

FUNDING FOR THE FUTURE

RESERVE NOW OR REGRET LATER!



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www.reservestudy.com

Picture yourself onboard an airplane for a long-awaited family vacation. As you watch the clouds float by, you happily day-dream of the adventures in store for you and your loved ones. As the flight attendants hand out the first round of drinks, the pilot makes a sudden announcement: "Folks, we're terribly sorry, but the plane is almost out of fuel. What's worse, the wings are barely held together by duct tape, and the landing gear has needed repair for months now." He goes on to tell you and the other shocked passengers that the



plane will need to make an emergency landing, and everyone will have to pitch in to afford the cost of the repairs. "But what happened to all the money we paid for these tickets?!" you practically shout to the attendant. "Didn't anyone think to use some of that money to care for the plane?" As tension rises in the cabin, the pilot safely makes the emergency landing. After a long and costly wait, the plane is fixed and you continue on your trip, but not before your sanity and your pocketbook have been put to the test.

No doubt this is an extreme scenario, but unfortunately we can draw a comparison to something that happens every day in communities around the country. Imagine the feelings of a homeowner who's bought a home in what she thought was a great community association, only to find out that her building's elevators are on their last legs, the roof is constantly leaking, and her balcony railing is rusted through. When she raises her concerns at that month's board meeting, she's told that there's no money for the work that needs to be done, and that the residents will have to cover the replacement costs through a major special assessment. You can imagine her disappointment, anger and frustration, all of which could have been avoided had the association been planning and preparing for these expenses all along. Just like the passengers on the airplane, she's wondering how this could have happened, and who is to blame for the problem.

Surprisingly, this is a very common situation, and is almost always the result of short-sighted planning, particularly with regard to an association's Reserve funds. In every community association, a significant portion of the assessment fees collected from the owners should be held in special accounts known as Reserves, only to be used for specific purposes. Not to be confused with routine "Operating" funds which cover everyday expenses such as insurance, utilities, and management fees, Reserve funds are intended only for repair, restoration, replacement, and maintenance of the association's major physical assets. Typical Reserve-funded projects include roof replacements, painting, pavement resurfacing, replacement or modernization of HVAC and other mechanical systems, interior remodeling, amenity area updates, and many more. Because they typically don't occur every year (and sometimes not for many years at a time), these large costs are often underestimated or overlooked completely.

To adequately prepare for these inevitable expenses, a community association needs to determine how much money should be contributed to Reserves each year so that sufficient funds are available when components reach the end of their useful lives. This can quickly become a complicated exercise, especially in older properties with many projects due (or overdue) for serious work. Combined with a universal desire to keep assessments as low as possible, this often means that funding of the Reserves is put off until "next year."

As the years go by, and major expenses creep closer, the association will find itself in increasingly dire straits. Eventually, the residents will look around and notice that the paint is peeling, the streets are crumbling, and the amenities are sorely in need of updating. At that point, tough decisions need to be made. Will the association be able to pass a special assessment to raise the funds? Will it need to take out a loan, committing to years of interest payments? Or will it let the property continue to decline until home values become negatively affected? Clearly, none of these is a desirable option. The wisest method of preparing for major projects is to identify ahead of time what will need to be done, properly estimate the scope and schedule of the projects, and design a Reserve funding plan that will allow for timely repairs & replacements. In other words, the association will need to conduct a Reserve Study and incorporate the findings into the annual budget process.

A Reserve Study that is prepared in accordance with National Reserve Study Standards will communicate three key results:

1. A Component List detailing the scope and schedule of the items that the Association is obligated to maintain
2. A calculation of Reserve Fund strength (also known as % funded)
3. A Funding Plan that allows for timely repairs & replacements, with an emphasis on avoiding special assessments

The Component List is compiled through a thorough, detailed inspection of the Association's actual physical assets, such as buildings, streets, amenity areas, and so on. Photographs are taken to establish the current condition and measurements are taken to help define the scope of all expected projects. Schedule is determined by assigning a Useful Life and Remaining Useful Life to each line item.

Using this framework of data, current repair and/or replacement costs are estimated and a Funding plan is determined that allows for the various project identified in the study to be completed on schedule.

Reserve Studies have become an integral part of the annual budgeting process for Associations across the country. Associations that are well-prepared for large expenses are easier to manage and are more desirable to prospective buyers. More importantly, current residents of these associations will be less exposed to the financial difficulties that result from poor planning. A community association is not an apartment complex. All owners collectively share the responsibility of protecting the value of the association's shared assets. Proactive, responsible board members must embrace their fiduciary duty to do right by the people they represent, and association managers must help put their clients in a position to make wise decisions.

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A reliable Reserve Study takes time and expertise to prepare. With the necessary experience and credentials, a professional Reserve Study provider is an independent third party, able to take responsibility for the recommendations shown in the study. While board members and property managers often contribute valuable background information, a

professional is able to give clear, unbiased recommendations grounded in facts and objective data. As with filing taxes or determining insurance requirements, the Association should always seek the advice of specially trained experts when it comes to major financial decision-making. If your association doesn't have a current, professional Reserve Study, there's no time to waste. Whether it's an airline ensuring the safety of its passengers or a community association planning ahead for care of its most important assets, crossing fingers and hoping for the best is no substitute for diligent, responsible planning.