THE VOICE OF THE VACATION OWNERSHIP INDUSTRY

Developments

June 2011

ACE PROJECT OF EXCELLENCE

Plus:

- Inside the 2011 ARDA Convention

WESTIN PRINCEVILLE
HAWAII

arda.org

Studying Reserves

Are timeshare resorts borrowing from their futures?

BY BETH MOORE, CPA

Beth Moore, CPA, a partner and timeshare niche leader for Dixon Hughes Goodman LLP, has over 22 years of public and private accounting experience. Her team specializes in providing audit, accounting and tax services to timeshare associations and currently serves over 75 associations throughout the United States. Her e-mail is ***bmoore@goodmanco.com****.*

Serving on a homeowners' association (HOA) board of directors may just be the most difficult job in vacation ownership today. Increasing maintenance fee delinquency rates, owner complaints about subsequent maintenance fee increases, and numerous resorts needing repair all add up to create enormous stress on HOA boards.

Unfortunately, one tactic some are using during these tight times could eventually cause that stress to increase. Although statistics aren't currently available, anecdotal evidence suggests that many HOAs are decreasing payments to reserve funds to compensate for unpaid maintenance fees. Other industry trends are contributing to this problem, and it is one every board needs to tackle before it becomes worse.

The Plan

In a perfect world, each developer's resort planning would include adequate reserve funding from the very beginning. That planning would be based on a carefully researched reserve study, and maintenance fees would be set at a level appropriate to fund all anticipated needs, taking into account inflation and other factors. The study would look at all aspects of a resort's operation and determine the useful life of assets such as carpet, pools, roofs, and heating and cooling systems. Once needs are scheduled into the plan, costs are divided by the number of owners and the number of years left before the items must be replaced, and these funds are placed into a reserve fund.

It's apparent that we're not living in a perfect world.

"This is an issue of top concern," says Larry Vanderhoof, chief reserve management director at Farrow Commercial Construction. "Associations aren't funding reserves at the levels they would like to or need to—often they're using that money to just keep the property operating."

It's not that HOAs are irresponsible, it's just that they may not see an alternative.

"When you have diminished funds, your choice is to eliminate spending on operations," explains Michael Cousins of inFUSION Consultancy. "You fund payroll and pay utilities. Reserve funds tend to come last."

With the latest ARDA International Foundation research showing that as many as 12 percent of owners are in arrears on maintenance fees, that's a lot of money for boards to compensate.

Another factor the industry is just beginning to realize is that the longer sales cycle in place at many projects means HOAs are taking control of resorts later than originally planned. Rather than a three-year sell-out, developers may be running the show until year nine or 10, and if they're not making contributions to reserve funds for unsold

units, the HOA starts out behind in reserve funding—right when major repair bills start cropping up.

"Frequently, the intent is to turn the resort management over to the HOA before reserve funding becomes critical," Cousins says.

Although developers in this situation intend to help the HOA, not many are going to write a $5 million check. The only alternative is to do a special assessment or increase maintenance fees dramatically, and neither is a palatable choice.

Long-Term Survival

With these pressures, putting off contributions to reserve funds may seem like the only way, but such a strategy can put a resort on the path to bankruptcy.

"Jettisoning reserves to keep assessments under control is penny-wise and pound-foolish," says Rob Webb, senior hospitality partner at the law firm of Baker & Hostetler. "Eventually, your exchange company ratings will go down, and you'll be caught in a downward cycle."

Vanderhoof agrees. "Owners are interested in equal or better accommodations than their primary residences," he says. "If you don't keep the resort fresh, they won't want to come back." Owners who don't plan to come back are even less likely to pay their maintenance fees.

There's also a fiduciary duty at play.

"Depending on the state, the law says that you may not use reserve funds for operating expenses without an owner vote," Webb advises. "Also, you may not fail to fully fund reserves without an owner vote."

The accounting firm that audits resort finances won't give opinions or advise on this topic but will add a supplementary statement noting that the reserves are not funded to the level required. That should be a red flag to the HOA board.

Unfortunately, state agencies aren't as active in enforcing these laws as they once were—the budget crunch has hit them, too.

"Nobody is catching them," Webb says. "This is a huge, huge problem. Owners aren't going to come back to resorts that aren't being maintained."

Best Practices

"Management's job isn't to convince boards to do one thing in particular; it's to recommend best practices and solutions," says Michael Schraibman, chairman and CEO of SPM Resorts, Inc. "It's important for management to show the board examples of resorts that are struggling without reserves. Management can also have an accountant speak to the board for training purposes and to highlight needs."

One argument is that it will be easier to save now than to do a special assessment.

"Management needs to wear a salesperson's hat," Vanderhoof says. "They have to make board members understand the importance of the reserve funds."

A related issue is spending funds now to save money later.

"I see a lot of band-aids going on," Vanderhoof adds. "If you take care of things, they'll have a longer, more useful life."

Schraibman agrees. "Preventative maintenance programs are of the utmost importance to keeping a resort in good working order," he says. "Purchasing good quality products and materials that have an extended service life ensures a property doesn't have to constantly purchase new furniture and materials. It's also important to purchase in bulk where possible."

If resorts are behind in funding reserves and need to do significant renovations, there are some options. The first is the dreaded special assessment, but that can become pricey, very quickly. If a resort needs to raise $1 million and there are 4,000 intervals, each owner would need to pay $250 over and above the normal annual maintenance fee.

Another option is a bank loan. "The loan could be secured by receivables," Schraibman advises, "with perhaps the best loan being one that can be paid from reserves over a five-year period."

Once the resort is through the crisis, keep revisiting the reserve study to make sure it's up to date. ■

Reserve Studies 101

- Include any expense over $10,000, as well as roofing, exterior painting, pavement, and interior furnishings, fixtures, and equipment.
- Schedule funding for maintenance, repairs and replacements, providing assurance that funds will be in place when needed.
- Update the plan annually.
- Do a new study every five years or after major renovations.
- Incorporate contributions from management, HOA boards, and engineers, so the study is accurate.

"Many HOAs are decreasing payments to reserve funds to compensate for unpaid maintenance fees, which could lead to compounded problems long-term.