

# *Foresight Financial Services, Inc.*

## *AB 2718 COMPLIANCE*

First we would like to take this opportunity to thank our numerous clients for their loyal support, to reaffirm our dedication in serving you and your best interests, and to underscore our firm and continuing commitment to provide our clients with the finest reserve analysis available. In that spirit, and as we are all aware, AB 2718 became effective July 1, 2005 and in our customary fashion we have conducted a diligent review of our entire Reserve Study procedure to evaluate and address its relevant potential impacts. As a result, Foresight Financial Services, Inc. has completed any necessary enhancements to ensure compliance with the new statute. Our Study includes a 30 year cash flow analysis and we believe not only meets, but far exceeds, all of the requirements and provisions set forth by the California Civil Code.

## *NEW DISCLOSURE SUMMARY*

One of most talked about topics of the new law is the addition of Section 1365.2.5 which creates a new form, the **Assessment and Reserve Funding Disclosure Summary**, and requires its inclusion in the annual budget package that must be published to the owners. As its name suggests the form contains information regarding the associations' assessments (items 1 & 2) and its reserve funding (items 3 through 6). To serve you as effectively as possible, we will provide a proposed Assessment and Reserve Funding Disclosure Summary as part of our standard Reserve Study package for all clients for whom we provide a *current* Reserve Study.

Due to timing concerns we have come to the conclusion that the most efficient way to accommodate this new requirement is to split the form into two parts. Foresight Financial Services, Inc. will provide a proposed Disclosure Summary at the time your Reserve Study is prepared which will include responses for items 3 through 6 (the reserve disclosures), and the Management Representative/Board of Directors should provide for items 1 & 2 (the assessment information) after the association approves its new budget. Since the information for items 1 & 2 is not known until the very end of the budgeting process and the Reserve Study is typically prepared at the beginning of the budgeting cycle, we believe this division will be preferred. It eliminates the extra steps necessary for the Board to communicate its final budgeting decisions to us for inclusion into the Summary at a crucial time when there is often great pressure to meet publication deadlines. Our Disclosure Summary will be provided in an electronic format which will allow you to respond to questions 1 & 2 and then print the entire form as one continuous document. A copy of our intended Summary is included for your convenience.

Please remember that the new Disclosure Summary must be published to the owners every year in the annual budget, and we can only provide the document for those clients for whom we have prepared a current Reserve Study.

## **THE FAMOUS QUESTION #3**

Foresight Financial Services, Inc. will provide information for your response to the Assessment and Reserve Funding Disclosure Summary addressing items 3 through 6 at the time your Reserve Study is prepared. However, one item is particularly awkward and warrants further discussion. Question #3 on the new form reads as follows:

(3) *"Based upon the most recent reserve study and other information available to the board of directors, will currently projected reserve account balances be sufficient at the end of each year to meet the association's obligation for repair and/or replacement of major components during the next 30 years? Yes \_\_\_ [or] No \_\_\_ "*

The question as stated, cannot be answered either way without qualification, but the form as indicated, allows for no such qualification. The form only allows a further response in item #4, again without qualification, if one answers "No" to item #3. The question serves only one purpose and that is to place prospective and existing homeowner association members on notice of a possible risk that they may incur additional assessments or other contributions to reserves in the future. An unqualified "Yes" answer offers no such notice or warning to these members, but instead becomes a representation by the Association that they do not have a risk of an additional assessment, which could expose the Association to potential liability. In our opinion, such an unqualified "Yes" would be nothing more than a "guess", and should be avoided. Secondly, there is no place on the form to offer a qualified "Yes", and by altering the form, you may abandon the statutory safeguards that protect the association from liability by offering a qualified "No" response. We further believe that offering any "Yes" response contradicts and negates the premise and basis of the Reserve Study that is expressly based upon a variety of assumptions and predicates. This could give rise to misunderstandings of the purpose and content of a Reserve Study and also expose the Association to potential liability.

We recommend that the response be in the form of a "supplemented or modified" one as permitted in the statute and it is our judgment that no matter what the Reserve Study indicates, a "qualified or supplemented" "No" would be the most appropriate answer and in your best interest. It should further be understood that even though the "NOTE" states: "The financial representations set forth in this summary are based on the best estimates of the preparer at the time", there is a difference between an "estimate" and a "guess", and given the many logical qualifications in the Reserve Study, providing specific numbers in Question #4, would be merely a "guess", and we advise against providing such numbers. This "form qualification" assumes a burden on the preparer, to insure that the estimates given are in fact the "best estimates" at the time, without further limitation, and not "guess work".

Therefore, the following document contains the language we intend to incorporate into our Summary for your consideration in responding to the Disclosure Summary. We believe this to be the most suitable response and in the best interest of our clients. Since it is not our intention to provide legal advice on this matter, as these issues may transcend those of our consulting engagement, we recommend that you review this matter with your legal counsel or other appropriate professionals.

# SAMPLE HOMEOWNERS ASSOCIATION

## ASSESSMENT AND RESERVE FUNDING DISCLOSURE SUMMARY

DECEMBER 31, 2005

(1) The current assessment per unit is \$xxx per xxx.

*Note: If assessments vary by the size or type of unit, the assessment applicable to this unit may be found on page xxx of the attached report.*

(2) Additional assessments that have already been scheduled to be imposed or charged, regardless of the purpose, if they have been approved by the board and/or members:

<i>Date Assessment is Due</i>	<i>Amount per Unit per Month</i>	<i>Purpose of the Assessment</i>

*Note: If assessments vary by the size or type of unit, the assessment applicable to this unit may be found on page xxx of the attached report.*

The association's board of directors has relied on information, opinions, reports and statements presented to it by vendors, contractors, reserve study specialists, CPAs and/or other professionals and is relying upon this information, financial data and reports pursuant to Corporations Code § 7231 in providing the association membership the information contained in this Assessment Reserve Funding Disclosure Summary.

(3) Based upon the most recent reserve study and other information available to the board of directors, will currently projected reserve account balances be sufficient at the end of each year to meet the association's obligation for repair and/or replacement of major components during the next 30 years?

Yes \_\_\_\_\_ No   X  

(4) If the answer to #3 is no, what additional assessments or other contributions to reserves would be necessary to ensure that sufficient reserve funds will be available each year during the next 30 years?

<i>Approximate date assessment will be due:</i>	<i>Amount per unit per month:</i>
<b>See note below *</b>	

\* The need for, the amount of, and the timing for additional assessments or other contributions to reserves are directly correlated to and expressly conditioned upon, actual and sometimes unforeseen events that will occur over the next 30 years, in conjunction with a variety of other factors that will determine whether improvements can last their estimated useful lives and whether replacement costs have been accurately predicted.

ASSESSMENT AND RESERVE FUNDING DISCLOSURE SUMMARY  
(CONTINUED)

DECEMBER 31, 2005

A Reserve Study is periodically prepared for the association as mandated and in compliance with California law to assist in the budgeting for a major repair, refurbishment and/or replacement of association owned improvements and major components that are expressly identified in the Reserve Study ("Major Components") that are properly maintained. While the Reserve Study cannot be used as a guaranty of any of its budgetary conclusions, it is used by the association as a tool to anticipate and estimate how Major Component reserves should be currently funded in an effort to mitigate the need to make additional assessments in the future.

The Reserve Study relies upon numerous assumptions and predictions and expressly excludes a comprehensive analysis of factors and future events that are essential in determining the structural tolerances and actual useful life of a component. The Reserve Study findings can easily be invalidated by changes in any of the assumptions or the occurrence of any events typically excluded from the analysis, such as weather, environmental, seismic and geological impacts, quality of construction and installation, possible construction and/or other manufacturing defects or failures, acts of vandalism, the actual useful life and/or actual wear and tear of a component, the actual replacement cost of a component, economic and inflationary factors or the future availability of labor and materials at current or future price estimates. In addition, the Reserve Study does not include a comprehensive analysis or an engineering analysis of Major Components.

The Reserve Study relies on a variety of assumptions and predicates concerning each Major Component, to generate budgetary estimates, which estimates are based upon industry standards, manufacturer specifications, a program of scheduled maintenance and anticipated environmental conditions and other conditions affecting wear and tear. These estimates are generally accepted in the practice of formulating reserve studies, and include estimates of replacement value and life expectancies of the components as well as assumptions regarding future events. As a result, any one or more of the statistical components that form the basis of assumptions that are used to project anticipated events and conditions can fail. Therefore the actual replacement cost, useful life and remaining life may vary from the reserve study and the variance may be significant. In addition it is impossible to conclude that any mathematically supported and financially prudent funding mechanism adopted by the board of directors and used to fund reserves can guarantee sufficient funds for each Major Component for the next 30 years. It is also impossible to provide a "best or reasonable estimate" of the adequacy of reserve funds or the likelihood and/or risk of, magnitude, or timing of additional assessments for the next 30 years due to the multitude of variables, assumptions and predicates as well as the sheer duration of time. Any such attempt would simply constitute a guess. Additionally, other factors may influence a board of directors in establishing assessments within the association, which may have little to do with the results of a Reserve Study.

For these reasons, the Reserve Study is not able to accurately predict or even reasonably estimate, what additional assessments or other contributions will be necessary to ensure that sufficient reserve funds will be available each year during the next 30 years. However, presuming that the association does in fact fund its reserve accounts at the levels recommended in the Reserve Study, presuming that all of the assumptions and predicates of those items and components examined by the Reserve Study, as more fully identified and described in the Reserve Study, remain true and correct for the next 30 years, and presuming that those matters not included within the scope of the Reserve Study analysis, or that are deemed immaterial or are expressly excluded from the Reserve Study scope of analysis, never become material or relevant over the following 30 years, there is no reason to conclude that over the following 30 years the association will be required to seek additional assessments or other contributions. Members and prospective homeowner association members are referred to the Reserve Study and the Associations' final adopted budget for a more comprehensive analysis of the foregoing and the likelihood and/or risk that a future assessment can occur.

ASSESSMENT AND RESERVE FUNDING DISCLOSURE SUMMARY  
(CONTINUED)

DECEMBER 31, 2005

(5) The following major components, which are included in the reserve study, are NOT included in the existing reserve funding:

<i>Major Component:</i>	<i>Useful remaining life in years:</i>	<i>Reason this major component was not included:</i>
<b>None **</b>		

\*\*At the time of this Reserve Study Report, there were no known components or items included in the reserve study and not included in the Reserve Funding.

(6) As of the last reserve study or update, the current balance in the reserve fund is \$0. Based on the method of calculation in paragraph (4) of subdivision (b) of Section 1365.2.5, the required amount in the reserve fund is \$0.

NOTE: The financial representations set forth in this summary are based on the best estimates of the preparer at that time. The estimates are subject to change. Major Components with a remaining useful life of more than 30 years have been excluded from the reserve analysis calculations. This summary is predicated on the Sample Homeowners Association December 31, 2005 Reserve Study Revision 0.