



Protecting Communities Through Strategic Reserve Planning



**CLEVELAND METROPOLITAN
BAR ASSOCIATION**



**KAMAN &
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- » Joined Reserve Advisors in 1999
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AGENDA

- 01 - Legal framework for reserves
- 02 - Capital project funding options and theories
- 03 - Safety considerations in capital planning
- 04 - Lending institutions evaluating risk
- 05 - Reserve Study concepts
- 06 - Getting your Reserve Study up to date

Reserve Concepts and Definitions

- » **Assessments** – Amounts charged to owners to fund the operation, administration, maintenance, insurance and management of the community association in accordance with an annual budget. Sometimes referred to as “dues,” “maintenance fees,” or “fees.”
- » **Reserves** – The actual funds on deposit at a given point in time to defray the future repair or replacement costs of major capital items the association is obligated to maintain.
- » **Capital Item** – An individual, man-made physical item currently existing on the property that deteriorates over time and has a useful life of several years.

Renewed Focus

- » Increased focus on capital planning, preventative maintenance and structural integrity:
 - » Tower that collapsed in Florida
 - » Lending institutions and insurance companies utilizing Reserve Studies to evaluate risk
 - » State legislation requiring reserve studies for community associations
 - » FL, MD, VA, MN, TN, NJ
 - » Proposed in IL and MI



Common Challenge

- » Common challenge for community associations (*especially those with aging infrastructure*) - how to fund capital intensive projects
- » What options exist for Associations to fund capital intensive projects?
 - » Big ticket projects - roofing, pavement, major mechanicals, elevators



Reserve Expenditure Funding Options

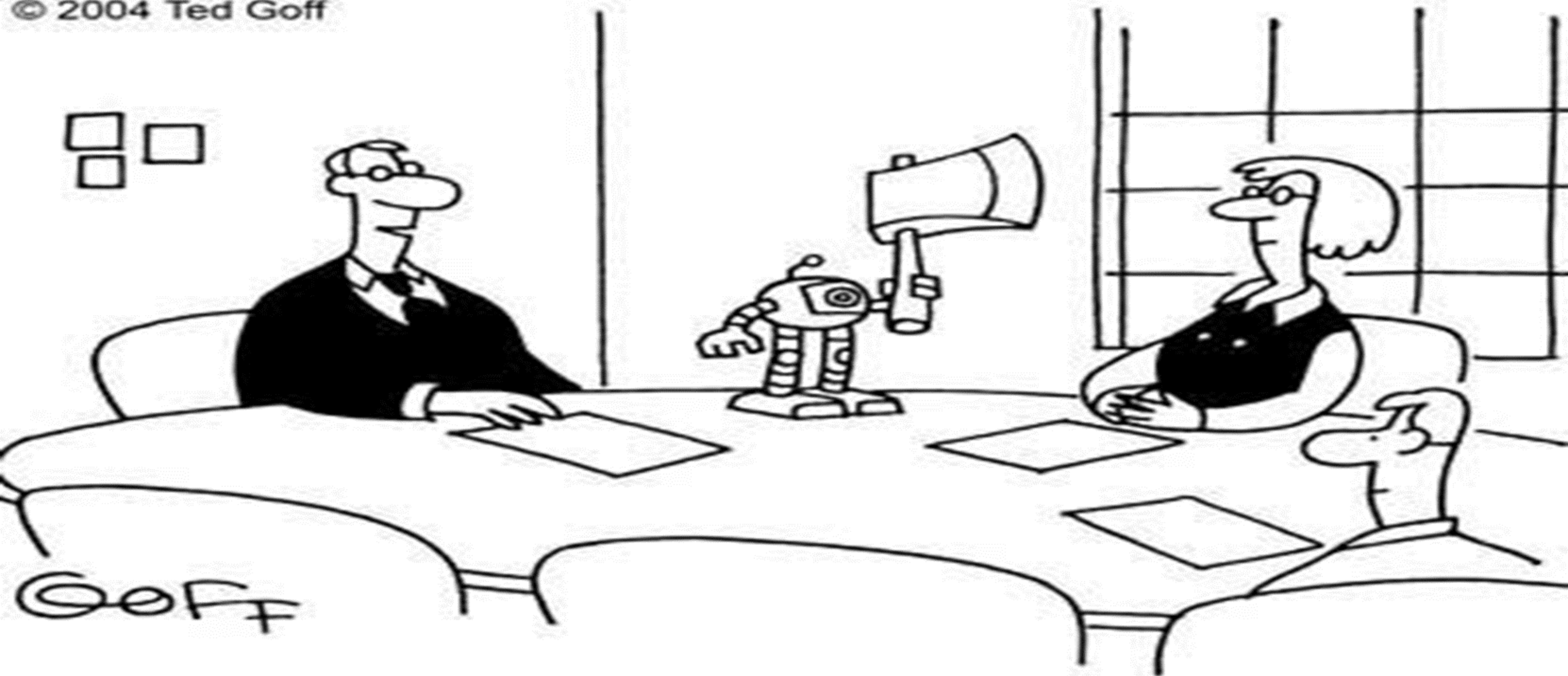
» Three funding mechanisms are:

- » Reserves
- » Loans
- » Special Assessments



Reserve Expenditure Funding Options

- » Many different theories as to which funding option is best:
 - » By setting aside appropriate reserves, owners pay fair share of weathering and aging each year they live at the property
 - » If 20 year useful life – contributions set aside $1/20^{\text{th}}$ of the cost each year
 - » Think in terms of paying for annual USE of the Association maintained elements as opposed to paying for a project down the road
 - » Relying on special assessments/loans defers cost burden



“The homeowners donated this robot to help the Board with this year’s budget.”

How Much Should be Set Aside?

» Funding regulations

- » Tendency at times to tie a percent of the operating budget to a sufficient reserve balance or contribution

- » Michigan and FHA require 10% of the operating budget

- » Illinois states "reasonable"

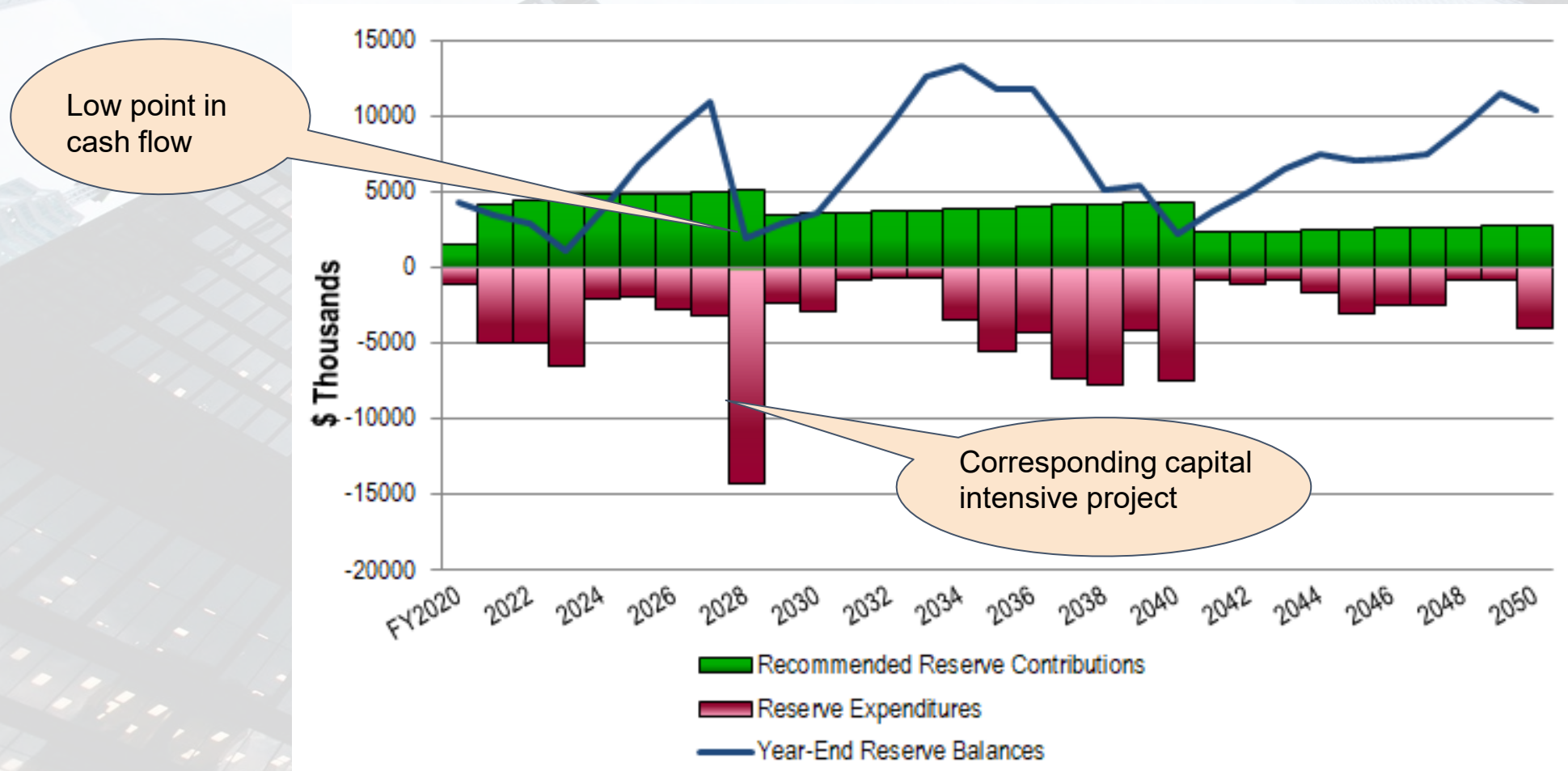
- » **OH SB 61** - Annually adopt and amend an estimated budget for revenues and expenditures. Any budget shall include reserves...unless the owners, exercising not less than a majority of the voting power of the owner's association, waive the reserve requirement in writing annually.

» Too many variables for a one size fits all percentage

- » Size, age, materials, maintenance history, amenities, etc.

- » Size of operating budget has nothing to do with cost to maintain façade, roofs, mechanical equipment, etc.

Relationship Between Reserve Contributions, Expenditures and Reserve Balances



Potential Pitfalls



Targeting the same reserve balance each year (and eyeballing a Reserve Balance)

Mitigate this by

Review the Reserve Study to understand that an appropriate balance varies and to understand the projects that will use up your reserves



Potential Pitfalls



Funding loan payments through reserves without calculating the impact

Mitigate this by

Build the loan payments into your Reserve Study to calculate the appropriate Reserve Contributions



Reserve Studies – What is a Reserve Study?

- » A reserve study is the tool to determine appropriate reserve contributions
 - » Most importantly, it allows Boards/owners to make informed decisions (i.e. develop a game plan to pay for big ticket projects and NO SURPRISES!)

Physical Analysis



Financial Analysis





Why Conduct a Reserve Study

- » Financial game plan to take on projects in a timely manner
 - » *Maintain property values*
 - » *Maintain structural integrity*
- » Independent opinion of the remaining useful lives of components
- » Independent opinion of the potential costs of capital repairs and replacements
- » Make an informed decision
 - » Reserve Contributions
 - » Additional Assessments or Loans

Why Conduct a Reserve Study

- » Financial institution revised procedures and policies:
 - » Obtaining a loan for capital projects
 - » Mortgage approval
 - » Refinancing of mortgages
- » *Reserve Studies are now a consideration in all of the above*

Fannie Mae and Freddie Mac Updates

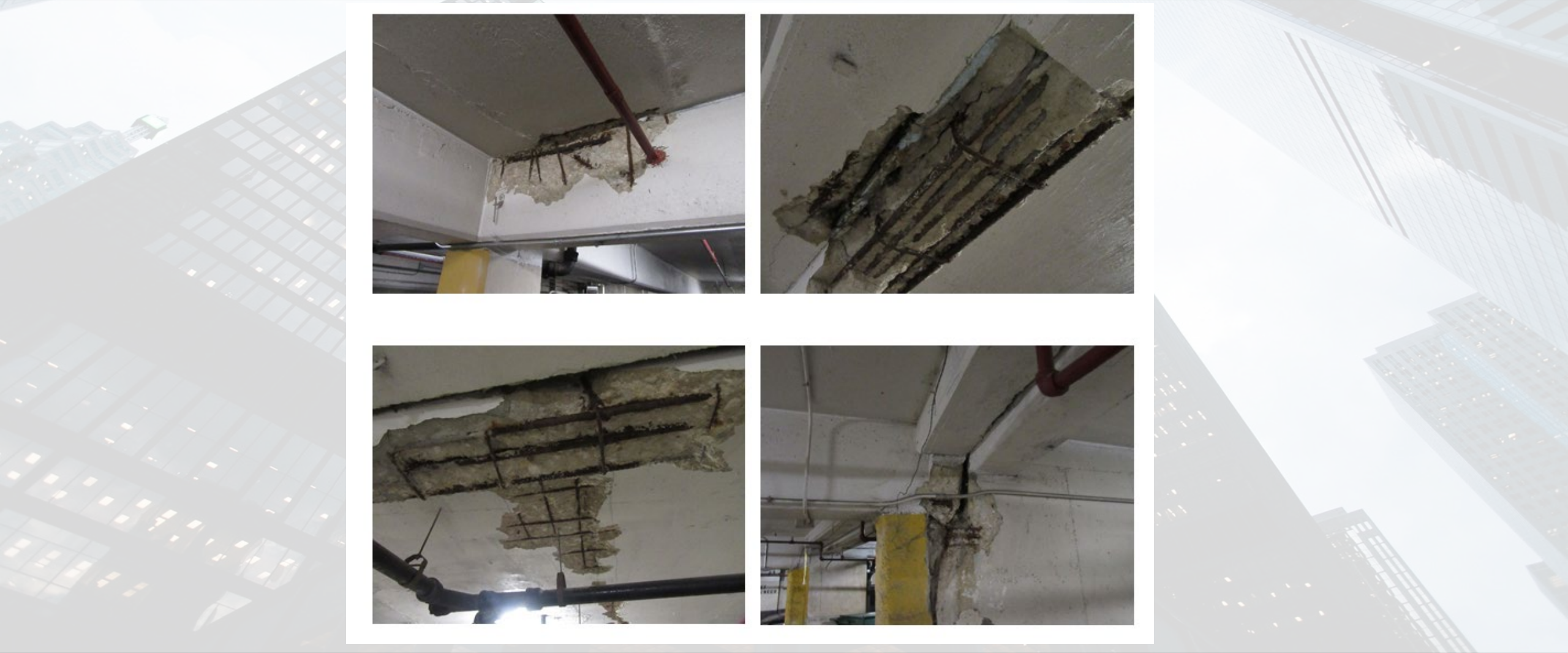
- » Condo Blacklist:
 - » Significant deferred maintenance
 - » Structural deficiencies
 - » Legal/financial troubles
- » Utilizing Reserve Studies to evaluate risk:
 - » Denying lending based on conditions noted in Reserve Studies
 - » Are they interpreting the Reserve Study correctly?



Evidence of water infiltration beneath elevated garage floor

Structural Conditions/Safety

- » Most importantly - Reserve Studies provide a plan financially to take on projects in a timely manner and to repair conditions before they become a safety hazard.
 - » Similar to a primary care physician, Reserve Study providers can identify abnormal conditions that warrant a specialist.
- » As painful as it may be at times, our function quite often is to inform our clients of significant underfunding of reserves.
 - » Failure to accumulate sufficient reserves may result in:
 - » Deferral of projects resulting in increased deterioration and thus costs to repair
 - » Failure to repair or replace a component in an appropriate manner (i.e. corners are cut)





Florida Legislation: Reserve and Engineering Services

- Original requirement = Licensed Professional Engineer
- 2022 Florida Legislation Requires:
 - Structural Integrity Reserve Studies
 - Structural Frame and Foundations
 - Roofs
 - Pipes
 - Life Safety Systems
 - Electrical Systems
 - Phase 1 and Phase 2 Milestone Inspections
 - Visual inspection of structural components
 - Phase 2 required if issues are noted in Phase 1 and includes invasive or more in depth analysis of a condition/component.



Life Expectations: Improper Maintenance



Reserve Studies – Common Fallacies

We don't need a reserve study. Our property is new, we have no near-term projects.

Setting aside appropriate reserves ensures each owner pays their fair share for the use of association maintained elements each year they live there.

We don't need a reserve study. Our community has minimal common elements.

Repair or replacement of community assets can be very costly regardless of the number of common elements. Understanding future capital needs is critical to maintaining the investment of the owners.

We don't need to pay a reserve study firm to tell us how to spend our money.

An independent analysis from a firm that specializes in reserve studies can provide guidance that maximizes the useful life of your community's common elements, makes the most efficient use of reserve funds and supports board decisions.

Reserve Studies – Common Fallacies

We don't need a reserve study. We know we are underfunded - We can't raise dues.

You are a fiduciary. The reserve study highlights your community's current financial health and recommendations to maintain its common assets. Armed with this information, the board can make informed decisions.

We don't need a reserve study. We had one completed in the last 10 years.

The reserve study is a snapshot in time. As elements age, the timing and cost of replacement will vary and will impact reserve funding needs. Frequent updates account for this as well as inflation, allowing your community to remain on track.

We don't need a reserve study. We have a contractor/accountant on our board.

Most boards have limited experience and expertise with conducting condition assessments and establishing useful life estimates which drives funding needs.

Engineering Analysis

- » Independent opinion of the remaining useful lives and costs to repair/replace components
 - » Should be no influence based on writing specs or managing projects (i.e. *no reason to increase costs or move a project up*)



Engineering Analysis

- » Purpose of reserve study is obviously NOT to predict exact times and costs of expenditures
 - » Remaining useful lives and costs are simply opinion based on experience for purposes of calculating a reasonable reserve contribution
- » Opinion of actual timing of projects may vary greatly
 - » Key is to have a plan in place to fund the project regardless of the exact year of conducting the project

Financial Analysis

- » Two primary methods to calculate reserve contributions:
 - » Cash Flow Analysis Method
 - » Minimum Threshold Cash Flow Analysis is most common east of the Rocky Mountains
 - » Minimum threshold will vary per property and is a debatable topic
 - » Minimum thresholds are the target for calculations and should be the focal points of reviews by the Board
- » If significant increases are required -- Potential for stepped or phased increases
- » Objections to properly funding reserves
 - » *We are on fixed incomes*
 - » *We can't afford that*

reserve study distribution

FIVE-YEAR OUTLOOK

Scenic Ridge
Association
Madison, USA

Line Item	Reserve Component Inventory	RUL = 0 FY2019	1 2020	2 2021	3 2022	4 2023	5 2024
<u>Exterior Building Elements</u>							
1.280	Roofs, Asphalt Shingles, Phased					228,696	234,414
1.400	Roofs, Flat, Phased					71,748	73,542
1.540	Sealants, Windows and Doors, Phased					12,418	
1.860	Walls, Stucco, Paint Finishes and Capital Repairs		38,438	39,398	40,383		
1.910	Walls, Trim, Soffits and Fascia, Paint Finishes		12,812	13,133	13,461		
<u>Interior Building Elements</u>							
2.200	Floor Coverings, Carpet, Hallways						24,891
2.800	Paint Finishes, Hallways						20,705
<u>Building Services Elements</u>							
3.060	Air Handling Unit, Rooftop Heating and Cooling Unit					9,934	
<u>Garage Elements</u>							
7.400	Door and Operator				3,231		
Anticipated Expenditures, By Year		0	51,250	52,531	57,075	322,796	353,552

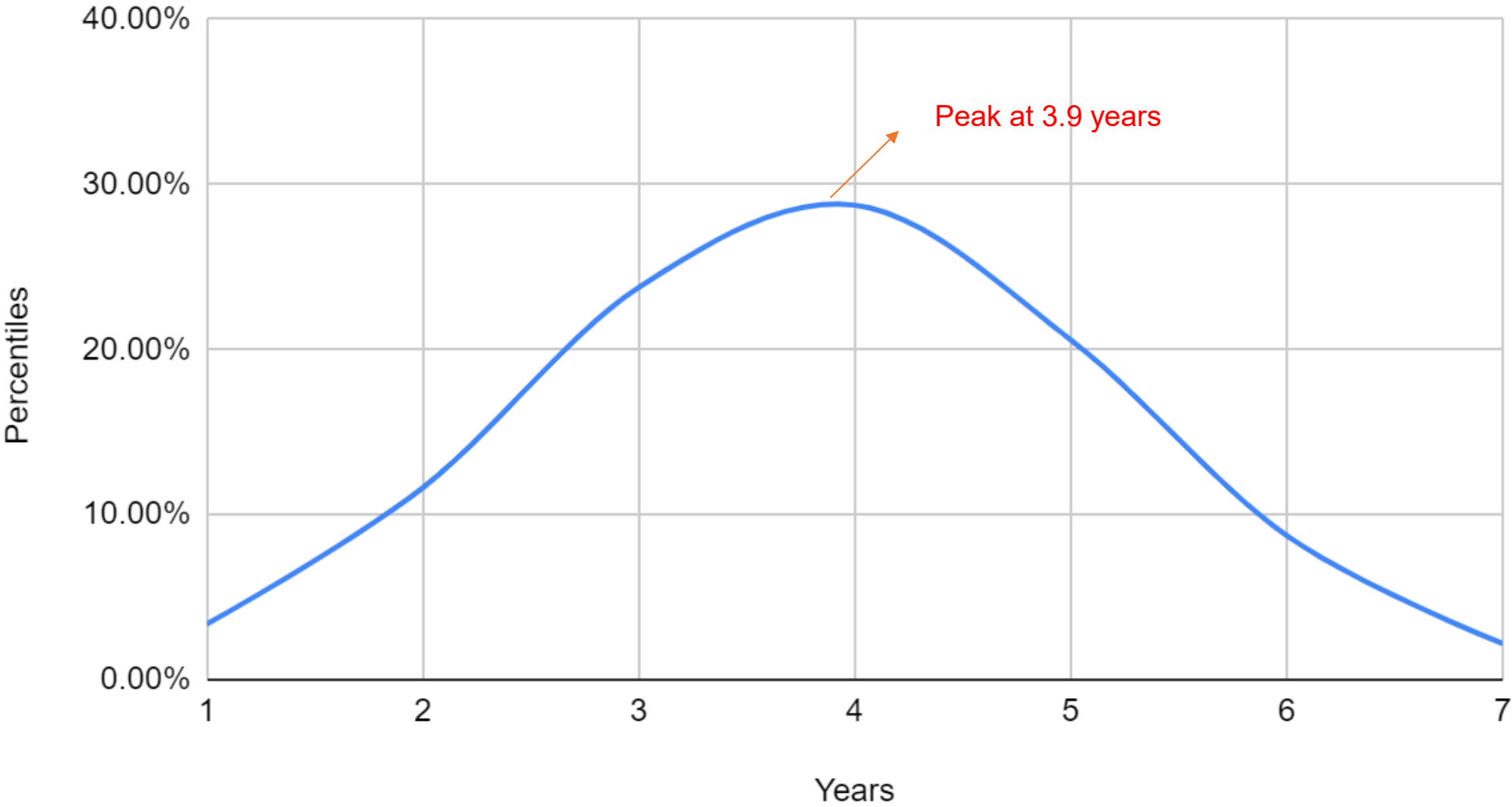


near term projects

Getting a Reserve Study Up To Date

- » Typically every 2- to- 5 years
 - » Of states with reserve study requirements: 3- to 5-years is interval
 - » One size fits all approach is NOT appropriate
 - » 2-3 years for older/more complex properties
 - » 3-5 years for newer/less complex properties
- » Changes in inflation and interest
- » Changes in the reserve balance or annual reserve contribution
- » Changes in codes (OSHA roof anchors)
- » Changes in maintenance practices
- » **Rate of Deterioration**

Illinois Updates



RS Standards – Preventative Maintenance

- » Best Practices Report on Maintenance
- » Reserve Study Standards
 - » Combination of preventative maintenance and a properly executed reserve study = financial integrity
 - » Financial integrity leads to structural integrity

RS Standards – Preventative Maintenance

- » CAI Recommended Supplemental Information
 - » **Preventative Maintenance**
 - » Disclosures within Reserve Study required
 - » Some preventative maintenance projects included as Reserve Components
 - » **Structural Inspections**
 - » Inclusion of reserve expenditures for inspections and costs to remediate conditions

Source: [CAI Reserve Study Standards](#)

Concluding Reserve Study Related Points

- » Appropriate reserve contributions ensure that owners pay for their fair share of weathering and aging each year (pay for the USE)
- » *Board's fiduciary responsibility is to maintain the investment of owners – not save owners money*
- » Educated condominium buyers are asking about reserves
- » In our experience, communities with appropriate reserve balances/reserve contributions are in better overall condition



Thank You!