



STATE OF WA

WHY SHOULD YOU UPDATE YOUR RESERVE STUDY

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The primary responsibility of the Board of Directors is to maintain, protect, and enhance the assets of the association. Typically, the most significant assets and related expenses of an association are those identified within a Reserve Study. To be an effective planning, communication and disclosure document, it is essential that the data within the Reserve Study be both accurate and *current*. But Jim, “We had a Reserve Study performed last year and the major items within our community like the roofing, painting and asphalt are unchanged and deteriorating on schedule! Why should we update the report when nothing has changed?” Because the less predictable forces that were considered at the time of the Reserve Study recommendations *have* most likely changed. Let’s take a look at a few of these:

Economic: From a Macroeconomic point of view, how many of you have noticed that the financial markets tend to go up and down, and as a whole have declined significantly over the last few years? (I’m sure glad that my kids won’t be going to college this year, and I can currently plan to retire at the age of 92) While many of you do not have your reserve funds invested in the equities market, the typical interest bearing accounts used as investment vehicles for your reserve funds have also suffered. Just a few years ago, many associations I worked with were reporting returns of 4 to 6%. Currently, those same accounts are earning in the 1% range or less. What does this mean to the status of your reserve fund? The mathematical correlation is as follows: for every 1% change in the rate of interest (either up or down), your reserve contribution rate should change 4%. The numbers for inflation are even more dramatic: for every 1% change, your reserve contribution rate should change approximately 12 to 13%. From a Microeconomic point of view, the local labor and materials market can be very dynamic and also have a profound impact on your reserve fund status. Here in the Pacific Northwest, we have seen costs for several of the “Big Seven” projects (painting, roofing, asphalt, siding, decks, windows and plumbing) significantly outpace CPI inflation at times. The ramifications are obvious, if for example, your painting project was estimated a few years ago at \$50,000 and now costs \$75,000. A good reserve study provider has ongoing contact with local vendors and

contractors as well as recent cost data from similar projects in the area to track the changes in these costs. While these issues affect all associations, they are especially significant to mature communities which are ten years old or more and have major projects due within a few years.

Care, maintenance and weather conditions: The manner in which you care for and maintain the common elements within your association will also have a significant impact on your reserve plan. An experienced Reserve Study provider has had the benefit of observing many communities and common elements similar to yours, which in part leads them to develop the Useful Life/Remaining Useful Life estimates contained within a Reserve Study. He (she) is also expert at identifying the conditions present that can alter these UL/RUL estimates. Do you regularly inspect, clean and repair your common elements as part of the overall maintenance plan? Is there an abundance of mature trees or other vegetation in contact with these elements? What areas face the prevailing weather and are therefore subject to accelerated wear? Was it a mild or stormy winter? How do topography and wind pressures affect the improvements? What level of quality and workmanship went into the projects to begin with? Does your community have a generally older resident population, or is it more family oriented? The answer to these and other questions were likely known and considered at the time of the last Reserve Study. But, for example, what if there are changes to those answers that point to that \$75,000 painting project needing to be done in three years instead of five as originally projected? Or, and this will lead directly into the next sub-topic, what if there has been a change in the policies and practices of the board?

Decisions by past Board of Directors: A responsible, strong and proactive board operating within the framework of a thorough set of Governing Documents is needed to most effectively enhance and maintain the assets of the association. Sometimes limited by this framework or policy of past boards (such as under-funding reserves), they are faced with making tough decisions. In our industry, perhaps the greatest Oxymoron of them all is Special Assessment. In a standard presentation that I give, I cite the example of a fairly young association that appeared to be in relatively good financial shape; 50% funded, mid-five figure reserve balance and several years before major projects were due. They were setting aside \$2,000 a month for reserves. Upon financial analysis, I determined that with their current contribution rate their reserves would be fully depleted within ten years. In consideration of this and their projected expenses, I recommended that they increase their Monthly Reserve Contribution to \$3,250. With good intention, the board decided to settle somewhere in between at \$2,500. When updating their reserve study, I concluded that with this increase to \$2,500 their reserve fund would now be depleted in twelve years instead of ten! Even though the differential of \$750 per month (\$7.50 per unit in this case) does not sound like much, you can't underestimate the power of compounding and the nature of cash flow. In an effort to appease homeowners and theoretically save money, I have seen associations dismiss their management company, landscaper, maintenance personnel, etc...As a matter of fact; I've seen maintenance altogether stopped! The bottom line is that you will have to pay for these projects one way or another, with the worst way by lower property values and decreased market appeal of your homes.

Other examples of poor policy decisions might be: always choosing the lowest bidder, not enforcing rules, lack of oversight, etc...

Updating your Reserve Study should be considered as integral as your annual accounting and budgeting procedures. Remember, the largest investment of having a Reserve Study performed is the first time when the component inventories are established. Reserve Study updates can save the community significant money and headaches if performed regularly. A Reserve Study is by nature a one-year document and should be viewed as an ongoing “Framework for Wise Decisions”.