Reserve Study Providers & Professional Ethics

Many industry practitioners have taken exception to CRC's position that it is unethical for community management companies to conduct reserve studies for the homeowners association under their management.

It has been suggested by at least one industry professional - whose opinion is tainted by the fact that they themselves engage in the practice of conducting reserve studies for the communities they manage - that this position is not shared by any of the trade organizations which are associated with the community management industry including CAI, the APRA or the CACM.

While it may be true that none of these organizations strictly preclude their management company members from conducting reserve studies for their clients, this fact alone does not mean the practice is any less unethical; as none of these groups have established a particularly comprehensive code of ethics for reserve study providers in general; leading one to believe that the matter simply hasn't been given that much thought.

This article examines why CRC believes it is not only unethical but *highly* unethical for community management companies to conduct reserve studies for the communities they manage; and why it would be equally unethical for a reserve study provider to manage communities for which they conduct reserve studies.

Independence, Objectivity & Duty of Loyalty – To fully grasp the ethical dilemma posed here, a basic understanding of ethics is required. Readers who do not have a rudimentary grasp of business ethics may wish to review ethical concepts such as the *duty of independence and objectivity*; the *duty of loyalty* and *conflict of interest* before continuing with this article, as it is assumed from this point forward the reader is reasonably conversant in these areas.

One circumstance which results in an ethical breach is when the professional may be prevented from rendering *impartial, independent* and *objective* service due to other involvement with the client which results in financial gain for the professional.

Exactly such a situation exists when a community management company is managing a homeowners association - an act which results in financial gain for the management company - and they then offer to provide other professional services such as conducting reserve studies.

Not only is there a very real ethical question raised as to whether or not the reserve study truly represents an *impartial*, *independent and objective* opinion regarding what constitutes a realistic level of reserve funding for the homeowners association client; it also raises at least one other ethical question which is:

Has the community management company violated its *duty of loyalty* to their client by conducting the reserve study, if in fact it might have been more appropriate for another (perhaps better qualified) reserve study practitioner to have conducted the reserve study?

Of course the correct answer to this question may be virtually impossible to discern; which is one more reason why it *must* be viewed as unethical conduct on the part of the professional. In the context of business ethics the professional is *expected* to be knowledgeable enough to know when conduct is unethical; and to not engage in conduct which may be detrimental to the client due to unethical circumstances. It is the *responsibility of the professional* to recuse themselves from participating in the relationship if they have reason to believe an ethical breach might exist.

Actual & Apparent Conflict - One of the most fundamental concepts of ethics in general, and *business* ethics in particular, is that of conflict of interest. The principle of conflict of interest suggests there are two types of conflict; *actual conflict* and *apparent conflict.*

Actual conflict of interest exists when the unethical nature of the relationship between the professional and their client *actually* results in detriment to the client.

Apparent conflict of interest exists when a third party might *reasonably conclude* the relationship between the professional and their client *could* lead to a conflict of interest.

Apparent conflict does not have to result in actual detriment to the client (or *damages*) to be considered unethical; the mere *appearance* of conflict is sufficient to deem the relationship unethical.

It is this most fundamental of ethical concepts which leads us to conclude that the practice of allowing community management companies to conduct reserve studies for the homeowners association they manage is unethical. Regardless of whether or not other professionals or industry trade groups agree or not, it is quite obvious that an apparent conflict of interest exists any time a community management company undertakes a reserve study on behalf of a client from whom they also receive income for managing the association.

Whether an actual conflict of interest ever occurs does not matter. The possibility that a conflict could exist is sufficient grounds to suggest that such conduct is unethical.

What Should You Do? - Within most professional codes of conduct such behavior is strictly forbidden or at the very least tightly regulated to ensure the conduct of the professional does not result in detriment to the client. As a result of the limited oversight to which reserve study practitioners and community management companies are subjected, homeowners association have little choice but to establish their own policy regarding how they are going to handle such ethical dilemmas when they are encountered.

At the very least it should be standard practice for the Board of Directors to review the possible ethical conflicts which any proposed vendor relationship might create. In any situation where the management company might be a potential vendor of services which are not included as part of the management services agreement, the potential for unfair competitive advantage must be considered.

Unfair competitive advantage exists when one of the parties to a competitive procurement process is in a position which might result in an unfair advantage over competing vendors, due to involvement with the client which is unrelated to the contract for which they are competing. In some highly regulated bidding environments such as certain types of government contracting, this situation is strictly prohibited.

In general it is probably the best policy for the large majority of homeowners associations to hire a management company that *specializes* in community management and limit their involvement to managing the association. When the services of other vendors are required hire vendors who *specialize* in their chosen professions; hire the best qualified providers you can afford, and limit their involvement to their respective line of work.

In this age of specialization it is generally not good policy to utilize the services of a jack-of-all-trades operation for any important project.