

**Board of Directors
Reston Association
1930 Isaac Newton Square
Reston, VA 20190**

RA Governing Documents - October 28 Drafts

Dear RA Board Members,

The October 28 drafts reflect clear policy choices on a number of important issues (e.g., reducing from 40% to 25% the quorum requirement for material amendments, or increasing the Maximum Assessment accelerator from CPI to ECI, or requiring clusters to obtain certain insurance, etc.). While there continues to be discussion within ARCH on a number of these issues – perhaps, most significantly, with your decision against adopting any of the budget or audit committee ideas put forth in our last matrix -- we see little point in rehashing those issues at this time.

Rather, we would like to focus in this letter on several key issues as to which we remain less clear about the Board’s policy choices and/or would like to raise again before final decisions on the documents are taken.

1. Board Discretion to Increase Spending Without Need of Member Approval

The additional revenue streams proposed in the current drafts – increasing to \$534 the Maximum Assessment and the \$250 resale fee – would allow the 2007 Board, without need of prior Member approval, to: (a) increase the Annual Assessment by at least \$118; and (b) increase spending by at least \$2.64 million (including \$250,000 in new revenue from resale fees) over the 2007 proposed \$11.1 million budget, or by 24% (see Appendix A for the detail on these calculations). Given growth to these numbers via the annual accelerator, the actual discretionary assessing and spending authority will be higher (significantly so).

The two principal rationales cited for this increased authority are the need to address RA’s “aging infrastructure” and improve existing services. ARCH is four square behind those rationales. Consequently, as detailed in the Appendix, we built into our calculations the following: (a) the Board needs to generate approximately \$427,000 annually on average between 2008-2015 to fully fund the capital improvement needs of the community (as specified in the 2006-07 Capital Budget); and (b) we assumed expense budget increases of 4% per year to address non-capital requirements. Even with those additions, the Board would still be left under the proposed drafts documents with in excess of \$2 million in discretionary spending each year – or 20% over the \$11.1 million expense budget for 2007. Projected over a ten-year period, that accumulates to over \$20+ million in additional spending authority (twice the size of the current RA budget) without any need for seeking Member approval to spend that money.

If one believes the RA Board should have total flexibility over the budget and be accountable only through the annual election, then these changes will be of no concern and, from that point of view, will not prevent a “yesable” referendum. If, on the other hand, one believes in having some meaningful Member ability to check significant increases in annual

spending, then these changes are likely to be of significant concern. For the latter group, two fundamental questions must still be answered:

- (i) Why does the Board feel it needs in excess of \$2 million annually in discretionary spending authority, or approximately 20% over current budget?
- (ii) Does the Board feel this wide discretionary authority to raise revenue (and thus increase spending) is consistent with a model that ostensibly is designed to provide the Members with some meaningful review/check over spending (through a reasonable limit on the principal revenue raising source – the Member assessment)?

In partial response it might be said that increasing the Maximum Assessment to \$534 (or some other number to account for the pool roll in, see footnote 1) effectively returns the status quo under the 1984 Deed. Of course, in fairness, it is not exactly the status quo given the addition of the \$250 resale fee and changes to the accelerator. Regardless, the “status quo” has taken 22 years to trigger Member review of the assessment/spending question (actually 24, since per the approved 2006-07 budget there will be at least two more years before the current Maximum Assessment is exceeded). With some \$20 million in cumulative discretionary spending authority through 2015 provided under the current draft changes, it is likely to take at least another two decades before Member review would again be triggered.

We want to be clear. ARCH understands and supports the notion that the Board, as the elected representatives of the Members and charged with the fiduciary duty of acting for the Members' best interests, must have some reasonable degree of flexibility to increase spending and/or assessments without need of going to Member referendum. While it is true that many HOAs require member approval of every budget and assessment increase, ARCH agrees that model is impractical for an HOA of this size, and would be debilitating, costly, and unnecessary. The issue for those who support the concept of meaningful Member review over assessing/spending authority is whether \$2 million in annual discretionary spending authority and/or Member review once every two (or more) decades is a meaningful or adequate control over Board authority.

The ARCH Board is not at this time taking a position on this or any other aspect of the drafts. This letter is not an attempt to argue a “no increase” position, and/or to argue the Board should have no spending flexibility. Rather, we endeavor to better understand why the Board feels it needs such wide discretionary authority and how the Board understands this to be compatible with the RA governance model that was designed to provide Members with some meaningful ability to approve significant increases to their assessments (and by doing so indirectly have a voice over significant budget increases).

2. Use of RA Common Facilities

An issue that continues to generate discussion among our members is whether RA assessments targeted for proposed capital projects should be for projects designed principally for the benefit and use of RA Members (those paying the assessments). To be clear, no one within ARCH has suggested that non-RA Members be excluded from use of RA capital facilities. Rather, the issue is one of emphasis – RA Common Area facilities and programs should principally benefit those paying for their construction and management (or, if RA

funds are part of a partnership of some kind, that projected RA Member use of such a facility would be proportionate with the RA contribution made). This idea merely tracks what is stated in the Deed (that the Board is charged with acting “for the benefit of the Members,” in Article III.2(b)) and echoed in the Bylaws (that it “foster fullest usage of lands and facilities . . . [to] serve the leisure time needs of the Association residents,” in Section 11.1).

Despite this, Article IV.2 (d) in the proposed Deed places no similar limit or qualification on the Board’s authority “to permit non-Members to use the recreational facilities of the Association and other Common Area” (other than permitting different fees for non-Members).

We also note that, where referendum approval by a majority vote of owners is required for addition, alteration, or improvement to the Common Area, replacement and depreciation costs continue to be excluded from the required five-year statement of projected operating costs that will be provided to Members. If the proposed Common Area asset is not primarily for use by Members (and to an appropriate extent their guests), the significant costs for replacement and depreciation is important information RA Members should know and consider before approving such a proposal.

3. Communicating to Members the Need and Benefits of the Referendum

Within ARCH, much of our membership remains confused or feels inadequately informed on the “how, what, and why” of this process (and perhaps some or all of these questions will be addressed in the forthcoming communications plan):

- **HOW** will the proposed revenue increases (increasing to \$534 the Maximum Assessment and the \$250 “resale fee”) meet RA’s future needs (Point 1 above)?
- **WHAT** are the differences between the existing documents and the proposed drafts? The current drafts helpfully specify these in the footnotes; a concise, digestible summary of these changes could perhaps aid in getting to “Yes.”
- **WHY** is this being done? There has been repeated reference to a general “need to update the documents since they are 20 years old”; but our sense is clearer, more substantive explanations are needed. Some examples (and there are a number):
 - The drafts eliminate ambiguity in the Deed by making clear Members have referendum authority over conveying RA assets and property.
 - The drafts clarify the primary authority of clusters to control their common area.
 - The drafts improve DRB accountability by making the Design Guidelines subject to Board approval.

4. DRB

1. In the previous draft, adoption of the Design Guidelines and any changes to them were subject to notice and public hearing. That appears to have been eliminated from the current drafts. (See Proposed Bylaws Section 1.1(r).) Is there a reason for this?

2. Proposed Bylaws Section III.7(5) grants the Covenants Committee, and Section III.6(d)(4)(vii) grants DRB, power to provide temporary exceptions to their guidelines. This authority probably makes good sense, but there are no limitations on duration or rationale in using this authority. Is that needed?
3. Previous drafts helpfully included a requirement that DRB decisions include, if requested by an affected party, an “impact statement” clarifying how/why the DRB believes its decision to be in the best interests of maintaining property values and/or quality of life. Did the Board intend to remove this from the drafts and, if so, why?

* * *

We hope this letter is of further aid to you in making final decisions on the drafts. We greatly appreciate the enormous effort so many of you have made on this project, and look forward to your further response.

Sincerely,

ON BEHALF OF THE ARCH BOARD

Frank Pfeilmeier
ARCH President

Detail Back-up to ARCH 10/28 response
<http://www.restonarch.org/RAdocs/ARCHDataSummary1028.xls>

Appendix A

Assumptions and Analysis Used in Calculating the Discretionary Board Spending Authority under the Draft Governing Documents

The only facts ARCH used in making its calculations are those currently available in the public record. Those facts are as follows:

- Under the 2006-07 Biennial Budget the Board just adopted, the Assessment for 2006 was increased to \$437.00, \$16.00 below the estimated 2006 Maximum Assessment of \$453.00 (which assumed an inflation index of 1.75%). If adopted in 2006, the draft documents would increase that Maximum Assessment to \$534.¹
- In 2007 the Maximum Assessment would increase under the proposed changes to at least \$555 (through application of the new accelerator of the greater of 4% or ECI). With the Actual Assessment staying flat in 2007 at \$437 (per the approved 2006-07 budget), the gap between the Actual and Maximum Assessments would grow to \$118. Put differently, in 2007 the RA Board would have the authority to increase the Annual Assessment by \$118/household – a 27% increase to the current assessment.
- With approximately 20,200 homes currently within RA,² the \$118 gap in assessment authority as of 2007 represents \$2,383,600 in discretionary spending authority for the Board.
- Added to that is a proposed new revenue stream – the \$250 resale fee. We have conservatively assumed the sale of 1,000 RA homes annually (currently, approximately 1,500 RA homes sell annually; we generously attributed 500 of those as “internal” moves that would be exempt from the resale fee requirement under the current drafts). The proposed \$250 resale fee, therefore, will generate approximately \$250,000 in additional revenue annually (which will also increase by the same accelerator annually). Adding that number to the discretionary total afforded by the increase to the Maximum Assessment means the current drafts provide, cumulatively, a minimum of \$2.63 million in total discretionary spending authority before a Member referendum would be necessary. That represents more than a 23% increase to the proposed 2007 RA expense budget of \$11.1 million.³

¹ During the summer, the Members were told the Maximum Assessment was being increased by \$69; however, \$534 is actually an \$81 increase (not \$69) over the 2006 \$453 estimated Maximum Assessment that is part of the approved Biennial Budget. In the footnotes accompanying the latest drafts, it is noted the \$534 is a \$69 increase to the 2005 Maximum Assessment of “\$464 as of December 2005”; but the 2005 Maximum Assessment is actually \$444 (and \$69 added to that number would be \$514). Alternatively, if the \$69 is added to the 2006 Maximum Assessment of \$453 (given that no changes, if any, will be approved before 2006), then the proposed increase would be to \$524. In any event, whether there is a mistake here and the proposed Maximum should be reduced by \$10 or \$20 begs the broader question the ensuing analysis raises: does \$69 added to any of these numbers strike the appropriate balance between Board discretionary authority and a meaningful right of Member budget review/approval?

² Since some apartments do not pay full dues we have adjusted the number of “Lots” used in our analysis (out of approximately 21,155) to 20,200 to represent the number of equivalent Lots paying full annual assessments.

³ Another way to look at this is that the \$250,000 in resale revenues would represent an approximately \$12 assessment increase if that money were to be generated from assessments. Added to the \$118 in additional assessment authority under the drafts, that would effectively mean as soon as fiscal 2007 the Board would have discretion to effectively raise assessments by \$130 – a 30% increase to the currently proposed 2007 assessment - before ever coming to the Members for approval via referendum.

We recognize that, commencing in 2008, the Board must increase spending to continue addressing two needs of the Association:

- First (according to the 2006-07 approved biennial budget), RA must allocate an average of approximately \$427,000/year (\$21/year/lot) to fully fund RA's identified capital needs through 2015.⁴ This, in effect, is what will be required to address RA's "aging infrastructure."
- Second, RA needs reasonable flexibility to address personnel and services needs. To account for this need, and without access to ten-year projections from the Board, we conservatively assumed an annual 4% increase to the actual Assessment (or starting in 2007, a total of \$351,480).

We then factored in this agreed need to address the aging infrastructure, and the conservative assumptions we allowed to meet non-capital needs. Accounting for these items, this would still yield – on average – greater than \$2 million in total discretionary spending authority afforded the Board each year through 2015 – approximately 20% increase over 2007's \$11.1 million expense budget.⁵ Projected through 2015, that would cumulatively equate to an additional \$20 million in total discretionary authority without need of Member approval.⁶

If any of this math is understated, overstated, or misstated, please advise so we can more faithfully inform our membership of the relevant facts in assessing the merits of the referendum.

⁴ These numbers are based on the chart included in Section 7 of the 2006-07 Budget, entitled "Ten Year Capital Budget."

⁵ The total discretionary authority is actually understated, since there are additional actual or possible revenue sources, mainly significant increases to user fees in the approved 2006-07 Biennial Budget (increasing Resident Pool and Tennis Passes, the most popular and pervasive Member services, from \$6.00 in 2005 to \$15.00 in 2007 for adults and from \$3.00 to \$10.00 for children) and the possible addition of new members (as contemplated under the draft documents).

⁶ We have prepared a spreadsheet detailing these numbers that we would be happy to share so we can be sure we have the correct analysis here. It is also worth noting that we ran two sets of numbers – one that used the \$534 Maximum Assessment given in the drafts, and one that reduced that to \$514 in the event, as explained in footnote 1, the \$534 is a mistake. In *both* cases the total discretionary spending authority afforded the Board would exceed, on average, \$2 million per year and aggregate to more than \$20 million through 2015.