FINANCIALLY SUSTAINABLE COMMUNITIES AND REPLACEMENT RESERVES

PRESENTED BY

PHILIP POINTON
MILLER DODSON ASSOCIATES

NOVEMBER 14, 2015

millerdodson ASSOCIATES | Capital Reserve Consultants

Housekeeping Note …

Because there is a lot of material and a short period of time, please hold questions to the end.

Take notes if you wish, but this presentation may be downloaded as a color PDF from our website:www.mdaReserves.com

Listen! Learn! Understand!

Property Values in your community could plummet in less than five years! Unless…

Your community becomes Financially Sustainable!

Today's Learning Objectives

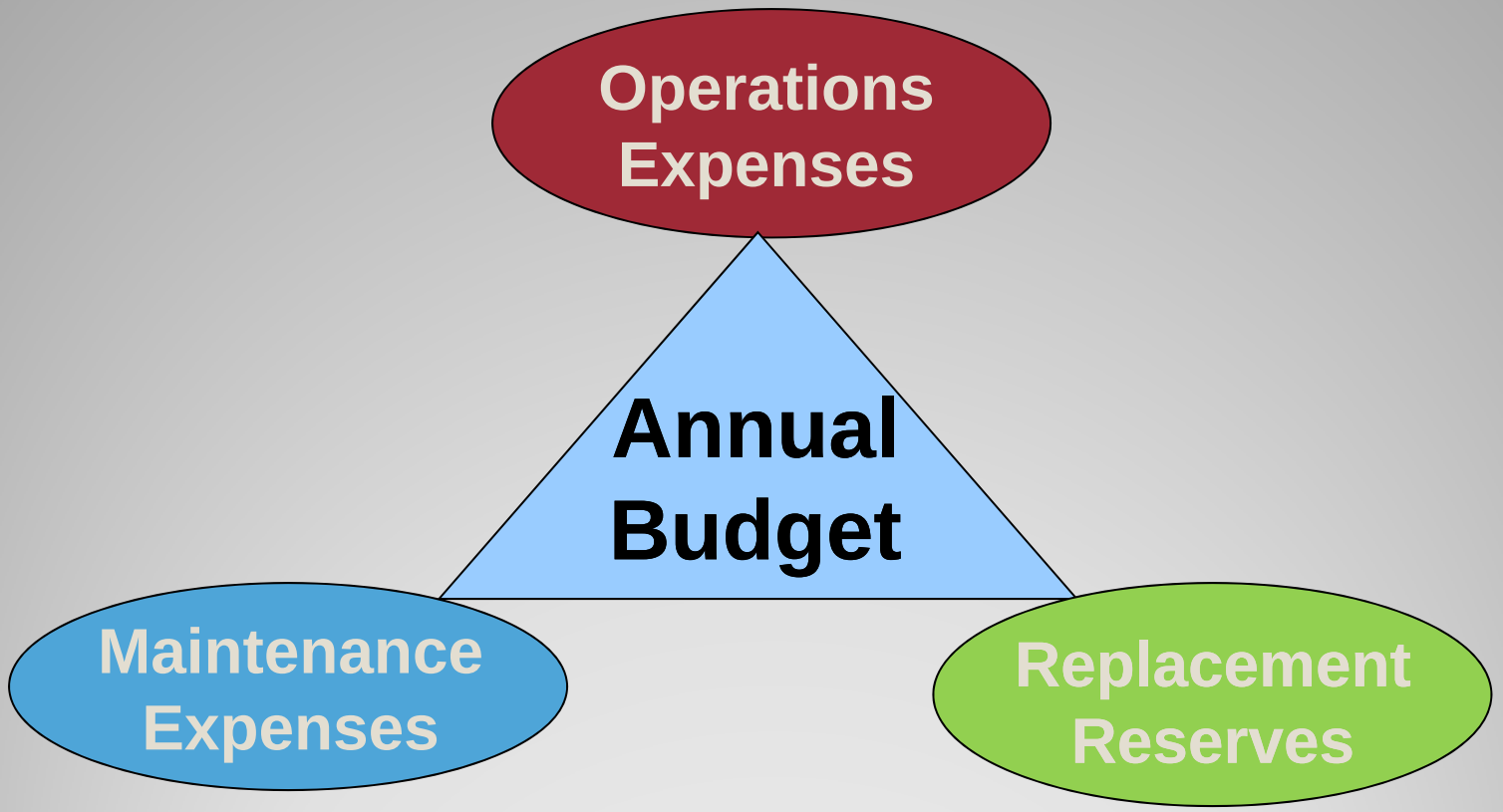
- Why does a replacement reserve study have to be done?
- Why is it important to have a reserve study done?
- What is covered by a reserve study?
- How are the calculations done and what is the difference between cash flow method and component method recommendations?
- How is a reserve study to be read and used?

Five Truths!

1. Most financial disasters occur due to lack of planning!
2. All materials deteriorate over time!
3. All material costs increase over time!
4. Money spent on sound maintenance is money soundly spent!
5. It will eventually have to be replaced!

Strategy for a Financially Sustainable Community

- Optimize "Economic Life" of Facilities and Components.
- Reserve For Timely Replacement.
- Use Best Practices For Replacements.
- Involve Your Experts early and often!



These are not equally weighted, but are all equally important!

Optimize Economic Life - Maintenance

- Sound preventative maintenance makes sound economic sense!
- The longer an asset (reasonably) stays in service, the lower the life cycle cost.
- “Saving” money on maintenance just to avoid spending money is “wasting” money long-term!

Optimize Economic Life - Replacement

- Use a Professional to prepare your scope of work
- Hire the Best Contractor that you can find!
- Use the Best Appropriate Materials for the job.
  - Upgrade to a better quality, or
  - Consider alternative materials if applicable.
  - Do the necessary prep work before installation.

Why does a Replacement Reserve Study have to be done?

- Pro-active financial planning
- The Virginia Condominium Act
- Fiduciary Responsibility of the Board
- Separate replacement reserves from other gross income (IRS Ruling 75-370)

Is there a Statutory requirement to conduct a reserve study?

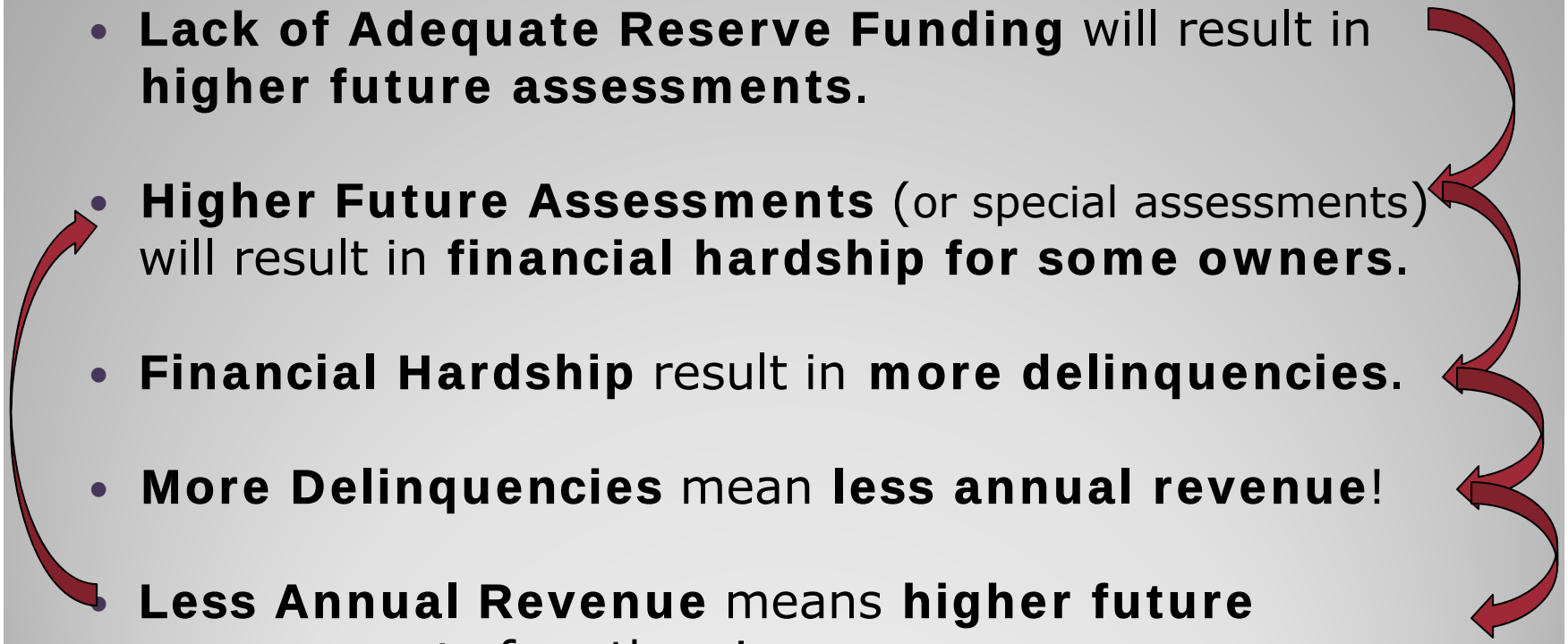
- Virginia – requires a reserve study be updated at least every five years.
- CAI National Standards – recommends every 3 to 5 years
- Best Practices – encourages updates after major events

The Board is Responsible!

- It is the primary responsibility of the Board to **maintain**, **protect** and **enhance** the assets of the Association.
- This includes budgeting enough income to pay all the bills, including **adequately funding the reserves.**

Reserve Funding Pitfall Cycle

- **Lack of Adequate Reserve Funding** will result in **higher future assessments.**
- **Higher Future Assessments** (or special assessments) will result in **financial hardship for some owners.**
- **Financial Hardship** result in **more delinquencies.**
- **More Delinquencies** mean **less annual revenue**!
- **Less Annual Revenue** means **higher future assessments** for others!



Why is it important to perform a Reserve Study?

- Establish appropriate contribution levels
- Prepare for contingencies
- Assist in project planning
- Encourage routine and preventive maintenance
- Establish safe beneficial use of assets
- Maintain highest levels of satisfaction and values

Reasons for a Reserve Study

- Legal Aspects
- Financial Aspects
- Ethical Aspects

Legal Aspects

- **State Law,** where applicable;
- **Fiduciary Duty of Board**;
- **IRS Guidelines**;
- **FHA Compliance Guidelines** (Condo Mortgages)

Financial Aspects

- Vital data for budgeting process;
- Independent professional opinion with periodic updates (every 3 to 5 years);
- Formalizes decisions on:
  - which items are “Reserve Components”;
  - disposition of Reserve Funds for future financial obligations;

Ethical Aspects

- Protect, Preserve and Enhance
  - Property values in the community;
  - Investment of Owners;
- Ensure that everyone pays their fair share for the period of time that they live there!
- Protect Owners from unduly high assessments or Special Assessments!

IRS Ruling 75-370

- To avoid taxation as gross income, replacement reserves are to be held in a separate account
- Replacement reserves shall only be used for replacement and not for maintenance or operating expenses
- Capitol improvements can not be funded with replacement reserves

CAI Best Practices Recommended Plan

- Consult your Manager
- Consultant your Attorney
- Consultant your Accountant
- Consult your Reserve Specialist
- Choose a funding approach based on goals for the type of community you want

Reserve Expenses Grow if Deferred

- It is almost always more expensive to do multiple “Band-Aid” repairs.
- Deferred maintenance will adversely impact the value of the property.
- Inflation still plays a big part in costs!
- Kicking the can down the road makes the can bigger!

What is covered by a Replacement Reserve Study? (And what isn't!)

- CAI Best Practices
- Bylaws define common and limited common elements
- IRS guidelines
  - Separate Bank Account;
  - Designated dollars for specific Capital components;
  - Cannot be intermingled with maintenance & operations expenses;
  - Painting is NEVER a Capital expenditure!

What shouldn't reserve funds be used for?

- Capitol improvements
- Management fees
- Consultant fees (attorney, account, etc.)
- Cannot be used for Operations and Maintenance Costs, i.e.
  - Maintenance of capital components.
  - Long-term maintenance items such as painting hallways.

How are the calculations done?

- Inventory is the driver of the analysis
  - What components to include?
  - How much quantity?
  - Quality assumes in-kind replacement
  - Normal life expectancy?
  - Current age and condition?
- Time frame
  - 40 year projection captures long-lived components and re-occurring short-lived items
- Starting balance as furnished by Owner
- Adequacy of current funding

How are the calculations done?

- Inflation rate
- Interest earned on balance
- Algorithms determine the minimums thresholds and recommends annual averages and provides an annual recommendation that satisfies these
- Component method vs. cash flow method

Is there an obligation to "fully fund" the reserves?

- CAI Best Practices (fully funded, baseline funded, threshold funded and statutory funding)
- Is there a mandate in the Condo Act or in the Bylaws?
- Fiduciary Duty?
- Sound Business Judgment Rule? Sustainability.
- Bank financing requirements
- FHA's 10% of assessments requirement?

Component method or Cash Flow method, which should you use?

- Both methods use the same data!
- So why is there such a big difference?
- Which one should we use?
- What do the statutes and IRS guidelines say?
- Virginia is not a state that requires component method – but your bylaws might

CASH FLOW VS COMPONENT (Pooling vs. Full Funding)

CASH FLOW ("Pooling") METHOD

Treats Reserves as an aggregate "pool" of funds.

COMPONENT ("Full Funding") METHOD

Treats each Reserve Item as a separate "line item" budget.

Illustration of the Different Mathematical Models

- Four Projects:
  - Year One - Parging,
  - Year Two - Seal Coat,
  - Year Three - Plumbing,
  - Year Four - Retaining Wall
- One Project per year
- Cost of $12,000 per Project
- (Assume $Zero Starting Balance) (Assume $Zero Threshold)

Cash Flow Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	Annual Contributions to Reserves				
Parging Year One	$12	3	3	3	3	12
Paving Year Two	$12	3	3	3	3	12
Plumbing Year Three	$12	3	3	3	3	12
Retaining Wall Year Four	$12	3	3	3	3	12
Total Cost	$48	12	12	12	12	$48

Component Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	Annual Contributions to Reserves				
Parging Year One	$12	12	3	3	3	21
Paving Year Two	$12	6	6	3	3	18
Plumbing Year Three	$12	4	4	4	3	15
Retaining Wall Year Four	$12	3	3	3	3	12
Total Cost	$48	25	16	13	12	$66

How to Read and Interpret a Reserve Study

- Very carefully… and do not kill the messenger
- Evaluate the content from the 5,000 foot level and the 50,000 foot level
- Get off the X and take some action
  - Do not procrastinate verifying the inventory
  - Do not procrastinate getting clarifications
  - Do not procrastinate requesting revisions
- Do not suffer analysis paralysis

What to do with the completed reserve study?

- You as the Manager…
- You as a Board Member…
- You as a Finance Committee Member…

What's the Next Step?

You were just handed this Reserve Study!

It says to increase the Annual Reserve Funding from $90K to $150K!

Holy cr@p!

That's a $60K annual increase!

What Are Your Alternatives?

- Increase Normal Assessments
- Special Assessment
- Commercial Bank Loan

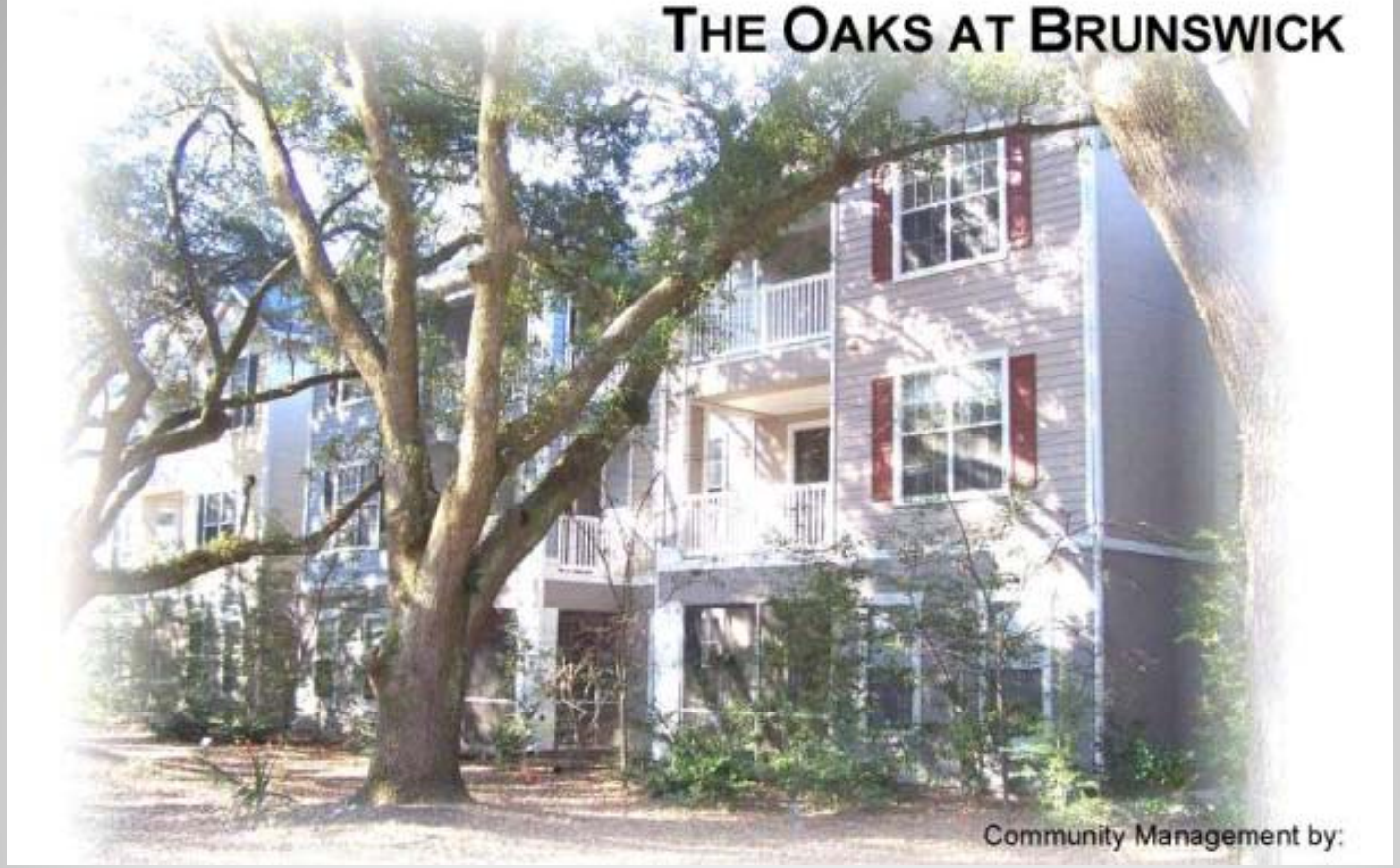
What if your association can't afford to "fully fund" the reserves?

- Should Reserve Funds be "fully funded" or "adequately funded"? And who decides?
- Precipitous increases are often a mistake!
- Ramp up over several years until the association is on path to fully funding the reserves.
- Use it as a financial planning tool! It is a roadmap for future expenditures

Sample
Reserve Study

REPLACEMENT RESERVE REPORT FY 2015

THE OAKS AT BRUNSWICK



EXECUTIVE SUMMARY

The Oaks at Brunswick Replacement Reserve Analysis uses the Cash Flow Method (CFM) to calculate Replacement Reserve funding for the periodic replacement of the 103 Projected Replacements identified in the Replacement Reserve Inventory.

$149,507 **RECOMMENDED REPLACEMENT RESERVE FUNDING FOR THE STUDY YEAR, 2015**
$57.68 Per unit (average), minimum monthly funding of Replacement Reserves

We recommend the Association adopt a Replacement Reserve Funding Plan based on the annual funding recommendation above. Inflation adjusted funding for subsequent years is shown on Page A5.

Oaks at Brunswick reports a Starting Balance of $77,240 and Annual Funding totaling $90,000. Current funding is inadequate to fund the $5,616,122 of Projected Replacements scheduled in the Replacement Reserve Inventory over the 40-year Study Period. See Page A3 for a more detailed evaluation.

GENERAL SITE IMPROVEMENTS
PROJECTED REPLACEMENTS

ITEM #	ITEM DESCRIPTION	UNIT	NUMBER OF UNITS	UNIT REPLACEMENT COST ($)	NORMAL ECONOMIC LIFE (YRS)	REMAINING ECONOMIC LIFE (YRS)	REPLACEMENT COST ($)
1	Asphalt road and parking area	sf	157,053	$1.30	20	15	$204,169
2	Seal coat asphalt	sf	157,053	$0.16	5	none	$25,128
3	Concrete curb & gutter (20%)	lf	1,072	$34.00	54	6	$36,448
4	Concrete flatwork (6%)	sf	817	$8.50	60	6	$6,945
	Repoint masonry entrance feature	sf	20				
5	Sandblasted wood signage	ls	1	$1,200.00	15	10	$1,200
6	Segmental retaining wall, 30%	sf	697	$45.00	40	35	$31,361
7	Mailboxes	ls	1	$18,000.00	25	15	$18,000
8	Dumpster pad	sf	816	$10.00	25	20	$8,160
9	Dumpster enclosure stucco repair	sf	805	$12.75	50	45	$10,264
10	Dumpster trellace	ls	1	$1,500.00	20	15	$1,500
11	Dumpster gates	pr	1	$1,000.00	10	5	$1,000
12	Site lighting	ea	26	$2,100.00	30	25	$54,600
13	Sanitary sewer - mains (10%)	unit	216	$155.00	20	15	$33,480
14	Domestic water - mains (10%)	unit	216	$95.00	20	15	$20,520
15	Storm water - structure & pipe (10%)	unit	216	$185.00	20	15	$39,960
16	Storm water pond dredging	ls	1	$50,000.00	20	15	$50,000
				GENERAL SITE IMPROVEMENTS - Replacement Costs - Subtotal			$542,734

CONDOMINIUM BUILDING EXTERIORS, Con't (CB)

PROJECTED REPLACEMENTS

ITEM #	ITEM DESCRIPTION	UNIT	NUMBER OF UNITS	UNIT REPLACEMENT COST ($)	NORMAL ECONOMIC LIFE (YRS)	REMAINING ECONOMIC LIFE (YRS)	REPLACEMENT COST ($)
34	CB Windows, 20%	sf	2,232	$35.00	30	21	$78,120
35	CB Windows, 20%	sf	2,232	$35.00	30	23	$78,120
36	CB Windows, 20%	sf	2,232	$35.00	30	25	$78,120
37	CB Windows, 20%	sf	2,232	$35.00	30	27	$78,120
38	CB Windows, 20%	sf	2,232	$35.00	30	29	$78,120
39	CB Window shutters	pr	160	$100.00	15	10	$16,000
40	CB Doors, 20%	ea	43	$950.00	25	18	$41,040
41	CB Doors, 20%	ea	43	$950.00	25	19	$41,040
42	CB Doors, 20%	ea	43	$950.00	25	20	$41,040
43	CB Doors, 20%	ea	43	$950.00	25	21	$41,040
44	CB Doors, 20%	ea	43	$950.00	25	22	$41,040
45	CB Patio doors, 20%	ea	12	$1,470.00	25	18	$17,640
46	CB Patio doors, 20%	ea	12	$1,470.00	25	19	$17,640
47	CB Patio doors, 20%	ea	12	$1,470.00	25	20	$17,640
48	CB Patio doors, 20%	ea	12	$1,470.00	25	21	$17,640
49	CB Patio doors, 20%	ea	12	$1,470.00	25	22	$17,640
	CONDOMINIUM BUILDING EXTERIORS, Con't (CB) - Replacement Costs - Subtotal						$700,000

SWIMMING POOL
PROJECTED REPLACEMENTS

ITEM #	ITEM DESCRIPTION	UNIT	NUMBER OF UNITS	UNIT REPLACEMENT COST ($)	NORMAL ECONOMIC LIFE (YRS)	REMAINING ECONOMIC LIFE (YRS)	REPLACEMENT COST ($)
66	Swimming pool - structure	sf	990	$70.00	45	40	$69,300
67	Swimming pool - finish	sf	990	$3.50	10	4	$3,465
68	Swimming pool - waterline tile	ft	135	$40.00	15	10	$5,400
69	Swimming pool pump (2 - 5 hp)	ea	1	$3,200.00	10	5	$3,200
70	Swimming pool filter/chlorinator	sf	990	$4.00	20	15	$3,960
71	Swimming pool valves & plumbing	sf	990	$2.00	20	15	$1,980
72	Swimming pool - concrete deck, 25%	sf	480	$10.25	30	5	$4,920
73	Swimming pool - concrete deck, 25%	sf	480	$10.25	30	10	$4,920
74	Swimming pool - concrete deck, 25%	sf	480	$10.25	30	15	$4,920
75	Swimming pool - concrete deck, 25%	sf	480	$10.25	30	20	$4,920
76	Swimming pool deck coating	sf	1,920	$10.00	10	6	$19,200
77	Swimming pool furniture (50%)	ls	1	$1,950.00	8	1	$1,950
78	Swimming pool furniture (50%)	ls	1	$1,950.00	8	3	$1,950
79	Spa structure	sf	50	$100.00	45	40	$5,024
80	Spa finish	sf	50	$10.00	10	4	$500
81	Spa waterline tile	lf	25	$40.00	15	10	$1,005
82	Spa filter/chlorinator	ls	1	$2,500.00	20	15	$2,500
83	Swimming pool lighting	ea	7	$900.00	30	25	$6,300
84	Pool perimeter fence - 6' (metal)	ft	186	$55.00	30	25	$10,230
85	Swimming pool retaining wall	sf	165	$40.00	35	30	$6,600
				SWIMMING POOL - Replacement Costs - Subtotal			$162,244

Miller + Dodson Associates, Inc. — **Projected Annual Replacements - Page C3**

Oaks at Brunswick — **June 14, 2014**

10624102OAKS.AT15

PROJECTED REPLACEMENTS - YEARS 4 TO 6

Item	2018 - YEAR 4	$
78	Swimming pool furniture (50	$1,950
	Total Scheduled Replacements	$1,950

Item	2019 - YEAR 5	$
67	Swimming pool - finish	$3,465
80	Spa finish	$500
	Total Scheduled Replacements	$3,965

Item	2020 - YEAR 6	$
2	Seal coat asphalt	$25,128
11	Dumpster gates	$1,000
27	CB EIFS coating	$344,960
69	Swimming pool pump (2 - 5	$3,200
72	Swimming pool - concrete d	$4,920
88	CO EIFS coating	$10,836
95	FC EIFS coating	$3,864
99	FC HVAC system	$2,500
	Total Scheduled Replacements	$396,408

Miller + Dodson Associates, Inc. — **Projected Annual Replacements - Page C10**

Oaks at Brunswick — June 14, 2014

10624 102OAKS AT15

PROJECTED REPLACEMENTS - YEARS 25 TO 27

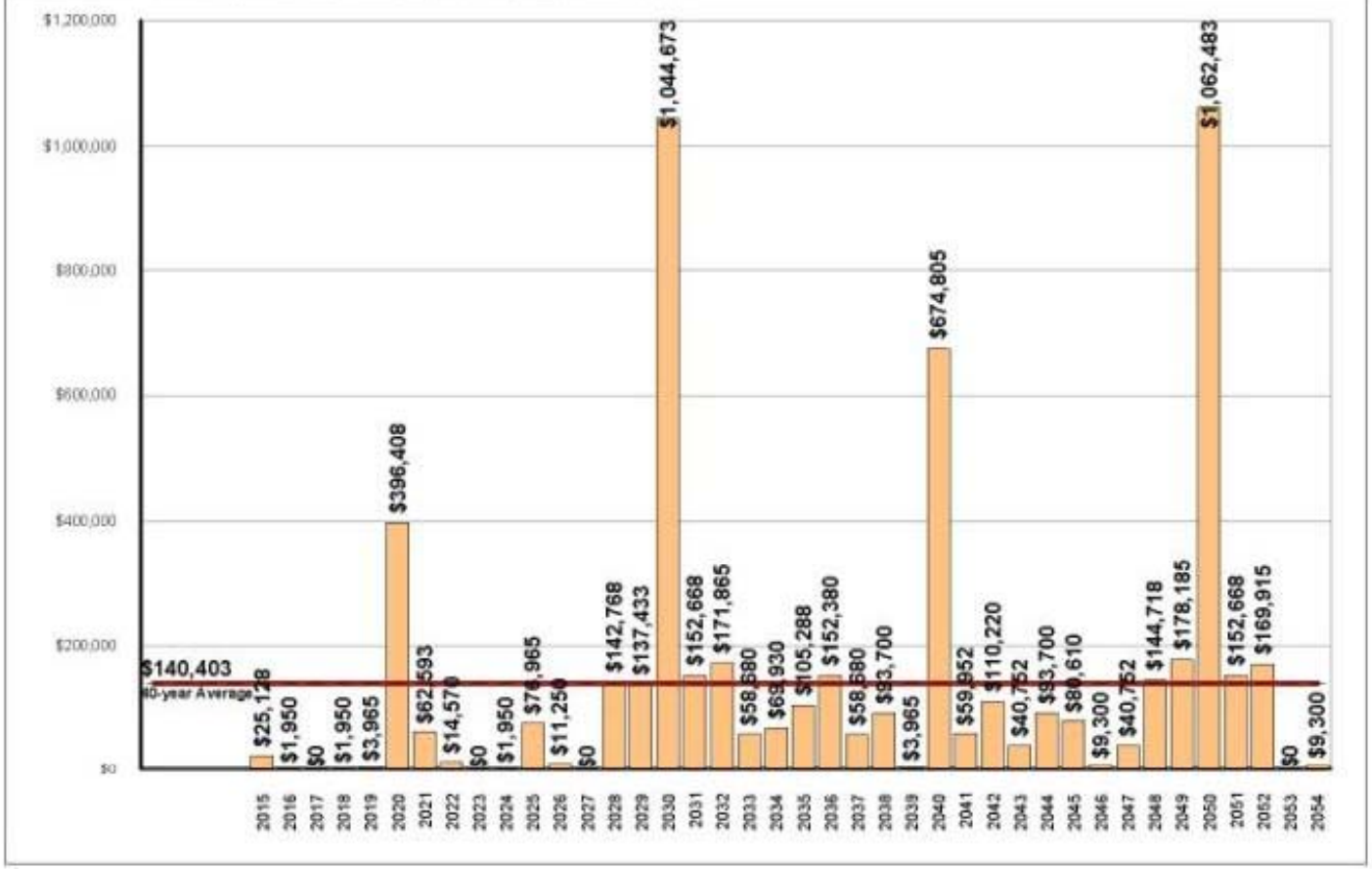
Item	2039 - YEAR 25	$
67	Swimming pool - finish	$3,465
80	Spa finish	$500
	Total Scheduled Replacements	$3,965

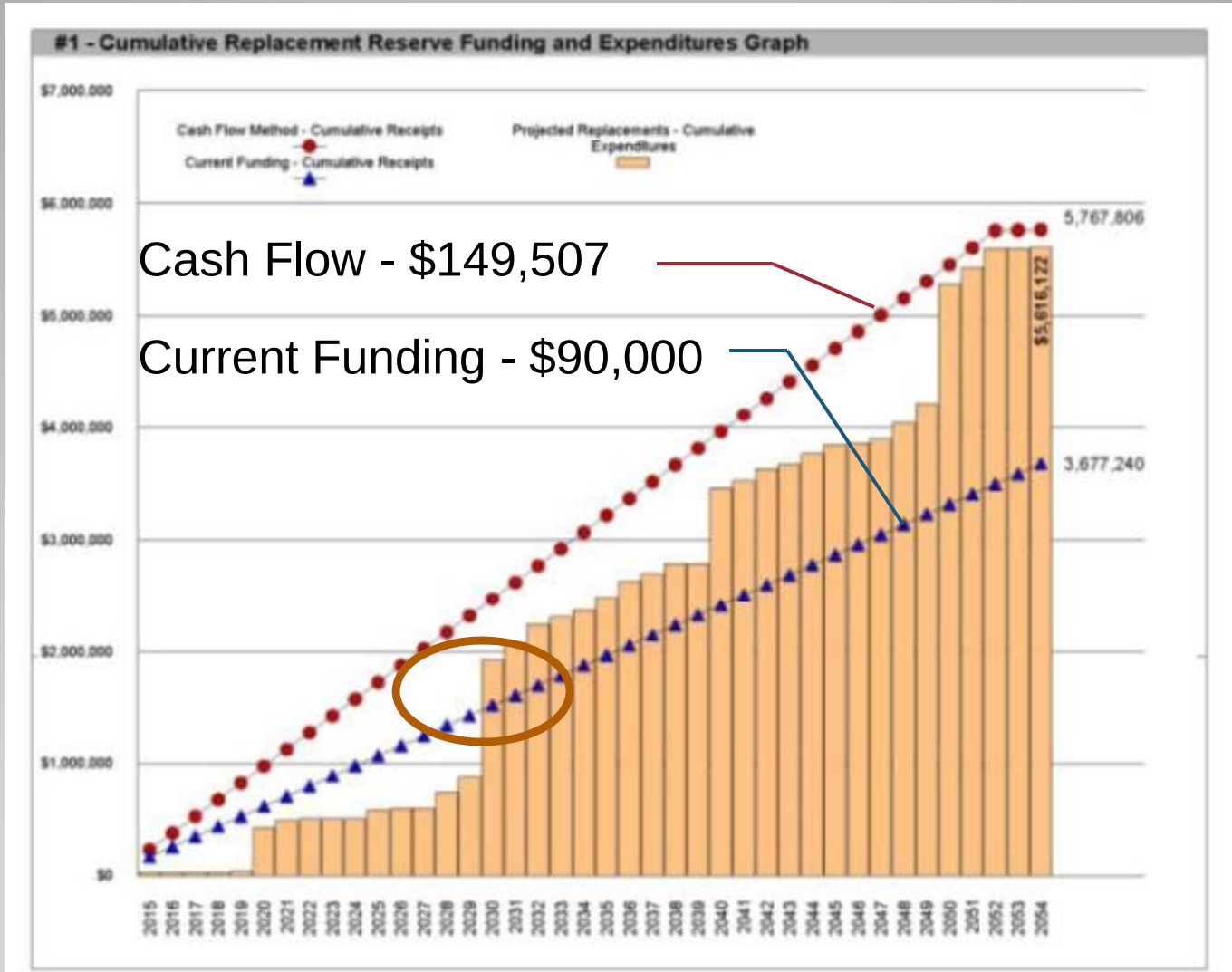
Item	2040 - YEAR 26	$
2	Seal coat asphalt	$25,128
5	Sandblasted wood signage	$1,200
11	Dumpster gates	$1,000
12	Site lighting	$54,600
27	CB EIFS coating	$344,960
36	CB Windows, 20%	$78,120
39	CB Window shutters	$16,000
55	CB Balcony structure	$58,800
56	CB Balcony surface	$21,112
60	CB Stairs, 20%	$15,580
65	CB Exit lights	$4,500
68	Swimming pool - waterline ti	$5,400
69	Swimming pool pump (2 - 5	$3,200
77	Swimming pool furniture (50	$1,950
81	Spa waterline tile	$1,005
83	Swimming pool lighting	$6,300
84	Pool perimeter fence - 6' (m	$10,230
88	CO EIFS coating	$10,836
90	CO Windows	$8,820
91	CO Window shutters	$1,000
95	FC EIFS coating	$3,864
100	FC HVAC condensing unit	$1,200
	Total Scheduled Replacements	$674,805

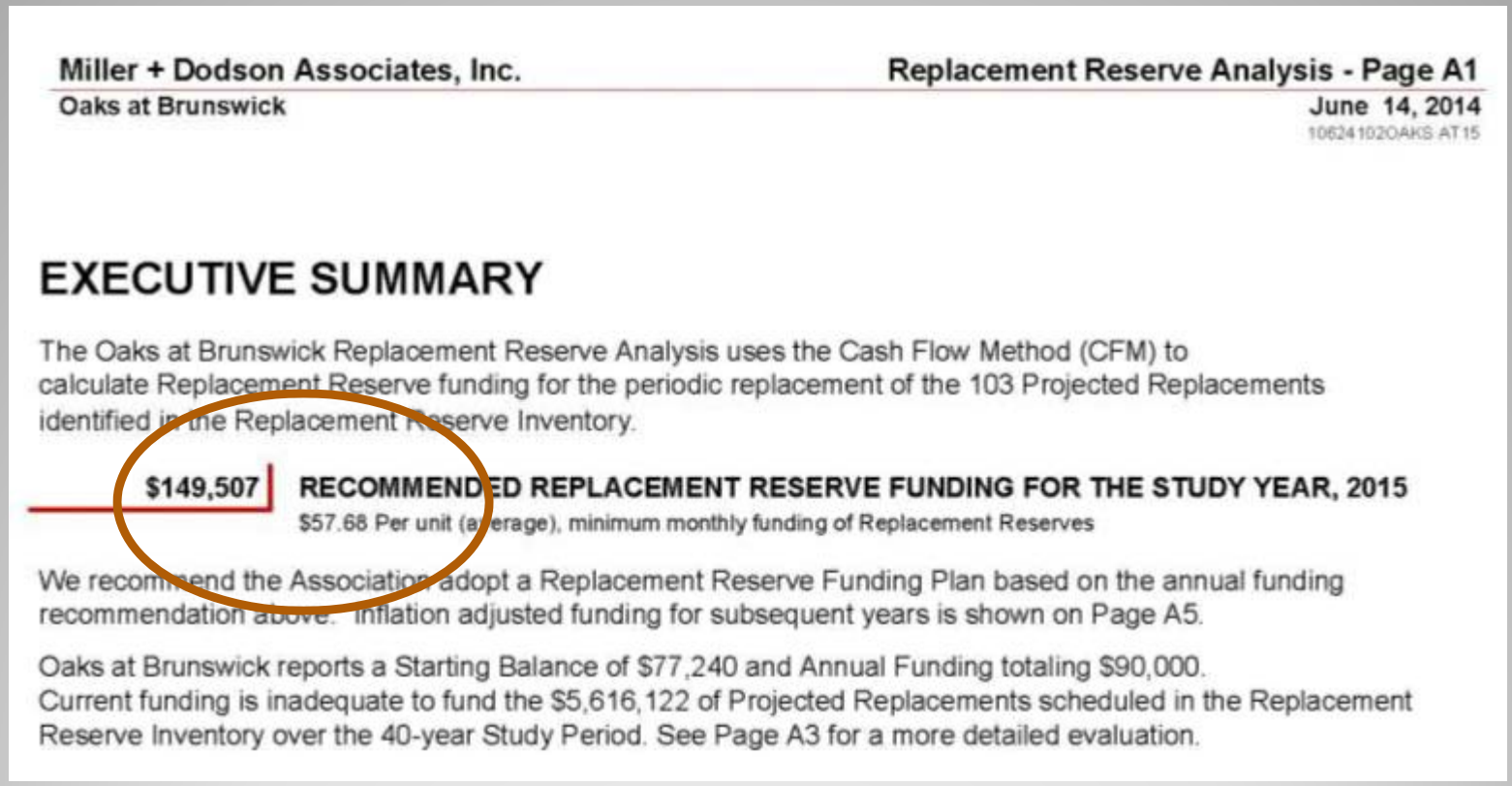
Item	2041 - YEAR 27	$
29	CB Vinyl siding, 20%	$40,752
76	Swimming pool deck coating	$19,200
	Total Scheduled Replacements	$59,952

#2 - Annual Expenditures for Projected Replacements Graph

This graph shows annual expenditures for Projected Replacements over the 40-year Study Period. The red line shows the average annual expenditure of $140,403. Section C provides a year by year Calender of these expenditures.




#1 - Cumulative Replacement Reserve Funding and Expenditures Graph
Cash Flow Method - Cumulative Receipts
Current Funding - Cumulative Receipts
Projected Replacements - Cumulative Expenditures
Cash Flow - $149,507
Current Funding - $90,000
5,767,806
$5,616,122
3,677,240
$7,000,000
$6,000,000
$5,000,000
$4,000,000
$3,000,000
$2,000,000
$1,000,000
$0
2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028 2029 2030 2031 2032 2033 2034 2035 2036 2037 2038 2039 2040 2041 2042 2043 2044 2045 2046 2047 2048 2049 2050 2051 2052 2053 2054



Miller + Dodson Associates, Inc. — Replacement Reserve Analysis - Page A1
Oaks at Brunswick — June 14, 2014
10624102OAKS AT15

EXECUTIVE SUMMARY

The Oaks at Brunswick Replacement Reserve Analysis uses the Cash Flow Method (CFM) to calculate Replacement Reserve funding for the periodic replacement of the 103 Projected Replacements identified in the Replacement Reserve Inventory.

$149,507 **RECOMMENDED REPLACEMENT RESERVE FUNDING FOR THE STUDY YEAR, 2015**
$57.68 Per unit (average), minimum monthly funding of Replacement Reserves

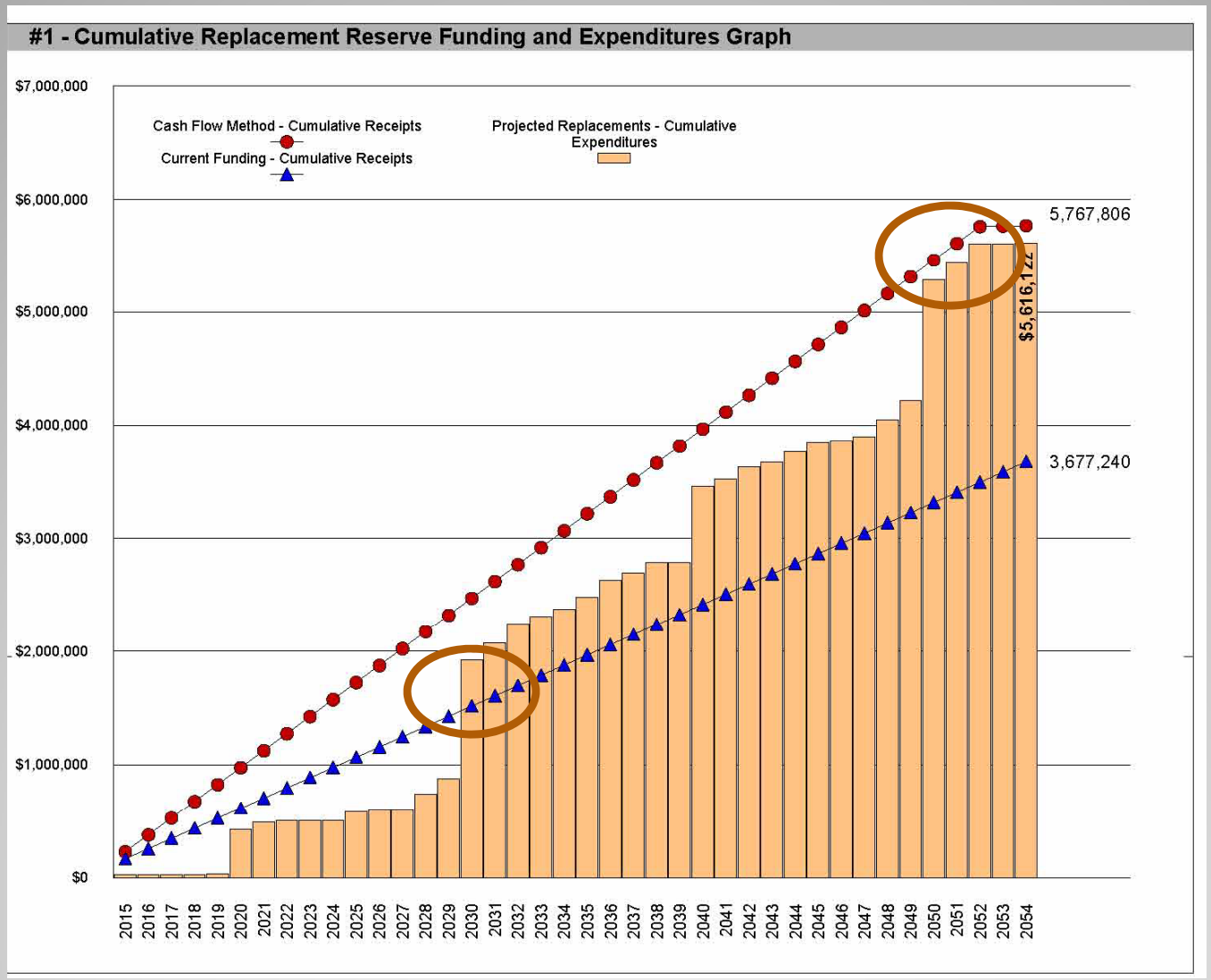
We recommend the Association adopt a Replacement Reserve Funding Plan based on the annual funding recommendation above. Inflation adjusted funding for subsequent years is shown on Page A5.

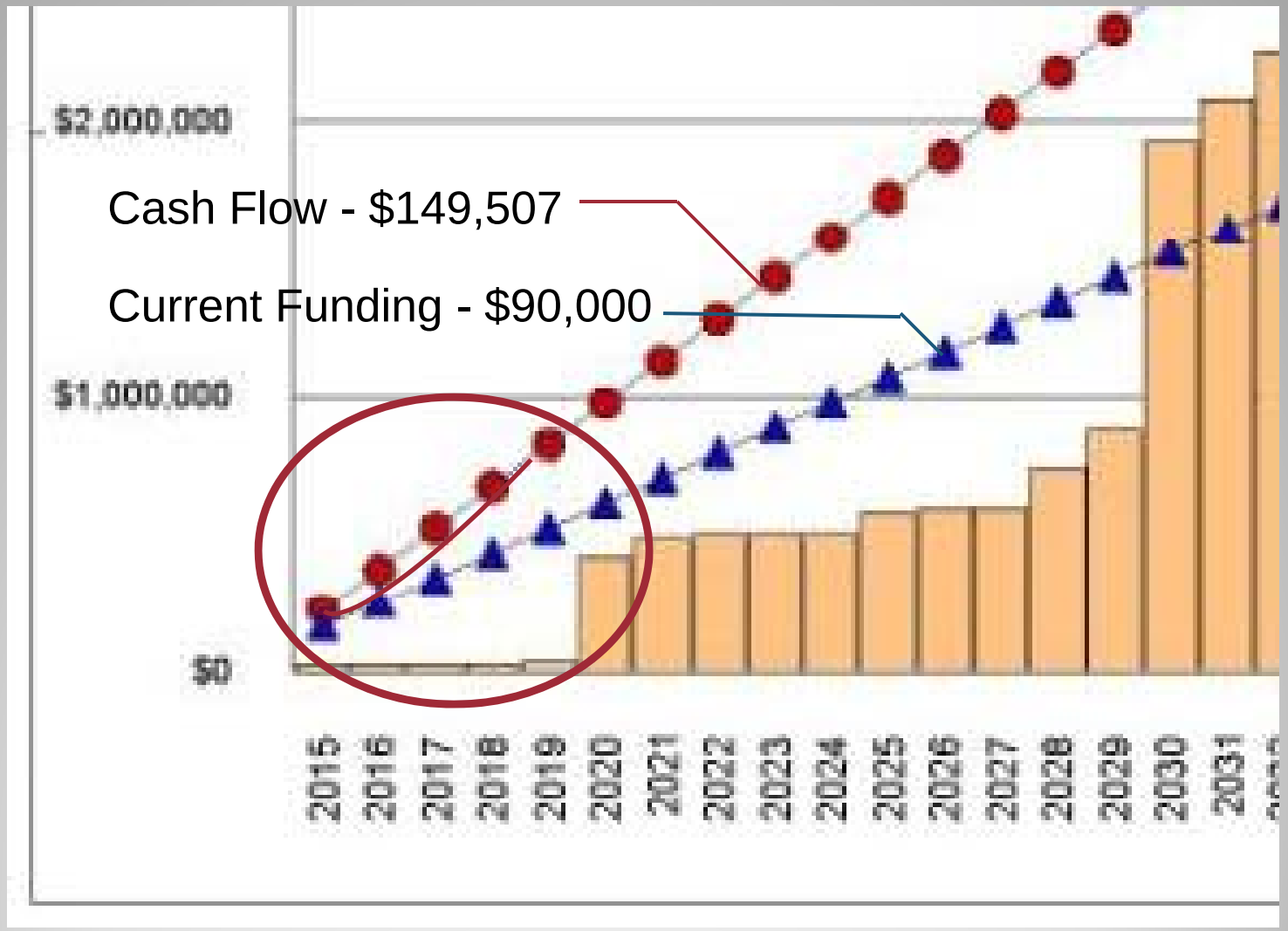
Oaks at Brunswick reports a Starting Balance of $77,240 and Annual Funding totaling $90,000. Current funding is inadequate to fund the $5,616,122 of Projected Replacements scheduled in the Replacement Reserve Inventory over the 40-year Study Period. See Page A3 for a more detailed evaluation.

People dwell on the number and not what it represents! Sustainability has a cost.

Next Step:

- Review inventory data. Make sure it's correct!
- Make sure the report reflects the community's goals and aspirations!
- Make revisions where necessary.
- Re-think replacement priorities.
- Develop Funding Plan!
- Educate your owners on the why and the how when facing any increase in contribution levels


#1 - Cumulative Replacement Reserve Funding and Expenditures Graph
$7,000,000
$6,000,000
$5,000,000
$4,000,000
$3,000,000
$2,000,000
$1,000,000
$0
Cash Flow Method - Cumulative Receipts
Current Funding - Cumulative Receipts
Projected Replacements - Cumulative Expenditures
5,767,806
$5,616,122
3,677,240
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
2026
2027
2028
2029
2030
2031
2032
2033
2034
2035
2036
2037
2038
2039
2040
2041
2042
2043
2044
2045
2046
2047
2048
2049
2050
2051
2052
2053
2054


$2,000,000
$1,000,000
$0
Cash Flow - $149,507
Current Funding - $90,000
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
2026
2027
2028
2029
2030
2031

Strategic Funding Plan

Ramp Up Annual Funding $12k per year over five years:

Year 1: $90K to $102K (13.3%)
Year 2: $102K to $114K (11.8%)
Year 3: $114K to $126K (10.5%)
Year 4: $126K to $138K (9.5%)
Year 5: $138K to $150K (8.7%)*

*Year 5 would bring a Reserve Study update and would adjust for inflation, underfunding, changed conditions.

Questions?

Thank You!

Useful Resources

This presentation may be downloaded as a color PDF from our website: https://www.mdaReserves.com

https://www.millerdodson.com/resources/articles

The CAI National Standards can be downloaded from:
https://www.caionline.org/CommunityManagers/Sample Forms and templates/a_national_reserve_study_standards.doc

The CAI Best Practices can be downloaded from:
https://www.caionline.org/

Speaker BIO

Philip Pointon, Architect, Reserve Specialist, LEED Accredited Professional

A Reserve Specialist with the firm of Miller Dodson Associates, Philip Pointon has performed hundreds of Replacement Reserve Studies for community associations. He is a licensed architect in Virginia, holds the professional designation of Reserve Specialist (RS) through CAI, and is a LEED Accredited Professional by the U.S. Green Buildings Council.

Mr. Pointon has authored articles for the Southeastern Virginia CAI Chapter publication "Currents" and has been a featured speaker and lecturer for other CAI Educational Seminars. Philip has been an adjunct faculty for the Hampton University College of Architecture.

Philip has a Bachelors of Architecture from the College of Architecture and Urban Studies at Virginia Tech, earned a Masters of Engineering Management from Old Dominion University and is a graduate of the Army Management Staff College.