



CAPITAL IMPROVEMENTS VS. RESERVE EXPENSES



by Robert M. Nordlund, PE, RS
CEO/Founder
Association Reserves, Inc.

September 2006

www.reservestudy.com

What is the difference between a Capital Improvement and a Reserve project? Or more specifically, when can a Capital Improvement be more properly considered as a Reserve expense? This question becomes important to Association-governed communities as they consider what funds can be used (Reserves or a Special Assessment?) and what authority (homeowner vote?) is needed to execute the project.

Reserve projects are simpler to accomplish than Capital Improvements, because the Reserve Funds exist for that purpose and the Board has the authority (and responsibility!) to expend those funds to protect, maintain, and enhance the existing assets of the corporation.

Let's examine this distinction of "existing assets" carefully. Suppose an association has an older pool area, and in refurbishing this asset they wish to add a spa. We would recommend the Board obtain two proposals, one that spells out the cost for refurbishing the existing pool area and one that includes the cost of adding the previously non-existent spa. We would counsel our client to use Reserves to pay for the pool area refurbishment and consider the additional spa expense as a "capital improvement".

Let's consider another situation where a neighborhood community association wishes to add street entry gates and perimeter fencing to enclose the association. Clearly, that asset did not previously exist, and it should also be considered a capital improvement.

Now consider a tougher example. An association with a plaster/gunite pool surface may wish to upgrade to a fiberglass surface. The fiberglass is more expensive and will last longer, and most would consider it an upgrade. We would argue that since the pool existed, the Board is well within their authority to choose a different quality of material to use in the repair or replacement.

Here's one final example: Consider a pool area where one simple 10'x10' wood shade structure exists. In the pool refurbishment project (pool resurface, pool deck, perimeter fence, etc.), the architect proposes adding two larger shade structures, each 10'x20'. Is that a Capital improvement? We would suggest no, since the asset already existed in some form, and the change is generally about size and style.

The bottom line is that we would argue that Associations should be free to upgrade in surface, size, aesthetics, and technology as part of normal Reserve projects. An association with a key-based entry system should be able to expend Reserves to "modernize" to a telephone or card-swipe based system. An association left with an "empty" recreation room by the developer should be able to furnish that room and perhaps add wireless Internet and a cable TV as part of a periodic refurbishment project.

As times change, the Board will be faced with many decisions where the repair or replacement of association assets with exactly similar assets would be inappropriate. We are in business to safely, responsibly, and cost-effectively help our association clients protect, maintain, and enhance the assets of the corporation. We believe in many cases this means expending Reserves to replace an old asset with something "better" than what was there in the past. Such cases are not capital improvements necessitating homeowner votes and special assessments!