CHO activities, a terminated CHO must reapply and register as a new CHO.

A CHO operates short term rentals (less than 30 days) of condominium units. Authorization for short term rentals within a condominium association is contained in the project documents (declaration and bylaws) and permitted by City and County zoning rules. CHO activity is governed by Hawaii Revised Statutes § 467-30 and its accompanying administrative rules.

Pursuant to HRS § 467-30 (g) (2), a registered CHO may not be licensed as a real estate salesperson or broker. Licensed real estate brokers may conduct CHO activities under the brokerage; a real estate salesperson may conduct CHO activities only under its supervising brokerage.

Not all Reserve Studies are the same. Most professionally prepared Reserve Study Report state the following key pieces of information in the first few pages of the Report:

1. Name and location of the association.
2. Who prepared the study or supervised its production.
3. What credentials and experience the preparer holds.
4. Current Reserve Fund status.
5. Methods and objectives utilized in computing or evaluating the association's Reserve Fund status.
6. Type of report: Full study with site inspection (Level I), Update with site inspection (Level II) or Update without site inspection (Level III).
7. Starting reserve fund balance for report period.
8. Report period covered.
9. List of reserve components requiring funding.
10. Listing of component quantities or descriptions, and current replacement cost.
11. Methods and goals of the funding plan using National Standard terminology. Goals can be Full Funding, Threshold Funding (Hawaii 50% Funding), or Baseline Funding (Hawaii Cash Flow Method).

This is a partial list of what is required by **National Reserve Study Standards (NRSS)**. The National Reserve Study Standards provides a check list of items required in the report. Download and use the checklist found at CAI website www.caionline.org.

The Reserve Study is budgeting tool for properly maintaining the property major assets (components) in the future without cash problems, deferred replacement, or need for loans or special assessments. A Reserve Study should be prepared without bias. This is achieved by selecting an independent preparer or someone with no interest or investment in the property. The current status and strength of the Reserve fund is based on a complete Component list and an accurate evaluation of the state of deterioration of the Components. Fact: all reserve components start deteriorating as soon as they are installed and begin service. Leaving components off the component list, overestimating reasonable and predictable Useful Life (UL) of a component, or underestimating the deterioration and resulting Remaining Useful Life (RUL) left before replacement is necessary, biases the Reserve Fund Current Status. This puts the association at risk of cash problems and deferred maintenance in the future. It's your reserve study and you have a considerable investment in your home and share of the Common Areas of the association. Make sure the Component List is complete, accurate and reflects the true deterioration of the components listed.

Future projections of component cost, Remaining Useful Life (RUL), and scheduled replacement are based on current conditions. The Current Fund Status and Fund Strength mentioned above are considered accurate and reliable calculations. The Report future funding plan and component replacement schedule is much less reliable. Calculations are based on prediction of future events that may or may not occur exactly as predicted. These projections, based on current economic trends, are better than ignoring future funding requirements. Due to unknown future events, accuracy of these projections certainly diminishes with time. The first 5 years of the Reserve Study projected future funding plans have much more reliability than projections from year 6 onward into the distant unpredictable future. Future economic conditions can not be predicted with complete accuracy. For example, did we know how long the current Recession would last in 2008 (6 years ago)?

Hawaii State Law requires the Board of Directors annually review and adjust the association Reserve Funding Plan for current conditions. This rule was put into law to maintain reliability and adequate funding for major component replacement in the future. Due diligence by the Board will verify if the projected costs, deterioration and scheduled replacement of the current fiscal year match the projections provided in the Reserve funding plan being used. If current conditions do not match the Reserve funding plan projections then the plan and resulting reserve contribution rate needs to be adjusted. If component replacement is not performed as scheduled then the deteriorated cost remains and requires adequate funding and replacement rescheduling in the future. Ignoring these changes and not adjusting reserve funding is unacceptable under Hawaii Law.

Now that you have read and evaluated the key parts of your reserve study, do you feel secure and protected from future surprise cash problems, special assessments or need for loans to make up for inadequate funding? If not, it is time to update the reserve study to current conditions of the association. Adequate funding of Reserves is responsible, required by lenders, and fair to all owners now and in the future. Please make wise reserve study decisions.

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Mediation Case Summaries

From September 2014 through November 2014, the following condominium mediations were conducted pursuant to Hawai'i Revised Statutes § 514B-161, and subsidized by the Real Estate Commission. Mediation Center of the Pacific conducted additional condominium mediations in Honolulu District Court.

In September, Ku'ikahi Mediation Center received a \$5,000 grant from the Hawai'i Island United Way to provide mediation services to Puna residents impacted by Tropical Storm Iselle. On November 9, 2014, in participation with the Hawaii County Bar Association, Ku'ikahi held its Ninth Annual Recognition Dinner and Auction in Hilo to help fund the non-profit human services agency. This annual dinner provides a significant portion of the funds that Ku'ikahi needs to provide free and low-cost dispute resolution services to the East Hawaii community.

Congratulations, Ku'ikahi!

Mediation Center of the Pacific

Through Skype video conferencing capabilities, MCP has been conducting additional mediations with condominium owners who live part-time in Hawaii and are currently residing out of the state

Owner vs. Board	Foreclosure action initiated by board.	Mediated; no agreement.
Owner vs. Board	House rules dispute over access to the parking area.	Closed; no mediation.
Owner vs. Board	Unapproved modifications to unit.	Closed; no mediation.
Board vs. Owner	Dispute over alleged house rule violations.	Parties declined mediation.

Mediation Services of Maui

Owner vs. Board	Requested documents not received; concerns re: board-approved water and septic system.	Mediated to agreement.
Owner vs. Board	Owners being charged for upgrades that they did not ask for or approve.	Mediated to agreement.

Ku'ikahi Mediation Center, West Hawai'i Mediation Center and Kaua'i Economic Opportunity did not report any condominium mediations for this period. They continue to reach out to the condominium communities to educate owners about the benefits of mediation as a dispute resolution tool.

2014 - 2015 Real Estate Commission Meeting Schedule

Laws & Rules Review Committee – 9:00 a.m.

**Condominium Review Committee – Upon adjournment of
the Laws & Rules Review Committee Meeting**

**Education Review Committee – Upon adjournment of the
Condominium Review Committee Meeting**

Real Estate Commission – 9:00 a.m.

Wednesday, December 10, 2014

Wednesday, January 07, 2015

Wednesday, February 11, 2015

Wednesday, March 11, 2015

Wednesday, April 08, 2015

Wednesday, May 13, 2015

Wednesday, June 10, 2015

Wednesday, July 08, 2015

Wednesday, August 12, 2015

Wednesday, September 09, 2015

Wednesday, October 07, 2015

Tuesday, November 10, 2015

Wednesday, December 02, 2015

Friday, December 19, 2014

Friday, January 23, 2015

Friday, February 27, 2015

Friday, March 27, 2015

Friday, April 24, 2015

Friday, May 29, 2015

Friday, June 26, 2015

Friday, July 24, 2015

Friday, August 28, 2015

Friday, September 25, 2015

Friday, October 23, 2015

Wednesday, November 25, 2015

Friday, December 18, 2015

All meetings will be held in the Queen Liliuokalani Conference Room of the King Kalakaua Building, 335 Merchant Street, First Floor.

Meeting dates, locations and times are subject to change without notice. Please visit the Commission's website at www.hawaii.gov/hirec or call the Real Estate Commission Office at (808) 586-2643 to confirm the dates, times and locations of the meetings. This material can be made available to individuals with special needs. Please contact the Executive Officer at (808) 586-2643 to submit your request.

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