

Seven Things You Must Know Before Conducting Your Next Reserve Study

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One of the primary business duties of Community Associations is maintaining and preserving property values of the Association's common property. To do this properly, Associations must develop funding plans for future repair or replacement of major common-area components. A Reserve Study is a budget planning tool that identifies the current status of the Reserve fund and establishes a stable and equitable funding plan to offset the anticipated future major common-area expenditures. The Reserve Study consists of two parts: the physical analysis and the financial analysis.

There are many benefits to having a Reserve Study done. First, it meets legal, fiduciary and professional requirements. It provides for the planned replacement of major items that must, at some point in time, be replaced, as major items deteriorate during use. It minimizes the need for special assessments. And lastly, a replacement fund enhances resale values. Following are things to keep in mind when planning your Reserve Study.

1. **All Reserve Study preparers are not equal.** There are a number of ways to evaluate the qualifications of the person or firm, which you are going to retain to perform your study. Key factors when making your decision should include the following: knowledge and experience of the provider, ability to understand the clients' needs, local expertise and availability, quality control and accountability, and professional education. It would also benefit the Association to have its Reserve Study prepared under the direction of someone who has received the Community Association Institutes (CAI), Reserve Specialist (RS) designation. By obtaining this designation, the individual has proven through a combination of education and experience that they are qualified to perform a study in conformance with the National Reserve Study Standards of the Community Associations Institute. Since a significant portion of the Reserve Study is based on the condition of the individual components (such as the roofs and the roads) included within the study, someone with extensive field evaluation experience should be responsible for the evaluation of the components. A key to evaluating this qualification is to have this portion of the work performed under the direction of a

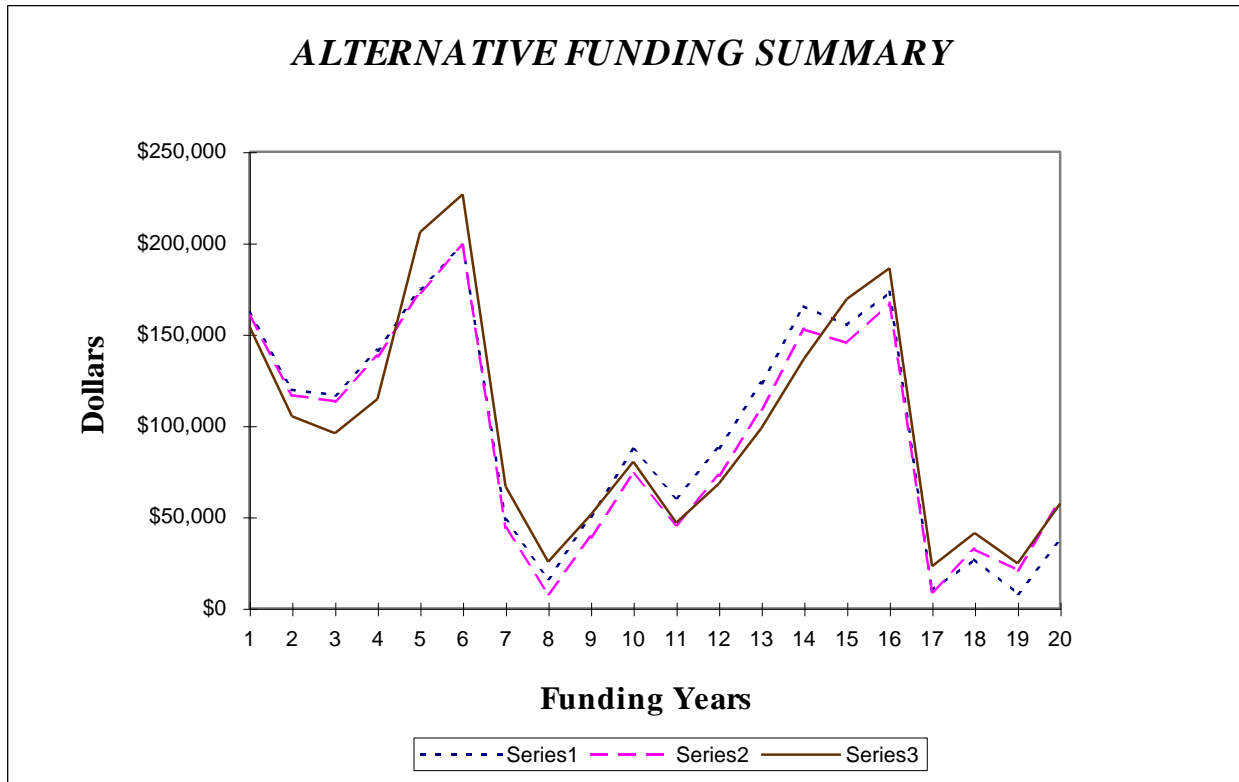
licensed Professional Engineer (PE), as the license confirms that this person has been trained and educated in performing this type of evaluation.

2. **All Reserve Studies are not equal.** In the past most Reserve Studies only included a list of all of the components, their replacement cost, and remaining useful life in order to determine what the next years funding should be. After many years of discussion and development by the Reserves Committee of the Community Associations Institute, it was agreed by the leading providers from across the United States that all Reserve Studies should include not only this "Financial Analysis" but also a comprehensive "Physical Analysis." This is now the standard. The physical analysis is important because it determines the existing condition and actual expected life of the common elements. The financial analysis, which includes a cash flow projection of the Reserve Fund over a 20-year period, is important because it focuses on the planning and budgeting of replacing these common elements based on the specific needs of the Association. A Financial Analysis enables the Association to consider long term planning decisions, rather than focusing only on the next year's replacement items. By providing this projection, the Association is better able to make an informed decision in regards to how much money should be set aside each year into the Reserve Fund and still feel comfortable that a special assessment will not be required over the life of the projection.
3. **Full Funding of a Reserve Study may mean that you are over funded.** Based upon the National Reserve Study Standards of the Community Associations Institute, there are a number of different "Funding Goals" which are recommended for use as the basis for your Association's future reserve fund planning. "Baseline Funding" is when the cash flow projection reaches \$0 at some time over the projection period. "Component Full Funding" is based on keeping every individual component within the Study 100% funded. In most instances, this will result in a significant amount of funds, which are never used during the cash flow projection period. "Threshold Funding" is when the amount in the fund during the cash flow projection period is based upon keeping a minimum balance within the fund. This is generally more than "Baseline Funding" and less than "Full

Funding.” “Statutory Funding” is based upon the establishment of the amount to be funded as dictated by the local State requirements.

4. **The Replacement Costs included within a Reserve Study should consider replacement alternatives, not just replacement with the exact same component or system.** In many instances the original component, which is being replaced, either is no longer available or has become outdated since it was first installed. By making recommendations for

alternatives to the initial installation, the Association may be able to install a replacement component or system with a significantly longer life, such as a new type of roofing system, or a component or system which is much more energy efficient such as a new HVAC system. In both cases, this will result in either a reduction in the recommended contributions to the Reserve Fund or a reduction in the client’s energy costs.



5. **The Reserve Study can be used for much more than just estimating the Association’s contributions to the Reserve Fund.** The Reserve Study cash flow analysis can also be used as a tool for determining how the Association’s Reserve Funds can be invested. They give the Association the ability to plan for the actual replacements, therefore making it easier to negotiate more effectively with contractors. The cash flow analysis will show how much money will be in the Reserve Fund and over what period of time. By reviewing this information with the Association’s investment advisor, an investment plan can be established to maximize the return on these funds based upon when they will be needed. In addition, by reviewing the anticipated replacements in the coming year on a regular basis, the Association can plan to have the required work performed before the actual

conditions deteriorate to the point that remedial work will be required as part of the replacement, which can cause a significant increase in the actual cost of doing the work. A common example of this occurs with pavement seal coating and overlays. If the application of the seal coating is not performed on the recommended schedule, even if the pavement looks good, it can result in additional deterioration of the pavement which must be corrected prior to the application of the overlay. This can reduce the anticipated time period before the overlay is needed, but also increase the cost of the work when it is done.

6. **The Reserve Study will not be the only funding the Association will need for the upkeep of the common elements.** The Reserve Study is only for the major repair or replacement of the common and

limited common elements that are the Association's responsibility. A reserve fund is intended to cover non-annual maintenance, repair and capital improvement costs. In all cases the cost of ongoing (annual) maintenance should also be budgeted for separately, as this is not included within the Reserve Study. If the proper maintenance is not performed, it can result in a significant loss of useful life for the reserve components. This will result in their replacement occurring sooner than anticipated when adequate funds have not yet been accumulated.

7. **The Reserve Study is a budgeting tool. The actual cost of performing the replacement work when it occurs may vary from the costs included within the Study.** In preparing the Reserve Study, the replacement costs which are used are based upon both industry estimating standards as well as the actual cost of similar projects which have been performed. The replacement costs are typically based upon current dollars and are not based upon the preparation of specifications and bidding of the work to actual contractors. It is intended to be used as a budget-planning tool. Actual costs at the time work is done are influenced by many variables such as material prices, contractor workload, weather, etc. In order to keep the replacement costs as well as the anticipated useful lives current, the Reserve Study should be updated (including a site visit) on a regular basis.