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Community LEADER

News for the New American Neighborhood

In this issue

Association Loans

Planning for Capitol Improvement Projects

Tax Returns for Non-Profits

Winter Rejuvenation Pruning

And Much More...



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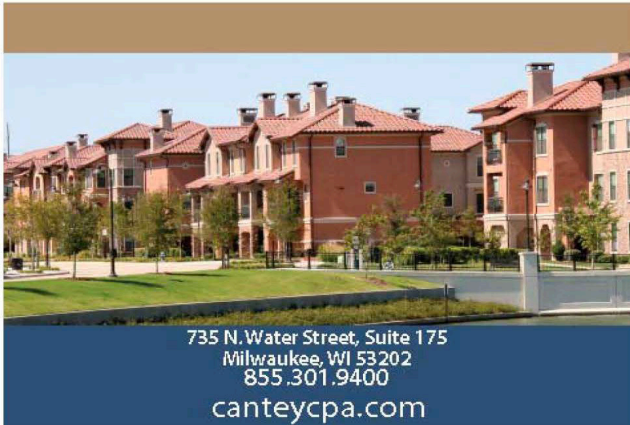
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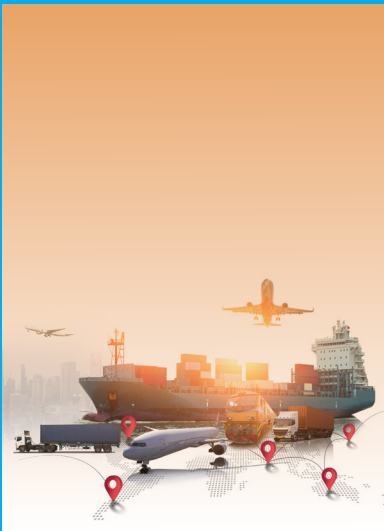
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Community LEADER

News for the New American Neighborhood



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Todd Sarauer, CMCA, AMS, PCAM
Hunt Management Incorporated, AAMC
10520 N. Baehr Road, Suite Q
Mequon, WI 53092
Phone: (262) 238-1480
todd@huntmanagement.com

President Elect

Sara Moker, CMCA, AMS, PCAM
Elite Properties, Inc.
700 Larry Ct.
Waukesha, WI 53186
Phone: (262) 373-1777
sclark@eliteprop.org

Treasurer

Dan Miske, CCAL
Husch Blackwell, LLP
511 N. Broadway Ste. 1100
Milwaukee, WI 53202
Phone: (414) 978-5418
Daniel.Miske@huschblackwell.com

Director

Chad Emrath, CMCA, AMS, CPO
Ogden & Company
1665 N. Water St.
Milwaukee, WI 53202
(414) 270-4173
chad@ogdenre.com

Director

Tom Holton
Holton Brothers, Inc.
1257 Terminal Rd.
Grafton, WI 53024
(262) 377-7887
tom@holtonbrothers.com

Director

Erica Joyce
Mid State Insurance
7105 W Mequon Road
Mequon, WI 53092
Phone: (262) 643-4674
ericaj@midstateis.com

Director

Michael Leach, CMCA, PCAM
Prospect Management Company, AAMC
224 N. 76th St.
Milwaukee, WI 53213
Phone: (414) 540-0004
mleach@pmmcwi.com

Director

Dan Merritt
Glen of Brookfield Home Owners Association
15340 Huff Way
Brookfield, WI 53005
Phone: (262) 309-5665
dmerritt33us@yahoo.com

Director

Ryan Maloney
Robertson Ryan & Associates
20975 Swenson Drive, Suite 175
Waukesha, WI 53186
Phone: (414) 221-0346
rmaloney@robertsonryan.com

Director

Dwight Morgan
Beerline River Homes
1963 N Riverwalk Way
Milwaukee, WI 53202
dwight_morgan@msn.com

Director

William Rheingans
Stillwater Condominiums
N24W24210 Saddle Brook Dr
Pewaukee, WI 53072-5869
(262) 232-8484
wrjeomgams@gmail.com

Local Contact/Staff

Chris Ruditys
Wisconsin Association Management
11801 W. Silver Spring Dr., Ste. 200
Milwaukee, WI 53225
Phone: (414)778-0640 Ext. 1
info@cai-wi.org

Tina Conley, Assistant Account Executive

Wisconsin Association Management
11801 W. Silver Spring Dr., Ste. 200
Milwaukee, WI 53225
Phone: (414)755-3353
tina@wamllc.net

Maiya Whelan, Marketing Director

Wisconsin Association Management
11801 W. Silver Spring Dr., Ste. 200
Milwaukee, WI 53225
Phone: (414)755-3354
maiya@wamllc.net

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President's Message



Turning the page to 2022...

This is the perfect time to assess the past year. Learn from it and use that knowledge to be better prepared going forward. We all have been through a very trying time and long-term test. The test I believe, once we can finally look back on this in

our rearview, will leave us better and stronger in our personal and professional lives.

One of the many things we have learned is that we must plan ahead of time in order to get products and services we need. Now is the time to work with business partners for proposals, and conversations about what they are seeing in their respective industries. Having these conversations now will set you apart from your peers and competition.

Another thing we all have learned, is part of any plan should be flexibility and patience. Timelines and schedules have become an estimate not definite. Plan

for and expect it and you and your stress level will appreciate it. Things are beyond everyone's control, as much as we are programmed to blame and want to hold someone accountable, we are better off preparing ourselves and clients for the fact we will not get what we want when we want it all the time.

In this issue of the magazine make sure to read the article on how to get loans for large capital improvement projects. Loans are valuable tool in funding large projects now opposed to waiting. This may help prevent further costs for additional needed repairs and save the Association money on the inflationary costs of the project down the road.

Work with your Management Company or your bank to see if your project qualifies for a loan. You may be surprised on how inexpensive it can be.

Wishing all you a Happy and Healthy 2022!

Sincerely,
Todd Sarauer, CMCA, AMS, PCAM
 CAI-WI President

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CONTROLLING CAPITAL CONUNDRUMS

A BASIC GUIDE TO ASSOCIATION LOANS

By Anthony Dister, Senior VP of Wintrust
Community Advantage

With the advent of a new year comes a new opportunity to review your association's common elements for capital repairs, improvements, and replacements. Commonly, reserve studies will help outline the useful life of these components. However, the task of what to do about it can oftentimes be daunting. Does your association have cash on-hand correct any deficiencies? Does the thought of a large special assessment keep your community up at night? Thankfully, association lending can provide a convenient and efficient solution to these questions as well as others related to repair projects, deferred maintenance, or large construction bills.

While most boards and management companies will address capital projects through sufficient reserve funding over the years, some communities need to

consider financing. To many, the idea of having your community take out a loan might seem frightening. However, words like “financing” or “loan” don’t need to be a cause confusion or concern. Once you have the knowledge and preparation to make an educated decision, a process like obtaining an association loan can be empowering – enabling your community to get the work done now, while paying for it over time. But where to begin?

What are the loan options?

First and foremost, your community should be asking itself “what are the types of loans that a bank can offer?” Traditionally this takes shape as either lines of credit or term loans. Each loan type serves a separate and unique purpose. Lines of credit allow for associations to borrow only what is needed (up-to a specified dollar amount). While using a line of credit,

most banks will require monthly interest-only payments to be made on outstanding balance. In some cases, a bank may be willing to make the line of credit “revolving” – or otherwise allow your community to re-borrow funds previously spent that have been paid back. While this may sound like a credit card, it is worth noting that many banks will require any borrowed amounts to be paid in full by the end of the line of credit’s term. The alternative to this would be a straight term loan. Consider this similar to a residential mortgage, or an installment loan (similar to a car loan). In this case, there is a set dollar amount to be financed, and then stretched over an agreed-upon term with your bank of choice. This will carry monthly payments of principal & interest until the loan is either paid in full, or reaches the end of the set term. Under certain circumstances, a bank may be willing to combine these two loan types – so



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CONTROLLING CAPITAL CONUNDRUMS CONT.

as to extend the benefits of both, and to offer a flexible financing solution that can serve the individual needs that your community has.

What option may be the most beneficial? In the case of a set project cost (plus any added contingency), a straight term loan may save the association on interest expense it would otherwise pay on a line of credit that they know they would fully-utilize. In the case of a project that will take an extended period of time to complete – this might be a good opportunity for your association to explore a line of credit. Work with your bank to see which options they can offer, and what may be best for your association. Communication is key, and understanding these options up-front can lead to a pain-free process.

Where to start?

Begin by talking with your bank. As bankers, we are here to ensure that your borrowing experience is superb. We will start by collecting provisional items and information. This can include financial material, identifying association information, and other pertinent details related to the project, the cost, and the timeframes. This material will ensure that you meet the specific guidelines for the bank, all while allowing your banker to work through situations that might work best for your community.

What to ask?

Every bank is different, and many have different terms & conditions to consider. Are there any fees associated with borrowing? How is the loan being collateralized? Is there any prepayment penalty? Are there any rules that the association must follow over the life of the loan? How does the community access the loan proceeds? Asking these questions will help boards and managers compare offers, and make the most fiscally-responsible decision for their association.

What happens next?

The bank will review the pre-qualification material, discuss the options with the board or manager, and then typically issue a proposal (also known as a “letter of intent,” or sometimes as a “term sheet”). At this stage, it is up to the board to review the option or options provided by the bank to determine which would be the best fit for their specific situation. Oftentimes, boards may need to consult their management company – or sometimes even the ownership – for a consensus as to the optimal path to take. Once an option has been selected, the board and/or manager would relay the community’s acceptance back to the bank. This could potentially involve formally signing or executing any applicable offer or proposal, and providing ancillary documentation that the bank would need for approval.

Once approved, a bank may issue a formal

commitment to lend – or otherwise move directly into the documentation phase of the transaction. During this stage, many banks will typically follow one of two paths: engage an accredited association attorney to draft the closing packet, or draft a standard documentation suite. Sometimes banks may require that these closing packages be reviewed, approved, and opined upon by the association’s attorney. Once this review phase has been completed, the bank would work with the association to schedule a closing. Part of this process will be collecting any final pieces of information required as a condition for funding, as well as ensuring that the documentation package is fully and appropriately signed & completed. From there, it’s on to the project – where the byproduct of your efforts will manifest in the betterment of your community!



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BID NOW, DON'T DELAY

By Brandon Grosz, CMCA, AMS, CERT and
Carissa Pezewski, CMCA, AMS

The holiday season has come and gone; the recovery from the holiday season is in full effect. Property managers had chance to take a breath and had some time to relax between Christmas and New Year's. The winter months can seem long with cold weather, less daylight and snow; but now is the time to start planning and obtaining bids for the projects that an association is looking to accomplish in the spring or summer. Looking out the window on a blustery, snowy day makes it hard to envision and plan exterior projects that are needed when the weather breaks, but do not delay. It is important to start the process now. The countdown to spring has begun!

Most, if not all, community association budgets have been created, adopted and distributed for associations that follow the January 1- December 31 fiscal year. The road map for spending is there for 2022. Projects that were built into the budget need bids obtained to secure them and get them scheduled. Last year, community associations across the country saw delays in start times because of the shortage of labor force and materials due to Covid-19. A far too common theme right now is employers are understaffed and are looking for employees. The building trades field is no different and companies are booking work months in advance. Far too often, we are hearing from board members that they want updates or the work to be completed as soon as possible. It is up to the manager to communicate with your boards to set expectations, especially when signing contracts. Depending on the size of the company, vendors

want to know what signed contracts they have up and coming so they know how to staff for full-time and seasonal positions. If self-managed boards or community managers wait until May 1 to investigate projects, there may not be the availability of workers to take on a project or the project could be delayed to the very end of the season.

The market for building products is another reason to plan now and obtain bids for projects. The cost of building materials has been rising and waiting until the last minute can cost the association more depending on how long it takes to complete the project. Case in point, an association that is completing a deck project saw an increase in material costs between November 2021 and January 2022. The shortages of materials can also cause the prices to rise. If an association is planning a roof replacement project, the roofing vendor chosen may be able to purchase materials now and store them until the weather cooperates for the replacement. Products that were once readily available may not be as easy to obtain as in the past. The idea of putting in an order and seeing products arrive without delay is not the current world situation. There are delays from factories, container ships and trucks that contribute to the timeline of receiving products. The current wait for windows just to be delivered to vendors is estimated between 12-20 weeks. This does not factor in when the vendor installation can occur.

When sending out the requests for proposals, take the time to write the scope of work or bid specs for that project. It is important the scope of

work is clear, and a full description of the project is included so that all potential bidders understand the job and can put forth a competitive bid. If the specifications are confusing and not clear to the bidders, the bids received may not be comparable to review and require bidders to submit a revised bid. This can then cause delays in awarding the contract and project scheduling. Another important piece in the request for proposal process is to give the due date of the bids and the expected timeline of the project. If the dates are not clear for the submission deadline and projected timeline, the bids may not come in timely or meet the expectations being sought after. It may take time to put the bid package together, but in the end, it will help achieve the results that all are looking for in the project.

As we are halfway through the winter season, look ahead to see what needs to be done this year (roofs, retaining walls, seal coating, siding or general landscaping). Consult your vendor list and send out requests for proposals as soon as possible. This will help reduce the stress on you and your vendors. Once you have all projects lined up, sit back and wait for those 80-degree days full of greenery and sunshine.

Brandon Grosz is a Community Manager for Hunt Management, Inc. AAMC and may be reached at brandon@huntmanagement.com. Carissa Pezewski is the Director of Community Associations for MPC Property Management and may be reached at carissa@mpcpm.com.

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REJUVENATION PRUNING PREPARES CONDOMINIUM COMMUNITIES FOR A HEALTHY SPRING

Submitted by Julie Metzger, CMCA, AMS,
Villani Landshapers

Rejuvenation pruning (sometimes called dormant or winter pruning)



has many benefits to the trees and shrubs on your condominium property. Once the thermometer edges above 32 degrees and the snow starts melting, landscape teams can start working on some property maintenance. Typically, rejuvenation pruning of trees and shrubs begins on condominium communities in southeast Wisconsin anytime between late February and the beginning of April.

The primary goal of rejuvenation pruning is to extend the life of the plant and promote its health during the growing season. Controlling the size and maintaining the appearance of the plant material is also important for many property managers and communities, and rejuvenation pruning will help manage plant growth.

Keys to Rejuvenation Pruning

An experienced landscape team will know just where and how to make pruning cuts so the plant responds the best and doesn't suffer any damage or disease. It's also essential to know which species of trees and shrubs respond best to rejuvenation pruning and how much to prune from each. Different species of shrubs need to be pruned at different times of the year. Summer flowering shrubs, such as hydrangeas, roses, and spirea, are best pruned in the late winter/early spring before they bud. Spring-flowering shrubs, such as lilacs and weigela, are best pruned after they have flowered for the year.

When pruning shrubs, commercial landscapers carefully perform cuts that reduce the height of the plant material and thin out older or thick

canes to promote new growth. On trees, crossing or rubbing branches are removed and thinned out.

Performing rejuvenation pruning during the late winter and early spring has many advantages. The plant material is dormant, so the pruning can be more aggressive without damaging the plant. Landscapers may remove from one-third to one-half of the existing branches on trees and shrubs. The next year, another third of the older branches can be removed and so on. Following rejuvenation pruning, the shrub will regrow from its roots, becoming a youthful, full, compact plant with maximum bloom.

At this time of year, the plant hasn't leafed out yet, making the structure much more accessible to pruners and giving them a much better idea of the plant's structure. Managing the size and shape of a shrub at the beginning of the season usually means there is less need for in-season pruning as well.

A healthy spring and summer for the trees and shrubs on your condominium community begins with late-winter rejuvenation pruning.



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ARE RESIDENTIAL NONPROFIT ASSOCIATIONS REQUIRED TO FILE AN INCOME TAX RETURN?

By Steven Silberman, CPA and Partner of PBG Financial Services, PLLC

This is a question that I have been asked many times over the many years that I have worked with condominiums, townhomes, and homeowners' associations. Most associations are usually incorporated as a not-for-profit corporation, however, they generally do not qualify for federal income tax exempt status, so they must file an income tax return. In order for an association to be a tax-exempt social welfare organization under the IRS code section 501(c) (4), the association must operate for the benefit of the general public. It must provide a community benefit, not a benefit to only the owners

of an association. Residential condominiums, townhomes and homeowners' associations may be taxed under the Internal Revenue Code (IRC) Section 277 or may elect to be taxed under IRC 528. Under IRC Section 277, associations file Federal Form 1120 and under IRC 528, associations file Federal Form 1120-H. An association can decide annually which form it would like to file, so let's discuss which form is right for your association and the differences between each form.

FEDERAL FORM 1120-H

Federal Form 1120-H was developed so that associations

would not be taxed for carrying out its main function of managing and maintaining the common elements. To qualify to file Form 1120-H, the following must apply:

1. More than 85% of the units within the association must be used as residences so commercial associations cannot file Federal Form 1120-H.
2. At least 60% of an association's gross income must consist of exempt function income.
3. At least 90% of an association's expenses for the year must consist of expenses to acquire, build, manage or maintain or care for its property.

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4. No member may profit from the association's profit.

IRC Section 528 states that income and expenses must be allocated between exempt function activities and non-exempt function activities. Associations are only taxed on its net non-exempt function income at a federal tax rate of 30% (Timeshare Associations are taxed at a federal tax rate of 32%), so what is exempt and non-exempt function income?

Exempt Function Income is:

1. Operating income received as assessments from owners of condominium, townhome, or homeowners' associations.
2. Assessments received from developers on unsold unit or lots.
3. The assessments must be assessed ratably.

Non-Exempt function income (or taxable income) is:

1. Income from non—association property such as commercial operations, interest, and dividends.
2. Income from non-members for use of association property.
3. User charges to association members for special services unless the user charge is assessed once in a twelve-month period and the benefit lasts for the entire twelve-month period. An example of a user charge is laundry income.

The advantages of filing Federal Form 1120-H are as follows:

1. Associations are not taxed on exempt function income.
2. The tax form is a one-page form, with supporting schedules, and no Balance Sheet, so it costs less to prepare.
3. The form has less risk associated with it than Federal Form 1120.
4. Fund accounting is not required since capital or reserve assessments are not taxed.
5. No election forms are required like on Form 1120.
6. No estimated taxes are required as long as you continue to file Form 1120-H.

7. A standard deduction of \$100 is allowed.

FEDERAL FORM 1120

IRC Section 277 states that income for Federal Form 1120 should be allocated between membership and non-membership income.

An association can be taxed on both if there is net income at a federal tax rate of 21%, however, an association can make an election to defer net membership income. Revenue Ruling 70-604 allows associations to defer net membership income for one year, however, if the association has net membership income in the next year, then the association would have to pay tax in the next year on the deferred income. An association can also make an election under Revenue Ruling 70-604 to refund net membership income. In order for revenue Ruling 70-604 to be valid, the election has to be made annually by all of the members (usually at the annual meeting) and it should be preferably made before the end of the year. The dollar amount does not have to be specified. One last point is to review your bylaws and declaration to see if it states what your association should do with excess operating income.

Capital contributions (reserve assessments) are treated as non-taxable on Federal Form 1120 if the following guidelines are followed:

1. The purpose of the assessment must be capital in nature. The reserve study supports the purpose of the capital assessment. However, painting and caulking even if it is included in your reserve study, is an operating assessment, not a reserve assessment according to the IRS.
2. Members have advance notice. Distributing copies of the budget to the members is considered advance notice.
3. The assessment must be accounted for as a capital contribution and held for that purpose. The books

and records, along with the budget should segregate operating and reserve (capital) activities. The association should, therefore, use fund accounting.

4. Reserve assessments should be deposited into a separate account and reserve expenditures should be paid out of this separate account. An association can pay for capital expenditures out of the operating fund account as long as the reserve account reimburses the operating account in a relatively short period of time, preferably in the same month.

A question that I get asked all of the time is: Can our association transfer excess net membership income to reserves to avoid paying taxes on this excess? The answer is NO if you are filing Form 1120. IRC Section 118 states that an association cannot transfer excess net membership income to reserves to avoid paying taxes since you cannot re-characterize what the assessments were for originally.

The advantages of Federal Form 1120 are as follows:

1. The federal income tax rate is 21% compared to 30% for Federal Form 1120-H.
2. Net operating loss carryforwards are allowed for net non-membership income and one year for net membership income if the 70-604 election is approved.
3. Tax planning can be done to help reduce any possible taxable income.

WHICH FEDERAL TAX FORM IS MORE BENEFICIAL TO YOUR ASSOCIATION?

Now that you have a brief understanding of the two forms, you might be wondering which form should your association be using? This is a hard question to answer unless your CPA knows the facts and issues associated with your association.

ARE RESIDENTIAL NONPROFIT ASSOCIATIONS REQUIRED TO FILE AN INCOME TAX RETURN? CONT.

Usually if your association has little interest income and no (or minimal) user fees, you will file Federal Form 1120-H. As interest income grows, your association should look at possibly filing Federal Form 1120 as an alternative. If your association has minimal interest income, but you have a net membership loss, (for example due to a painting project) you may want to file Federal Form 1120 since the loss gets carried forward to a future year when your association may need to file Federal Form 1120 to reduce or minimize your tax. If your association files Federal Form 1120 because of the large amount of non-membership income, you want to make sure you do tax planning ahead of time to minimize your net membership income.

You now should have a better understanding about the different types of Federal Income tax returns and which return is right for your association.

*Steven Silberman, CPA and Partner
PBG Financial Services, PLLC
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WELCOME TO CONDO CORNER



Welcome to Condo Corner, a new forum where you can share a story or ask advice on a pertinent issue in your Association. Our crew of CAI-WI industry professionals - comprised of committees, managers, and contractors – are standing at the ready to answer your question. Forward your submission to the email below to be considered for the next issue!

Hello Condo Crew --

We want to make changes to the design of our planting beds around the exterior of our unit once the weather breaks in spring. We'd like to remove and replace the old bushes/plants and install stone mulch instead of the existing bark mulch. We'd also like to plant a decorative tree in the common area lawn panel.

The Board of Directors tells us we must submit a landscape plan for approval prior to doing the work. Why must we do this if the planting beds are around our unit, and we maintain them?

Jim and
Dorothy S.

Dear Jim and
Dorothy --

Good question! Your association is governed by the rules set forth in your condominium documents. Although the association may sometime seem

like Big Brother when you want to make changes in and around your unit, a design review program is a benefit—not a burden. The association's design standards are based on harmony within the overall community, consideration for neighbors, and high-quality construction practices. The design review program exists to maintain, protect, and enhance the value of your property, and it strives for a balance between individual rights and the good of the entire community.

While association members have the biggest stake in property values, others are also very interested in seeing your community well maintained and looking its best. Builders' reputations and lenders' financial support are closely connected to the community. Also, public officials have an interest in maintaining and enhancing the community since tax revenues depend on property values.

We highly recommend you check the design review guidelines within your condominium documents if you are considering any type of exterior design change. The guidelines should contain everything you need to know about the approval process and design requirements. Quite often, the guidelines list the changes that don't need to be approved. If you need a copy, we suggest contacting your property manager or board member. We wish you the best of luck with your project!

The Condo Crew

Do you have a question for our Condo Crew? Submit your question to maiya@wamllc.net for an opportunity to have it answered by our panel of condo pros in the next issue.

****Please note that we cannot and do not provide legal advice. If you desire legal advice, please consult with an attorney who specializes in condominium or HOA law.****

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daniel.miske@huschblackwell.com
414.978.5311



Lydia J. Chartre, Partner, CCAL
lydia.chartre@huschblackwell.com
414.978.5418 | 608.234.6082
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CAI-WI LEGISLATIVE ACTION COMMITTEE UPDATE



Your CAI-WI LAC had been working with a number of groups to attempt to pass an HOA Act. However, that effort seems to have stalled. At the same time, LRB-1727/1 was proposed relating to the regulations of homeowner associations. It is being potentially sponsored by Senator Ballweg and Representative Brooks, we believe with Representative Brooks being the driving force. We have worked with Senator Ballweg before and found her to be very reasonable. We have reached out to her office and they quickly responded that Rep. Brooks is the “primary lead” on this legislation. We do not know Representative Brooks, but we have reached his office as well. They also responded and we are attempting to set up a meeting for shortly after the new year. What the law is proposing in part is a statewide searchable filing system that may charge a fee of up to \$25, and limits on various other fees charged by the association upon vendors or others seeking information from the association. While all of this may be helpful to Realtors, bankers and title companies, it does nothing to actually help homeowner associations. The bill conceptually is fine, but it needs some teeth for HOA’s as well. Specifically,

the proposed bill should create a priority for HOA assessments similar to that found in ch. 703 Wis. Stat. for condominiums. Ideally, the lien of the HOA would be superior to all other liens, except real estate taxes, since the association is tasked with maintaining, repairing and replacing common elements to keep the properties as valuable as possible. Since the funds are spent on maintaining the values of the properties, the costs of that should be paid by the benefiting lot or home, BEFORE the bank is able to say “thank you for spending the money to keep up the property, but now we are going to foreclose and take the property and be paid before the association is reimbursed one cent.” The lien priority statute as currently written does not make any sense, but it does benefit the banks greatly and they have a great deal of political leverage. We are hoping that Representative Brooks will at least agree to amend the bill to include the Ch. 703 lien rights. If we can also get the lien priority before the first mortgagee, that would be great (we know it’s a LONG SHOT). With this one change, we believe that CAI would support LRB-1727.

Your Help Needed. If you have any time and could email Christopher.Schaefer@legis.wisconsin.gov of Representative Brooks office with something like the following it would be greatly appreciated: “Representative Brooks, We have reviewed LRB-1727 and we are members of an association within the state. We believe that this proposed bill would better serve all of those involved if it actually gave some power, as opposed to just additional duties, to associations. One specific power that is needed is the right to foreclosure with lien priority rights similar to those found in Section 703.165 Wis. Stat. for condominiums. To place duties on associations, who are run by volunteers, without any enforcement mechanism is unfair if the associations have no ability to pass the costs onto the members generating the costs. Every state that has any type of an HOA act also has a similar lien priority provision, many (most) with those priorities being superior to all other liens except real estate taxes. Why? Because the association is the one tasked with the responsibility of maintaining, repairing and replacing the common element/areas to protect the value of all of the properties, and those expenditures should be protected BEFORE bank loans. This is because the banks have many other ways to protect their loan, the association does not. Our CAI-LAC representatives are happy to explain this to you further and I am sure they have already reached out to you. Our CAI-LAC organization looks forward to working with you on this legislation.”

Thank you so much.

CAI-WI NEW MEMBERS

As of 12.31.2021

Arlene Strunk

Lexington Court Condominiums
224 N 76th St C/O Prospect Management
Milwaukee, WI 53213-3554
(414)540-0004 • arlenestrunk45@gmail.com

Elene Wagner

Lexington Court Condominiums
224 N 76th St C/O Prospect Management
Milwaukee, WI 53213-3554
(414)540-0004 • wagemelene@yahoo.com

Edith Brown

Riverwalk Condominium Association
3120 S Toldt Pkwy
West Allis, WI 53227-3960
(414)327-2538 • edithvbrown@aol.com

Kate Munson

MPC Property Management, LLC
120 E Chestnut St
Burlington, WI 53105-1410
(262)661-4284 (315) • kate@mpcpm.com

Jane Opps

Barracuda Condominium Association
211 S Henry St #503
Madison, WI 53703
(608)846-9137 • janeopps@gmail.com

Matt Thompson

K.G. Stevens
11100 W Silver Spring Rd
Milwaukee, WI 53225
(262)432-1060 • mattt@kgstevens.com

Michael Avery

Northridge Lakes- East Bay Condo Assoc.
8957 N 70th ST
Milwaukee, WI 53223-2151 • popearl115@gmail.com

Lindsey Edwards

Northridge Lakes- East Bay Condo Assoc.
8973 N 70th ST
Milwaukee, WI 53223-2151
(414)712-5569 • lpedwards4311@gmail.com

Cara Hansen

Northridge Lakes- East Bay Condo Assoc.
9117 N 70th ST
Milwaukee, WI 53223-2115
(414)559-6598 • cmh813@hotmail.com

Brenda McMurtry

Northridge Lakes- East Bay Condo Assoc.
9001 N 70th ST
Milwaukee, WI 53223-2113
(317)627-9249 • bmcmurtry@sbcglobal.net

Rex Nelson

Northridge Lakes- East Bay Condo Assoc.
9187 N 70th ST
Milwaukee, WI 53223-2115
(414)315-0754 • rex@itlabs.net

Cheryl Sadowski

Northridge Lakes- East Bay Condo Assoc.
9101 N 70th ST
Milwaukee, WI 53223-2115
(262)364-8197 • eastbaycomplaints@yahoo.com

Sue Skaros

Northridge Lakes- East Bay Condo Assoc.
8933 N 70th ST
Milwaukee, WI 53223-2111
(414)531-5166 • sskaros@wiirr.com

Darlene Fink

Goldfinch, Inc
2611 Libal St
Green Bay, WI 54301-2865
(920)432-7176 • dfink@goldfinchliving.com

Edward Erickson

Windsor Estates of Mequon Homes, Inc
10775 N Cambridge CT
Mequon, WI 53092-8552
(701)204-2419 • edwardandleaann@gmail.com

Chris Sperry

Windsor Estates of Mequon Homes, Inc
10770 N Cambridge CT
Mequon, WI 53092-8552
(262)242-0395 • csperry1@aol.com

Jill Thorntonburg

Windsor Estates of Mequon Homes, Inc
7103 W Mequon Trl
Mequon, WI 53092-8548
(262)242-2532 • mjt-cpa@att.net

Jason Hill

Prospect Management Company
224 N 76th St
Milwaukee, WI 53213-3554
(414)214-8094 • jhill@pmcwi.com

Mandy Putnam

Prospect Management Company
224 N 76th St
Milwaukee, WI 53213-3554
(414)540-0004 • mputnam@pmcwi.com

Sybeill Bell

Beerline River Homes
2050 N Commerce St Unit 302
Milwaukee, WI 53212-3471
(262)238-1480 • sybilbell@gmail.com

Anne Empey

Beerline River Homes
2015 N Riverwalk Way
Milwaukee, WI 53212-3994
(262)238-1480 • anne.cheese3@gmail.com

Heidi Stoltenberg

Beerline River Homes
2030 N Commerce St
Milwaukee, WI 53212-3402
(262)238-1480 • heidi.stoltenberg@gmail.com

Susan O'Brien

Stillwater Condominiums
3415 N 127th ST Ste 300
Brookfield, WI 53005-3117
(262)373-1777 • llama4two@msn.com

Andy Kahrs

Servpro
N92W15600 Megal Dr
Menomonee Falls, WI 53051-1557
(262)250-1101 • andy@servpromn.com

Jane Cubbs

Riverwalk Condominium Association
3149 S Toldt Pkwy
West Allis, WI 53227-3956
(414)690-0040 • jcubbs3@att.net

Teri Koney

Riverwalk Condominium Association
3147 S Toldt Pkwy
West Allis, WI 53227-3956
(414)840-6343 • terikoney@yahoo.com

Sheri Maciolek

Riverwalk Condominium Association
3143 S Toldt Pkwy
West Allis, WI 53227-3956
(414)328-0434 • smaciolek7@gmail.com

Judith Steinke

Riverwalk Condominium Association
3129 S Toldt Pkwy
West Allis, WI 53227-3956
(414)545-6707 • jsteinke2@wi.rr.com

Sandy Zeugner

CCCINCHOWARD
2563 Telluride Trl Unit M
Green Bay, WI 54313
(920)412-8371 • osker21@outlook.com

Carolyn Ahrendt

Silver Ridge Condominium Association
283 Oconomowoc Pkwy
Oconomowoc, WI 53066-5840
(262)468-6227 • cjaaaaa@sbcglobal.net

Katherine Snow

Elite Properties Inc
700 Larry Ct
Waukesha, WI 53186-1803
(262)844-3247 • ksnow@eliteprop.org

Jesse Heinecke CMCA

Cities Management-Minnesota
2100 Summer St NE Ste 280
Minneapolis, MN 55413-3024
(612)381-8600 • jessehe@citiesmanagement.com

Sarah Mellerud

Cities Management-Minnesota
2100 Summer St NE Ste 280
Minneapolis, MN 55413-3024
(612)381-8600 • sarahm@citiesmanagement.com

Penny Mixhau

Cities Management-Minnesota
2100 Summer St NE Ste 280
Minneapolis, MN 55413-3024
(612)381-8600 • pennym@citiesmanagement.com

Sadie Vance

Cities Management-Minnesota
2100 Summer St NE Ste 280
Minneapolis, MN 55413-3024
(612)381-8600 • sadiev@citiesmanagement.com

Nick Demark

DeMark's Window & Pressure Cleaning
722 N Grand Ave
Waukesha, WI 53186
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Carbon monoxide, or CO, is a poisonous gas that can be particularly dangerous because it is colorless and odorless. Headache, nausea, dizziness and even permanent brain damage or death can occur. Hundreds of people die each year from accidental CO poisoning, many of them while using portable generators during severe weather.

A byproduct of burning fuels such as gasoline, propane, kerosene, natural gas, oil, wood or coal, carbon monoxide is emitted from internal combustion made by engines, like those that power lawn mowers, portable generators, cars, power washers and many household appliances such as furnaces, ranges, fireplaces, water heaters and room heaters. To prevent CO poisoning in your home, be sure to take the following precautions:

- Educate your family about the causes of CO poisoning and how to prevent exposure to this deadly gas.
- Do not use portable generators indoors, including in garages, carports, storage sheds and the like, even with doors and windows open. CO can quickly build to lethal levels in even partially enclosed spaces.
- Do not place pressure washer engines indoors, and, when using pressure washers outdoors, keep engines away from open windows, doors or vents during use, as CO can seep inside through the openings.
- Hire qualified professionals to install new furnaces and appliances and to inspect and service your HVAC system, chimneys and flues.
- Never service fuel-burning appliances without proper knowledge, skills and tools. Always refer to the owners' manual when performing minor adjustments or performing maintenance on fuel-burning equipment.
- Never use portable fuel-burning camping equipment or burn charcoal indoors.
- Never leave a car running in a garage, even with the garage door open.
- Never use your gas oven or clothes dryer to heat your home.
- Never operate unvented fuel-burning appliances in any room where people are sleeping.
- Do not cover the bottom of natural gas or propane ovens with aluminum foil. Doing so blocks the air flow through the appliance and can produce CO.
- Install CO detectors throughout your home as required by your local municipality - especially in hallways near sleeping areas, and follow the manufacturers' instructions for testing and replacing. Keep detectors unobstructed by furniture or draperies.



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