

Cypress Creek United Civic Associations
18th Annual Seminar and Trade Show
February 22, 2003

Risk Management

Ralph A. Troiano

C.I.A. Services, Inc.



Agenda

- Types of risk
- Risk management cycle
- Dealing with risk
- Insurance for Associations
- Contractual protections
- Business risk
- Financial risk

Types of Risk

● Webster's definition

Risk (risk) *n.* **1** the chance of injury, damage, or loss; dangerous chance, hazard **2** Insurance *a)* the chance of loss *b)* the degree of probability of loss *c)* the amount of possible loss to the insurance company *d)* a person or thing with reference to the risk involved in providing insurance *e)* the type of loss that a policy covers, as fire, storms, etc.

● Speculative risk – win, lose or draw

- Casino gambling, horse track betting, lottery
- Stock market

● Pure risk – lose or draw

- Swimming pools without lifeguards, not doing PC backups
- Walking in under a ladder, stepping on a crack, using illegal drugs



Risk Management Cycle

- Identify exposures
 - Inspect facilities using all resources
 - Understand obligations from governing documents & laws
- Analyze options
 - Control, transfer or retain risks
- Implement decision
 - Purchase insurance
 - Implement policy, procedure or facility changes
- Evaluate on a regular basis
 - Things change - keep up



Dealing with Risk

Control

- Eliminate risks (remove diving board, cement in swimming pool)
- Avoid risks (remove trip hazards, preventative maintenance at playground)
- Reduce severity of risks (install fire sprinkler systems)
- Redundancy (double locks on gates, data backups)

Transfer

- Purchase insurance (transfer financial risk to insurance company)
- Contract language (assign responsibility to others)
- Convey assets to a third party (pool/park to utility district or private entity)

Retain or Accept

- Identify and accept exposure (terrorism exclusion, motor fried by lightning)
- Insurance deductible (retain limited exposure on certain financial risks)
- Reserve funds (to handle small/routine risks)



Insurance for Associations - 1

Directors & officers liability

- Covers alleged wrongful acts, breach of fiduciary duty
- Covers board and generally, volunteers, employees & management company
- Defense costs are included in the policy limit
- Dollar or percent deductible
- “Claims made” or “date of occurrence” policies – watch out for gaps when converting from one to the other
- Typical exclusions are (1) failure to insure, (2) illegal acts, (3) willful wrongdoing, (4) insured suing insured and (5) discrimination claims
- The Texas Charitable Immunity & Liability Act provides additional protections to Associations only if they have liability insurance in place
- Don't leave home without this policy!



Insurance for Associations - 2



Commercial general liability

- Covers third party property damage, bodily injury, personal injury
- Policies have two policy limits: a limit for each occurrence and an aggregate limit for the policy period
- Defense costs are outside of the policy limits
- There are generally no deductibles
- Typical exclusions are (1) intentional injury, (2) contractual liability, (3) pollution, (4) asbestos, (5) various overlapping coverages
- The Texas Charitable Immunity & Liability Act provides additional protections to Associations only if they have liability insurance in place
- This is also a “must-have” policy even if you have no common areas

Insurance for Associations - 3

Property coverage

- Covers Association property and other property in which the Association has an insurable interest
- Common perils include fire, freeze, windstorm, vandalism
- A loss may be covered at “actual cash value”, “replacement value” or “reproduction value”
- Limits based on itemized list or blanket coverage – don’t underinsure or you’ll face “co-insurance” problems
- Deductibles apply and can vary by item
- Typical exclusions are (1) wear and tear, (2) certain acts of God, (3) glass, (4) mold, (5) terrorism, (6) coverages by other policies
- Other property coverages include Flood, Earthquake, Boiler & Machinery, Inland Marine, EDP
- You don’t need this if you don’t have any insurable interests

Insurance for Associations - 4

Automobile

- “Hired and non-owned” covers liability, damage, towing and rental associated with vehicles being used by those doing Association business
- Coverage is secondary to the driver’s personal policy – it provides coverage in excess of the driver’s limits
- Note that this only covers an injured third party and not the driver or his vehicle
- The cost of this coverage is very low

Insurance for Associations - 5

- **Workers' compensation & employer's liability**
 - Workers compensation provides for medical payments and wage compensation for employees injured on the job
 - Employer's liability protects employers from suits brought by injured employees
 - An Association must have this if they have employees (or persons you call independent contractors that are arguably employees under the law)
 - An Association without employees should still consider this for liabilities with casual workers or contractors who's coverage lapses – the cost is relatively low with no employees



Insurance for Associations - 5



Crime/fidelity/employee dishonesty

- Protects Association funds from theft, embezzlement, fraud or dishonesty carried out by employees, officers, volunteers, management company
- This does not cover acts by outside parties such as a burglary
- Typically only covers salaried employees so an endorsement is needed to include the Board, volunteers and the management company
- The acts of “principals” of the insured are excluded
- Requiring a management company to carry fidelity coverage to protect the Association’s funds is not effective for at least three reasons: (1) the insured is the management company and not the Association, (2) acts by the principals of the management company are excluded and (3) the management company probably manages many other Associations so the coverage to your Association would be diluted



Insurance for Associations - 6

Umbrella policy

- Provides additional liability coverage over underlying policies
- The underlying policies are specified in the Umbrella Policy and could include Commercial General Liability, Hired & Non-Owned Automobile Liability, Directors & Officers Liability and Employer's Liability
- The Umbrella may actually cover additional activities, events or perils not included in the underlying policies
- In cases where the Umbrella is filling a “gap” not provided by an underlying policy, there is likely a high “retained limit” (think of it as a deductible on the Umbrella) - \$10,000 would be typical



Contractual Protections

- The fact that there is a contract will provide a layer of insulation for the Association
- A contract will provide defined responsibilities for a third party that may clearly indicate their responsibility regarding a risk
- A “hold harmless” clause requires the contractor to indemnify and defend the Association
- The insurance clause provides the contractor with the means to perform the “hold harmless” provisions
- As to disputes with the contractor, a contract can provide clauses minimize the Association’s risk (termination rights, dispute resolution options, litigation rights)



Contract Examples

- Pool Contract – Defined Responsibilities

“Before the first freezing weather, the pool facilities should be winterized including, but not limited to, shutting off water to the area and draining non-circulating lines.”

- Park Handyman – Defined Responsibilities

“Inspect all play and park equipment on each visit for broken, loose, damaged or missing parts or any other safety hazard. Immediately make repairs within designated expenditure authority. For safety hazards, rope off the equipment until it is repaired.”



Contract Examples



Simple Hold Harmless Clause

“Contractor agrees to indemnify and hold Association harmless for any claims asserted by any employees, agents, or subcontractors of Contractor arising from such employees’, agents’, or subcontractors’ positions with Contractor. ”



Contract Examples



Mutual Hold Harmless Clause

“Contractor agrees to exert its best efforts in rendering services and performing its duties and responsibilities, and to supervise its employees to whom duties may be delegated. Association agrees to indemnify, defend at its own cost and hold harmless Contractor and Contractor's employees or subcontractors from and against any and all suits, actions, claims, damages, costs, expenses and attorney's fees arising out of or relating to actions taken by Contractor or Contractor's employees or subcontractors in the execution or performance of this contract; provided, however, that Association shall not be liable for any suits, actions, claims, damages, costs, expenses and attorney's fees arising out of a willful, reckless or negligent act or omission or an unauthorized act of Contractor or Contractor's employees or subcontractors. Contractor agrees to indemnify and hold harmless Association from and against any and all suits, actions, claims, damages, costs, expenses and attorney's fees arising out of or incidental to a willful, reckless, negligent or unauthorized act by Contractor or Contractor's employees or subcontractors.”



Contract Examples

Miscellaneous Provisions

“Should either party hereto be required to institute legal action against the other party hereto to enforce the terms of this contract or to collect fees owing pursuant hereto, the prevailing party shall be entitled, in addition to all other amounts, to recover a reasonable attorney's fee and all costs of court.”

“Either party may require that disputes between the parties be submitted to nonbinding mediation prior to litigation. Each party shall bear its own costs of mediation and equally share all fees charged by the mediator.”



Business Risk

- Issues related to the operations of the Association
- Minimize operational risk by:
 - Create written policies, procedures and guidelines – communicate
 - Hold open meetings, allow access to records, communicate
 - Be fair, be reasonable, be consistent
 - Strive to resolve issues without litigation
 - Operate within the spirit of the law and all governing documents
 - Get educated and make best use of professionals
- Deficiencies result in D&O claims, unhappy owners and difficult legislation



Financial Risk

Establishing adequate reserve funds

- Operating fund
- Replacement fund
- Capital fund
- Special purpose funds

Controlling investment risk

- Establishing an investment policy
- Managing cash flow

Reserve funds

Operating fund

- To handle fluctuations in Association's revenue stream or operating expenses
- Ideal level is set as a percentage of annual operating expenses – reasonable numbers are from 25% to 75% depending on character of community

Replacement fund

- To provide funds for the refurbishing or replacement of existing physical assets of the Association
- Ideal level is calculated through a “reserve analysis”

Capital fund

- To provide funds for a specific capital project at some time in the future – a capital project adds a new physical asset (playground)
- Ideal level is calculated through a “capital project plan”

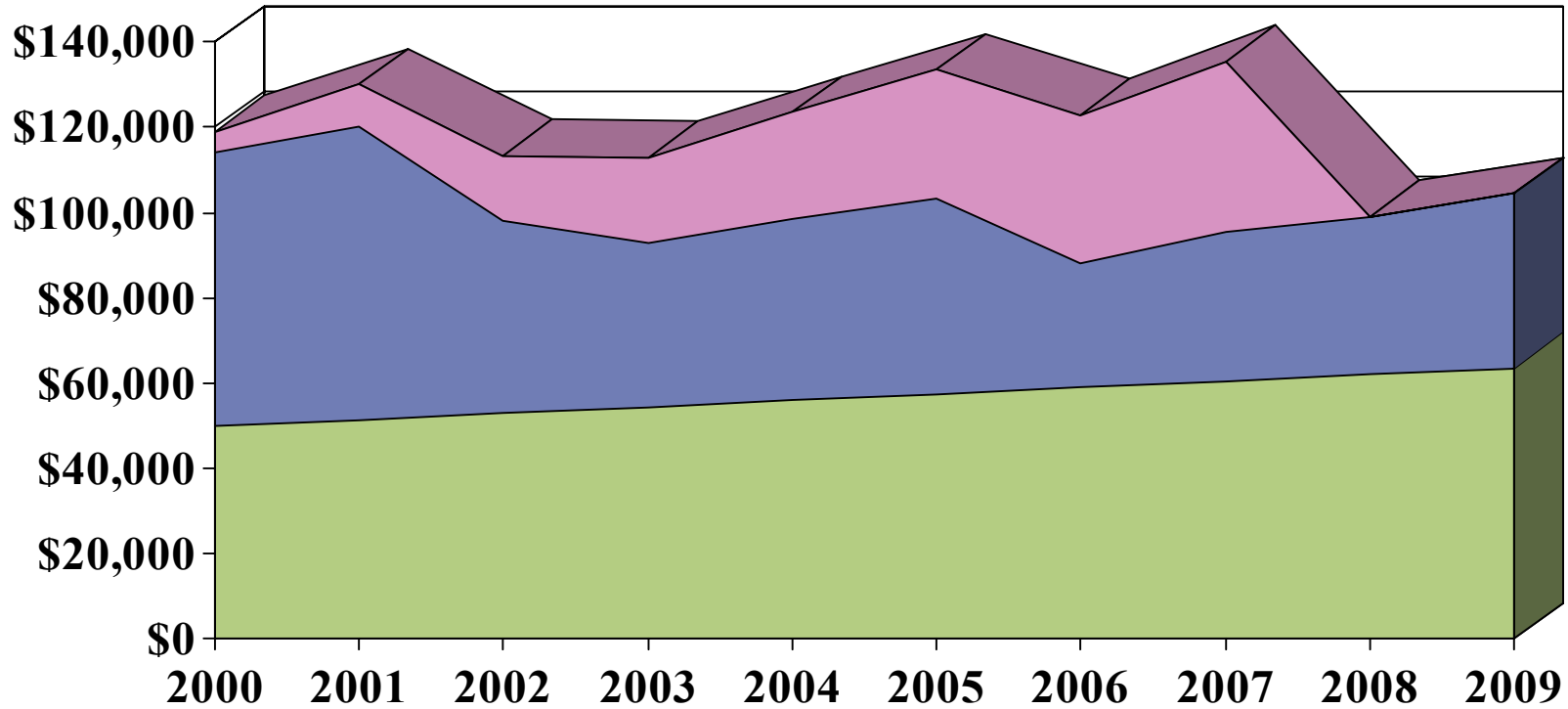
Reserve Analysis

Asset	Last Repair Year	Useful Life	Next Repair Year	Current Replacement Cost	Accumulated Balance as of 12/31/2002	2003 Contribution
Pool plaster	1998	8	2006	\$24,000	\$12,000	\$3,000
Clubhouse roof	1995	15	2010	\$6,000	\$2,800	\$400
Boulevard fence replacement	2000	18	2018	\$108,000	\$12,000	\$6,000
Boulevard fence painting	2000	5	2005	\$9,600	\$3,840	\$1,920
Totals				\$147,600	\$30,640	\$11,320

Capital Project Plan

Project	Added to Capital Project Plan	Project Ground Breaking	Estimated Project Cost	Accumulated Balance as of 12/31/2002	2003 Contribution
Install monument at 2nd entry	1999	2004	\$20,000	\$16,000	\$4,000
Install 1/3 mile jogging trail	2001	2006	\$36,000	\$14,400	\$7,200
Install exercise stations	2001	2007	\$14,000	\$4,667	\$2,333
Install pavilion with park equipment	2001	2009	\$30,000	\$7,500	\$3,750
Totals			\$100,000	\$42,567	\$17,283

Ideal Fund Levels



Operating Replacement Capital



Investment Policy



Investment priorities

- (1) Preservation of capital
- (2) Provide funds as needed for Association obligations
- (3) Earn additional revenue



Appropriate investments

- Bank accounts to FDIC limit
- Certificates of deposit to FDIC limit
- Brokerage house money market funds to SIPC limit
- U.S. Treasury bills, notes & bonds



Inappropriate investments

- Stocks, mutual funds, municipal or corporate bonds
- Futures, precious metals
- Anything with a fluctuating asset value
- Anything not insured or not guaranteed by the U.S. government



Sample Investment Policy

For a community association, an appropriate ranking of the conservative investment objectives is:

- (1) Minimize risk to funds (principal amount)
- (2) Ensure adequate funds are available to meet short and long term obligations
- (3) Maximize return on investments subject to the first two objectives

With these objectives in mind, there are a variety of investments which are appropriate and many more which are not. Appropriate investments include:

- Checking, savings and money market accounts at FDIC insured institutions in aggregate balances less than the \$100,000 FDIC limit
- Checking account equivalents at national brokerage firms in aggregate balances less than the firm's SIPC insurance limit
- Certificates of deposit in aggregate amounts less than \$95,000 from FDIC insured institutions
- Direct U.S. Treasury obligations such as treasury bills, notes or bonds
- Marketable obligations issued or guaranteed by U.S. government agencies such as mortgage loan obligations

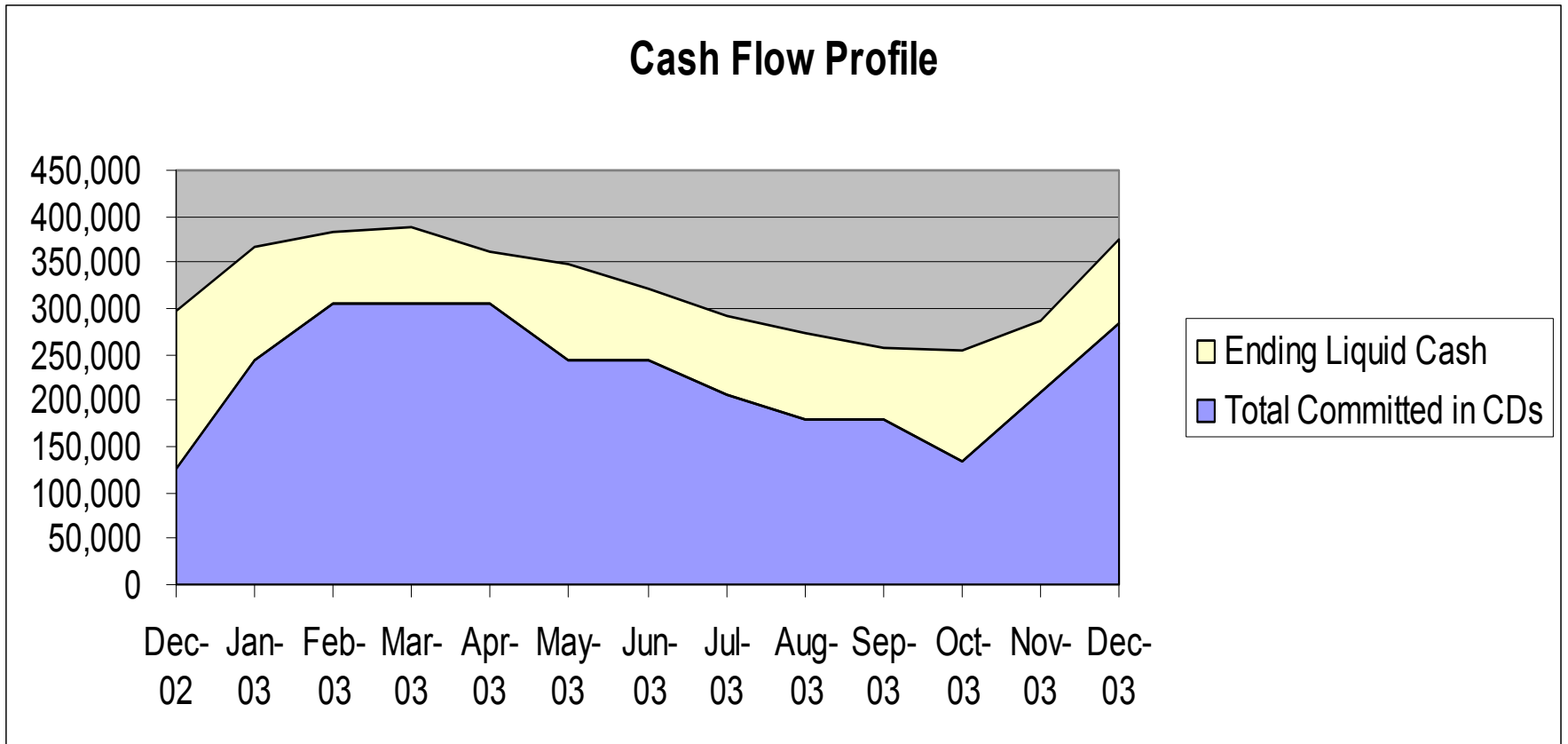
Inappropriate investments include:

- Stocks, municipal bonds, commercial paper
- Mutual funds with fluctuating asset values
- Any other investment not listed in the "appropriate" section

Scheduled Investments

	Dec-02	Jan-03	Feb-03	Mar-03	Apr-03	May-03	Jun-03	Jul-03	Aug-03
Total Ending Cash	298,520	366,520	382,520	387,520	361,520	347,520	322,520	292,520	272,520
Total Committed in CDs	125,000	245,000	305,000	305,000	305,000	245,000	245,000	205,000	180,000
Ending Liquid Cash	173,520	121,520	77,520	82,520	56,520	102,520	77,520	87,520	92,520
CD List									
Legg Mason 05/29/03	60,000	60,000	60,000	60,000	60,000	0	0	0	0
Morgan Stanley 07/01/03	40,000	40,000	40,000	40,000	40,000	40,000	40,000	0	0
Morgan Stanley 08/27/03	25,000	25,000	25,000	25,000	25,000	25,000	25,000	25,000	0
New 9 month CD	0	60,000	60,000	60,000	60,000	60,000	60,000	60,000	60,000
New 9 month CD	0	60,000	60,000	60,000	60,000	60,000	60,000	60,000	60,000
New 6 month CD	0	0	60,000	60,000	60,000	60,000	60,000	60,000	0
New 1 year CD	0	0	0	0	0	0	0	0	60,000
New 9 month CD	0	0	0	0	0	0	0	0	0
New 9 month CD	0	0	0	0	0	0	0	0	0
New 9 month CD	0	0	0	0	0	0	0	0	0
Total CDs	125,000	245,000	305,000	305,000	305,000	245,000	245,000	205,000	180,000

Cash Flow Profile





Ralph A. Troiano

Ralph Troiano is President of C.I.A. Services, Inc., a professional management company for community associations throughout Harris, Fort Bend, Montgomery and Brazoria counties. With 20 years of experience in the trenches, Mr. Troiano has presented numerous seminars on a variety of topics such as "Coping with Disaster", "Finance and Operations", "Strategic Planning", "Practical Deed Restriction Enforcement", "Super Budgeting" and "Myths in Management".

Prior to establishing C.I.A. Services in 1984, Mr. Troiano worked as an engineer and systems analyst for two major petrochemical companies. He has both bachelors and masters degrees in chemical engineering from MIT and has earned the PCAM designation from Community Associations Institute. His interest in community association management began by serving on the Board of Directors and being an active volunteer in each neighborhood he has lived. He currently also serves as the investment officer for a Fort Bend County Levee Improvement District.

C.I.A. Services, Inc.

9800 Centre Parkway, Suite 625

Houston, Texas 77036

Phone: 713-981-9000

Fax: 713-981-9090

5616 FM 1960 East, Suite 190

Humble, Texas 77346

Phone: 281-852-1700

Fax: 281-852-4861

www.ciaservices.com