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Trends in Reserve and Transition Studies

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Our Objectives for Today

- What is a 2021 Reserve Fund Study? The definition has drifted.
- The pros and cons of the current CAI Reserve Fund Study standards
- The benefits and pitfalls of a Reserve Fund Study by any standard

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Our Objectives for Today

- Current trends in the Association Board's expectations of a Reserve Fund Study
- The value of collaboration between the Board and the Reserve Specialist.
- The difference between a Reserve Fund Study and a Maintenance Plan

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Our Objectives for Today

- Current trends in Transition Studies
  - Becoming more adversarial

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The Birth of Community Associations

Common interest developments date back to 1963 in California. However, they were fragmented.

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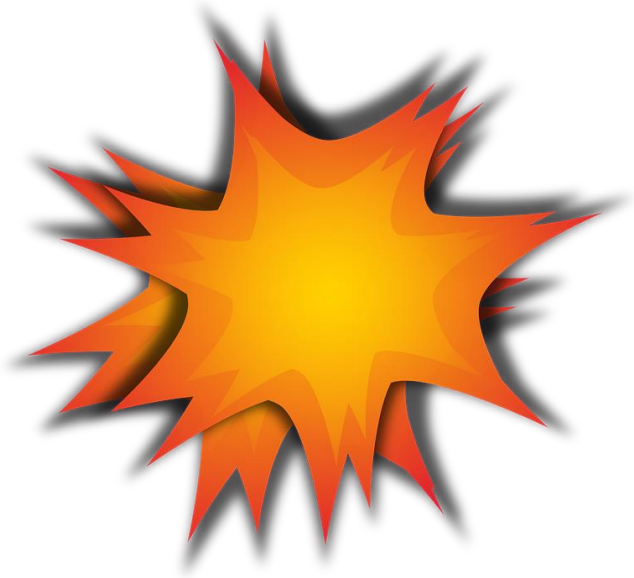
Davis–Stirling Common Interest Development Act in 1985.

In 1985 California Assemblymen drafted and passed an act that created a comprehensive body of law governing common interest developments.

An explosion was triggered.



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Community association growth

Year	Communities	Units	Residents
1970	10,000	700,000	2.1 million
2000	222,500	17.8 million	45.2 million
2019	351,000	27.2 million	73.9 million

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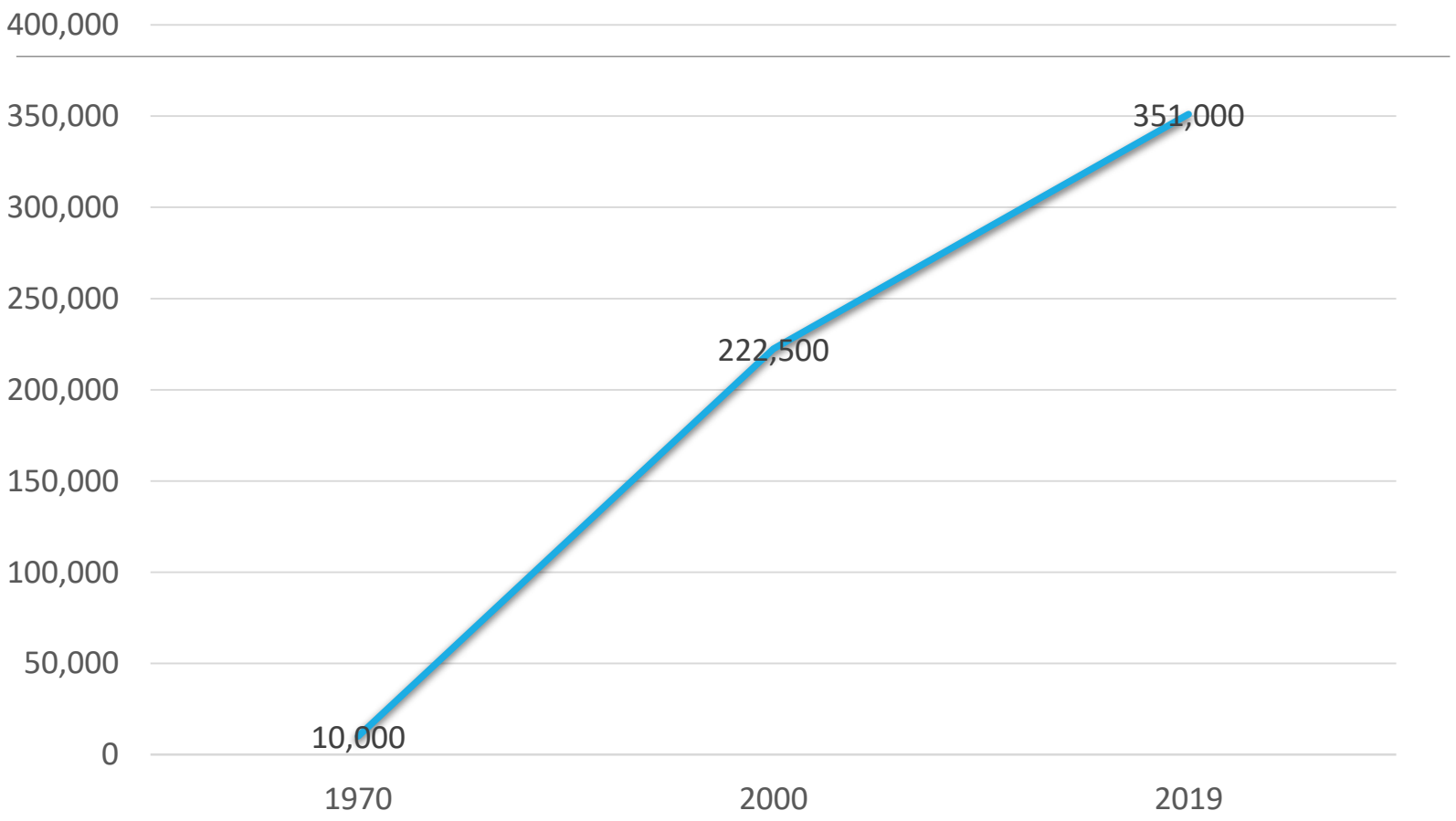
Communities



Reserve Fund - Current

What is it?

- A cash reserve for non-annual, expected, predictable expenses

Special assessments are to be avoided

What are General Accounting Practices (GAP)?

- Prudent guidelines
- Established standards of practice
- Defendable actions

The starting point for good financial management

Reserve Fund

Funding methods

- Cash flow
- Component

More later…

Vocabulary

Capital Improvement Fund

- Things you would like to do

Vocabulary

Capital Reserve Fund

- Things you plan to do
- Things you need to do

Vocabulary

Preventative Maintenance

- A good thing to control cost and avoid surprises
- Recommend maintenance contracts for accountability

Vocabulary

Reactive Maintenance

- *“If it ain’t broke, don’t fix it.”*

Not defendable management

Vocabulary

Annual Maintenance

- Not part of Reserve

Reserve Fund

What it isn't…

- It is not a maintenance plan

But not everyone agrees.

Vocabulary

Expected Useful Life (EUL)

Remaining Useful Life (RUL)

Estimates, based on professional, experienced judgment.

The heart of a Reserve Fund Study

Vocabulary

Upgrade

- To actually improve the system based on current technology
- How do upgrades and renovations fit with a Reserve Study?

Reserve Fund Account

Fund account options

- Separate account
- Trust account
- Mixed with general funds 

Separate account is best

Types of Reserve Studies

CAI Best Practices Document

Best Practices for Reserve Study/ Management

Published by the Foundation for Community Association Research

Types of Reserve Studies

CAI Type I: Full Reserve Study

"The reserve provider conducts a component inventory, a condition assessment (based upon on-site visual observations), and life and valuation estimates to determine both a fund status and a funding plan."

Types of Reserve Studies

CAI Type II: Update with Site Visit

"The reserve provider conducts a component inventory (verification only, not quantification), a condition assessment (based on on-site visual observations), and life and valuation estimates to determine both a fund status and a funding plan."

Types of Reserve Studies

CAI Type III: Update with No Site Visit

"The reserve provider conducts life and valuation estimates to determine a fund status and a funding plan."

Types of Reserve Studies

IV. Preliminary, Community Not Yet Constructed. A reserve study prepared before construction that is generally used for budget estimates. It is based on design documents such as the architectural and engineering plans. The following three tasks are performed to prepare this type of study.

- Component inventory
- Life and valuation estimates
- Funding plan

Types of Reserve Studies - Enhanced

In addition to the scope of work included in the Full Reserve Study, some firms offer associations an "Enhanced Reserve Study."

The Enhanced Reserve Study could include additional analysis of building and site systems which may not be included within the schedule. This inspection would provide recommendations for ongoing maintenance of all systems as well as a more complete condition evaluation of each in a detailed narrative report.

Four consequences of under-reserving

1. Deferred maintenance
2. Need for special assessments or loans
3. Lower property values
4. Liability exposure

How Are Cost Estimates Determined?

Quantity

Local unit prices

Professional judgment

- Objective, defendable

How Are Cost Estimates Determined?

Are they guaranteed?

- No; many things change
- Get contractor proposal for certainty
  - From someone willing to do the work
  - From someone qualified to do the work

Tips for Reserve Funding

Include all components

Include demo and disposal costs

Prudent Board Actions

Review your responsibilities

Make “right” (not necessarily popular) decisions

Become well versed in the Business Judgment Rule (BJR)

Business Judgment Rule

Limits the Board's decision-making liability when acting…

- within their power
- after reasonable inquiry
- in best interests of Association

It's just good management

Reserve expenses are not discretionary

Somebody pays them all!

"Board members in underfunded associations are sitting ducks for lawsuits."

- Anonymous Attorney

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Funding Options

What is the Basis?

Cash Flow

Component

Trending toward “adequate” funding

A much debated topic…

Definitions

Cash Flow Method – A method of developing a reserve funding plan in which contributions to the **reserve fund offset the variable annual expenditures** from it. Different reserve funding plans are tested against the anticipated schedule of reserve expenses until the desired funding goal is achieved. The Cash Flow method permits all of **the reserve funds to be pooled** such that the total available reserve balance can be used to meet the projected expenditures of any reserve component.

Definitions

Component Method – A method of developing a reserve funding plan in which the **total contribution is based on the sum of contributions for individual components**. The Component Method, often called the Straight-Line method, provides for the independent funding of each common element. That is, the reserves for each component, or type of component, are calculated separately and funded independently of other components. **With this method there is no pooling of reserve funds** and each component has to maintain its own reserve balance.

Definitions

Fully Funded Balance (Total Accrued Depreciation) - An indicator against which Actual (or projected) Reserve balance can be compared. **The Reserve balance that is in direct proportion to the fraction of life "used up"** of the current Repair or Replacement cost. This number is calculated for each component, and then summed together for an association total. The method of calculating the Fully Funded Balance is identical to that employed in the Component Method.

Definitions

Funding Goals - Independent of methodology utilized, the following are common terms for funding plan goals:

- ***Baseline Funding*** *– usually keep fund balance above zero*
- ***Component Full Funding*** *– another term for 100% fully funded using Component Method*

Definitions

Funding Goals - Independent of methodology utilized, the following are common terms for funding plan goals:

- ***Statutory Funding*** *– as may be required by state*
- ***Threshold Funding*** *– minimum balance, determined by Association*

Reserve Component “Four-part test”

Common area responsibility

Limited useful life

Predictable remaining life

Above a minimum cost

Cash Flow Funding

Item		1	2	3	4	5	6	7	>>>>>>>	18
Pool furniture		4,600								
Pool resurface							10,000			
Roof replace										80,000
Asphalt – seal				5,000						
Asphalt – resurface				25,000						
Building – repaint			50,000							
Elevator – modernize							80,000			
Hallways – refurbish								24,000		
Annual Totals		**4,600**	**50,000**	**30,000**	**-**	**-**	**90,000**	**24,000**	**-**	**80,000**
Opening Balance	**75,000**									
Annual Contribution		**15,000**	**15,000**	**15,000**	**15,000**	**15,000**	**15,000**	**15,000**	**165,000**	**15,000**
Cumulative Balance	**75,000**	**85,400**	**50,400**	**35,400**	**50,400**	**65,400**	**(9,600)**	**(18,600)**	**146,400**	**81,400**

Cash Flow Funding Benefits

Easy to understand

More practical for large asset lists

Funded by uniform contributions

Our general preference

Reserve Component List

Description	UL	RUL	Cost
Pool furniture – replace	5	0	$4,600
Pool – resurface	10	5	$10,000
Roof – replace	20	18	$80,000
Asphalt – seal	5	2	$5,000
Asphalt – resurface	20	5	$25,000
Building – repaint	10	1	$50,000
Elevator – modernize	20	5	$80,000
Hallways – refurbish	8	6	$24,000

Fully Funded Balance

Fractional age X Current cost

(Summed for all components)

Description	UL	RUL	Cost	FFB
Pool furniture – replace	5	0	$4,600	$4,600
Pool – resurface	10	5	$10,000	$5,000
Roof – replace	20	18	$80,000	$8,000
Asphalt – seal	5	2	$5,000	$3,000
Asphalt – resurface	20	5	$25,000	$18,750
Building – repaint	10	1	$50,000	$45,000
Elevator – modernize	20	5	$80,000	$60,000
Hallways – refurbish	8	6	$24,000	$6,000
TOTAL:				**$150,350**

Fully Funded Balance

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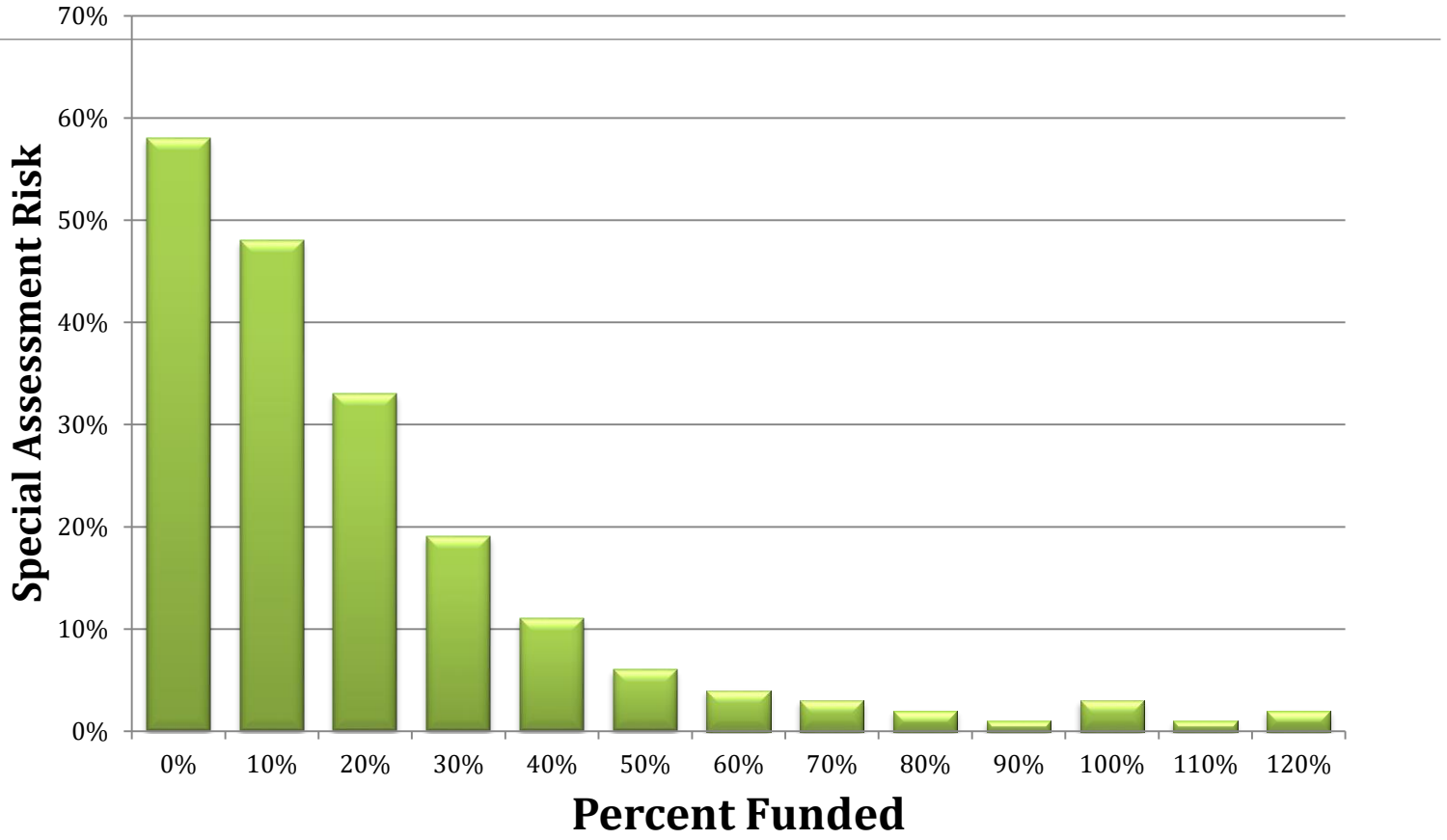
National Special Assessment Risk



Reserve Funding at Association-governed Communities

Well funded – 30%

Under funded – 40%

Severely under funded – 30%

} 70%

Using Component Method

The Big 3-0: *Trends*

Aging infrastructure

54% of community buildings are at least 35 years old (CAI statistic)

All buildings start to deteriorate the day after construction was completed.

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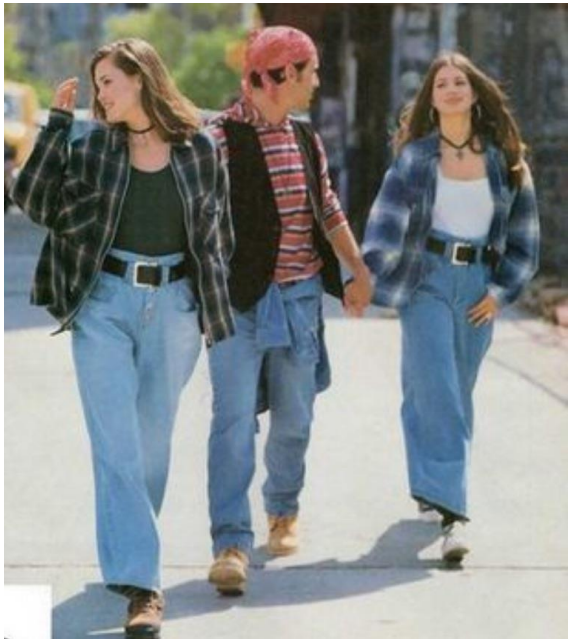
1990

Where were you?



The look ahead changes

After 30 years, the look ahead changes

- Siding
- Windows
- Vertical transportation
- Site drainage
- Paving

Current tools

Maintenance plan

- Annual maintenance, known systems

Reserve fund study

- In kind replacement
- Known assets
- Most Expected Useful Life (EUL) 20 to 30 years

Capital improvements plan

- Upgrades

But things change…

Even after 10 years, in kind replacement may not be appropriate

- Technology changes
- Owner expectations change

The “out of sight, out of mind” effect

Underground

Corrosion

Flashing

Underlayment

Erosion/Drainage

The “I don’t know what I don’t know” effect

Tile roof underlayment

Cast iron piping

HVAC/ventilation

Effect of water quality

How long?

The expected useful life (EUL) of a building?

- Many variables
- Generally 50 – 100 years

EUL criteria for most reserve fund study components is 20 – 30 years

Long range plan needed

How long?

What about components with EUL greater than 30 years?

- Reserve allowances
- Our white paper (available on request)

Establish a building baseline

Core systems

- Structure
- Building envelope
  - Walls
  - Windows
  - Doors
  - Roof

What's missing?

Compare to:

- Maintenance plan
- Reserve fund study
- Asset list
- Identify gaps

Peel the onion (a few examples)

Plumbing

- What kind of pipe?
- Where is the pipe?
- Effect of water quality

Peel the onion (a few examples)

Windows

- Flashing
- Seals
- Operation

Peel the onion (a few examples)

Building envelope

- Brick veneer
- EIFS
- Composition board
- Vinyl

Peel the onion (a few examples)

Building envelope

- Cracks
- Delamination
- Distortion
- Water intrusion
- Water retention (drainage plane)

Peel the onion (a few examples)

Vertical transportation

- Controls
- ADA

A good faith effort

It’s a subjective exercise, but credible

- A good faith effort to stay ahead of the curve
- The result offers an opportunity to choose
  - In-kind replacement
  - Or upgrade

Upgrade Energy Efficiency?

LED lighting

HVAC systems

Lighting and environmental controls

Improve Safety?

Site lighting

Balconies

Railings

Slip resistant surfaces

Tripping hazards

Improve Accessibility

Parking

Signage

Door hardware

Door openers

Restrooms

Pool accessories

Board Challenges

Reluctance to serve

Roberts Rules of Order?

Good intentions, limited experience

Lack of common objectives

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Trends in Transition

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From Developer to Association

Non Financial Objectives Of Transition Process

Enhance community relations

Minimize controversy

Build trust

Transfer/build skills

Resolve issues before they escalate

Minimize potential claims

Maintain continuity

Transition – The Challenges

- Construction Completion
- Preparation of Documents
- Guidelines for Governance
- Communications
- Maintenance of Common Property by the Association

Transition – The Challenges

Financial Control

Budgets

Litigation Risk

Engineering Reports and Punch Lists

Insurance

Transition – The Challenges

The trend toward more litigation

Transition – The Challenges

Who's on your team?

- Attorney
- Accountant
- Engineer

Developer Best Practices At Inception

Team approach

Obtain input from management early

- Services to be provided
- Staffing

Establish management protocol

Developer Best Practices At Inception

Define as much as possible – including service levels

Prepare an adequate budget that will

- Survive builder involvement
- Cover operating costs

Unit type fee differentials

Establish reserve fund

Transition – Strategies

Review of the design drawings

Review of the description of the community

Review of the budget

Review of the as-built construction

Transition – Steps

1. Transition Study – at transition, to confirm project completion

2. Reserve Study – to plan ahead for non-annual maintenance

Transition to Reserve

Pause to resolve issues

Community Associations Institute (CAI)

What does CAI say?

Transition Study Report

A description of the overall condition of building components and systems that are the responsibility of the Association, and conditions that may limit the expected useful life of the buildings and their components.

Transition Study Report

Information about significant deficiencies, deferred maintenance items, and material code violations based on a visual survey of the building and grounds, research of documents, and conversations with people who have knowledge about the community.

Transition Study Report

A transition cost estimate including a list of the individual components and the estimated cost for repair and/or completion of those components to comply with the noted standards.

Optional

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Transition Study

Are you getting what you should?

Transition Study

Answer these questions:

1. Reasonable compliance with construction documents

2. Reasonable compliance with good construction practice

3. Reasonable compliance with local regulations

What do we look at?

- All the major building systems

  Here are a few examples…

Illustration by Chris Gash

Detail of curtain wall and sliding door threshold at balcony

View of underside of metal flashing and balcony from terrace

Cooling tower pump controls

What do we look at?

We review the available documents

- Plans
- Specs
- Association documents
- Regulatory approvals

Transition Study

The work product?

A full written report

- Draft for your review
- Possible review by attorney
- Final

Realistic Expectations Of The Transition Process

Begin with the end in mind

Cost/benefit of procedures and work of experts

Understand the approach of your professionals

The team must have a captain

Identify issues early on and try to resolve them before transition

QUESTIONS?

Thank you!

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