

# STUMP THE RESERVE PROFESSIONAL!

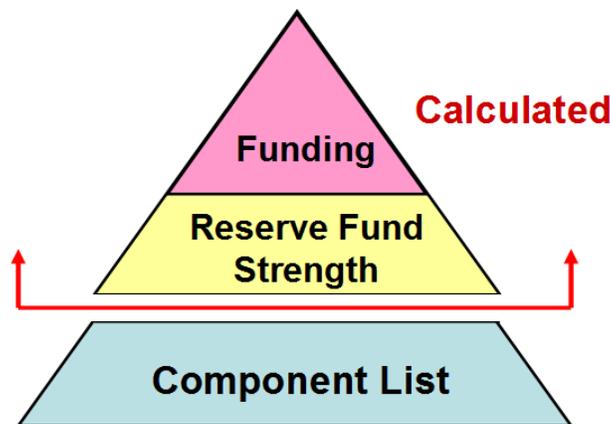
## WEBINAR OUTLINE

by Robert M. Nordlund, PE, RS, & Jim Talaga, RS

[www.reservestudy.com](http://www.reservestudy.com)

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**Brief Outline:** Every Reserve Study consists of three parts, the Component List, a calculation of Reserve Fund Strength, and a calculated multi-yr Reserve Funding Plan. We think of it this way:



There are three types of Reserve Studies:

- “Full” Reserve Study (created from scratch). Typically an association needs to do this Level of Reserve Study service only once.
- “Update With-Site-Visit” Reserve Study. A Reserve Study update involving a diligent visual site inspection.
- “Update No-Site-Visit” Reserve Study. A Reserve Study update based on information provided by the client and its vendors, without the benefit of a site inspection.

Reserve Study components are determined by the following National Reserve Study Standard four-part test. For a component to be funded through Reserves, one needs to answer “yes” to all of the following four questions:

1. Is the component the maintenance responsibility of the association?
2. Is the component Life Limited?
3. Does the component have a predictable Remaining Useful Life?
4. Is the repair/replacement cost above a minimum threshold cost of significance?



## Questions from the Audience!

**Q:** What are the Reserve Study laws for CA and WA?

**A:** CA and WA are two of the 30 states that now have one form or another of Reserve Study, Reserve Funding, or Reserve Fund disclosures laws. Both require an investigation of the needs of the association and disclosure of results to the owners. WA laws can be found in RCW 64.32, RCW 64.34 (condominiums) and RCW 64.38 (Homeowner Associations). The basics of CA law can be found in Civil Code 1365. Please contact a legal expert in your state for details. An outline of national Reserve Study laws can be found at: <http://www.reservestudy.com/legislation>

**Q:** What do you suggest telling our owners who don't want to contribute to Reserves because they're not going to be living here in 15 years when the roof is going to be replaced?

**A:** Reserve contributions are designed so that owners enjoying the use of assets while they are deteriorating will be paying for that deterioration while they own a home in the association. Reserve contributions are not for future expenses. Reserve contributions offset ongoing, current deterioration.

**Q:** Do you do our whole budget?

**A:** A budget consists of the Operating Budget (the daily/weekly/monthly expenses at the association) and the Reserve Budget (funds set aside to offset ongoing deterioration). So a Reserve Study, what we prepare, is only one portion of your total budget.

**Q:** How do you get your pricing for replacement project costs?

**A:** Due to the large number of Reserve Studies we prepare, we have a large database of "actual" costs recently experienced among our clients. That is the primary source of replacement project cost estimates used for other clients. If good, local, applicable, current pricing is not available, we contact the association's vendor or one of our network of reputable vendors to gain some insights into an appropriate replacement cost. In the rare event we still are not able to gain some pricing insights, we refer to standard industry cost estimating handbooks.

**Q:** Why didn't my last study list termite treatment as a component? It cost a lot of money and we weren't prepared.

**A:** Termites, like plumbing and other "hidden" deterioration, is difficult to predict. When indications exist that a major termite expense is approaching, a pest control project will be included in your Reserve Component List. Unfortunately, it often requires one termite expense to learn the exposure of the association to this type of possibly recurring expense.

**Q:** Does a Reserve Study need to be ratified/approved?

**A:** No. A Reserve Study provides important insights about the scope and schedule of upcoming Reserve projects, the strength of the Reserve Fund, and a recommended Reserve Funding Plan. As such, it provides findings and recommendations, insights for the Board and management to consider when making disclosures to owners and the budget for the upcoming year. It should be reviewed, but as it is (usually) the work-product of an outside professional, it does not need to be “ratified”.

**Q:** What is the difference between “replacement cost” (in the Reserve Study) and the “insured value” that appears in our insurance paperwork?

**A:** The replacement cost in the Reserve Study is the anticipated current cost to install a new roof or repaint the building due to the normal aging process of a building. It differs from “insured value”, typically a higher number which is associated with replacement in the case of an insured loss (fire, storm, etc.). Replacement after loss or damage is very different from a normal Reserve project, done when a component reaches the end of its Useful Life.

**Q:** What do you do if you borrow from Reserves for an Operating Fund expenses?

**A:** Repay the Reserve Fund. Many states have laws regulating how fast the borrowed funds must be returned to the Reserve Fund. If the laws in your state allow for repayment over multiple years, expect your Reserve contributions to be higher because borrowed funds are being replaced in addition to normal Reserve contributions.

**Q:** Under which circumstances is a Reserve Study not needed/required?

**A:** A Reserve Study helps an association prepare for the future, to avoid surprises. Every association, new or old, large or small, needs a Reserve Study annually to gain updated information on where it stands with respect to its Reserve projects, its Reserve Fund strength, and appropriate Reserve contributions. Even in associations that plan to handle Reserve expenses with special assessments, those associations should get Reserve Studies in order to responsibly give their owners notice of upcoming large assessments. Nobody likes to be surprised!

**Q:** Can a Reserve Study update be done in-house?

**A:** Yes. The most common type of Reserve Study done in-house is an update No-Site-Visit, in-between the more exhaustive Update With-Site-Visit updates typically done by a Reserve Study professional.

**Q:** If an association has had a Reserve Study prepared by one company, is it possible to switch to another company without starting all over again (with a “Full” Reserve Study)?

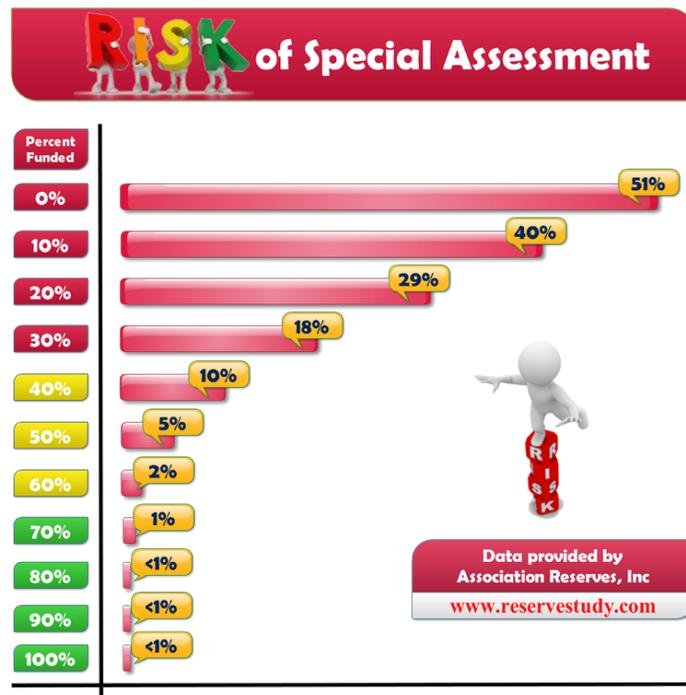
**A:** Yes. National Reserve Study Standards, formed in 1998, provide a standard framework for what is in a Reserve Study, the calculations, terminology, and disclosures. It should be no problem to switch from one company to another company, if both follow National Reserve Study Standards, allowing you to hire a different company with a different pricing structure, different customer service, or a different presentation of results.

**Q:** What do you say to an association that feels the Reserve Study is “off”, or “wrong”?

**A:** If it is a matter of a quantity that is incorrect, the report should be revised to get it “right” (if there are five elevators and the Reserve Study only accounts for four, the report should be revised to show the correct total of five). On an issue having to do with opinions, expect the opinion of the Reserve Study professional to appear in the Reserve Study. The association has hired the professional for their opinion, and that is what they should expect to get in the Reserve Study – the professional’s independent opinion on the matter (not a display of the client’s contrary opinion).

**Q:** What is a realistic funding level? Don’t associations find it too hard to be 100% Funded?

**A:** It is all about risk. The 100% Funded level shows the association is “on pace”, having collected Reserves in direct proportion to the deterioration of the Reserve components. The association can claim to be “ready”. As the association’s Percent Funded drops, the association increases its risk of being caught unprepared for a significant expense, and being forced into having a special assessment or deferred maintenance. See the chart below:



**Q:** Doesn't it cost a lot to be Fully Funded? Can any association do it?

**A:** The difference in Reserve contributions between Fully Funding and Baseline Funding (just keeping Reserves above zero) contributions is surprisingly small. In both cases, the same projects are scheduled to be accomplished, so the same expenditures are planned. The only difference is that Full Funding associations have some additional "margin". Full Funding contributions are typically 10-15% higher than Baseline Funding contributions, so it is not a significant difference.

**Q:** What do you do if your Reserve Study projects the roof to last 25 years, and after 27 years it is still going fine? We've done good maintenance, and we expect it to make it to 35 years.

**A:** Great for you! Timely maintenance is often money well spent. A Reserve Study should be updated regularly to reflect the latest assumptions for Useful Life and Remaining Useful Life. In your case, an inspection of the roof is likely to reveal a good estimate for Useful Life in the 30 to 35 years range. Your Remaining Useful Life should be adjusted accordingly.

**Q:** What do we do if we only need to replace half the roof? One half is in poor condition the other half appears to have a few more years left.

**A:** Split the roof replacement Reserve Component into two parts... one part showing a Remaining Useful Life of zero, and the other showing a few years left.

**Q:** If you split a component into two (or more) parts, do you also split up the funds dedicated to that component?

**A:** Dedicating funds to a component is a relatively arbitrary process, because funds can be re-allocated each year. The ultimate in re-allocation is the cash flow methodology, where there is one Reserve Fund that is drawn upon by all Reserve projects. In the cash flow methodology, an association never gets into the silly situation where they have \$200,000 in Reserves, but need to convene a meeting to re-allocate funds because they only have \$30,000 in "roof reserves" and the roof project is going over-budget and is now expected to cost \$40,000.

**Q:** Is it appropriate to Reserve for trees and shrubs?

**A:** Yes. Quite often major landscape upgrades and tree trimming meets the four-part test of being a common area maintenance responsibility, having a limited Useful Life, a predictable Remaining Useful Life, and being above a minimum cost of significance.

**Q:** If you don't do a project with a Remaining Useful Life of zero, does that show as a negative number in future years?

**A:** No. A Remaining Useful Life of zero means it needs to be done now. Deferring a project often increases its cost, but it can't be any more immediate than still needing to be done now! So you'll never see a Remaining Useful Life less than zero.

**Q:** If the Reserve Fund is 100% Funded and you do a large scheduled Reserve project (on time, on budget), does the Reserve Fund remain 100% Funded?

**A:** Yes. Check out "[An Interesting Math Problem](#)" in our online library to see what happens to Percent Funded when an underfunded association makes a significant expense.

**Q:** What's a good number to use for a Reserve Threshold of significance (below which it is best to do the project from the operational maintenance budget)?

**A:** Typically associations use the signature authority of a boardmember or manager as a good threshold, a number that is often in the range of .5% to 1% of an association's total annual budget.

**Q:** If our association pattern is to usually replace a component with lower-cost used equipment, what replacement cost should appear in the Reserve Study?

**A:** It is common to model actual association operations in the Reserve Study, but the Reserve Study is also a tool to recommend the most cost-effective solution for an association. If through great maintenance an association can enjoy a longer than expected Useful Life, that extended Useful Life should be modeled in the Reserve Study. If the association tends to use refurbished pool furniture that lasts as long as new patio furniture (but costs less), that should be modeled in the Reserve Study. If the association buys used equipment (80% the cost of a new unit) but it only lasts 50% as long as a new piece of equipment, that is unwise and should not be part of the Reserve plan.

**Q:** Can a previous boardmember be held liable if Reserves were underfunded for years and a special assessment is the result?

**A:** That question was answered in our "[Underfunding Reserves and the Business Judgment Rule](#)" webinar, the answer is "yes". Underfunding Reserves typically takes years of underfunding to create a special-assessment-sized problem. Boardmember names are typically well documented in association records, and association budgets are also typically well documented. If those Boardmembers selfishly, carelessly, or foolishly underfunded Reserves (ignoring the protections defined in the Business Judgment Rule), they have some significant liability exposure. See below for the Business Judgment Rule outline from that webinar:

Actions	Low Risk Behavior	High Risk Behavior
Within Authority and Power	<ol style="list-style-type: none"> <li>1) Setting budget per State Law and Gov Docs</li> <li>2) Collecting \$ from owners in proportion dictated by Gov Docs</li> <li>3) Protecting common areas from deferred maintenance</li> </ol>	<ol style="list-style-type: none"> <li>1) Failing to set a budget that collects "adequate Reserves", or as required by Gov Docs</li> <li>2) Deciding to not fund some components</li> <li>3) Planning to special assess future owners</li> </ol>
Making reasonable inquiry (Prudent Man Theory)	<ol style="list-style-type: none"> <li>1) Relying on a credentialed Reserve Study expert</li> <li>2) Updating your Reserve Study regularly</li> </ol>	<ol style="list-style-type: none"> <li>1) Relying on your own expertise when not an expert</li> <li>2) Guessing</li> <li>3) Ignoring Reserve issues</li> <li>4) Getting a Reserve Study, but ignoring it</li> </ol>
In good faith and in best interests of Association	<ol style="list-style-type: none"> <li>1) Getting projects done on time</li> <li>2) Fairly spreading out Reserve contributions over current &amp; future owners</li> <li>3) Maximizing appearance and property values</li> <li>4) Follow spending &amp; funding recommendations in Reserve Study</li> <li>5) Raising Reserve contributions as necessary</li> </ol>	<ol style="list-style-type: none"> <li>1) Thinking "we can't afford to..."</li> <li>2) Deferring decisions to future years</li> <li>3) Not disclosing Reserve Fund strength to owners</li> <li>4) Not disclosing Reserve Study results to owners</li> <li>5) Delaying necessary projects</li> <li>6) Jeopardizing property values</li> <li>7) Forcing future owners to pay more than their fair share</li> </ol>

**Q:** To what extent should the Reserve Specialist be involved in the physical site inspection?

**A:** If it is a "Full" or "Update with-Site-Visit" type Reserve Study, the physical site inspection is one of the key responsibilities of the Reserve Specialist, so they should be intimately involved.