

# REPLACEMENT RESERVES

PROTECTING, PRESERVING AND  
ENHANCING PROPERTY VALUES

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MARCH 5, 2016

# Housekeeping Note ...

**Please view, download, and share this  
presentation at**

**[www.millerdodson.com](http://www.millerdodson.com)**

“Perhaps the Greatest  
Duty of the Board is to  
**Protect, Preserve  
and Enhance** the  
value of the homes  
within the community!”



**Robert Lyles, Esq.** Charleston, SC 2015

# Topics

- Financial Planning (or lack thereof)
- Reserve Funding Pitfall
- Reasons to Maintain Reserves
- Importance of Proper Maintenance
- Understanding Your Reserve Study
- Developing Strategic Funding Plan

# Meet Mrs. Jones...

- Retired school teacher,
- Lives on a fixed income,
- Has lived in your HOA for 20 years,
- She is the ideal neighbor!
- As a member of the HOA Board of Directors...

**you are foreclosing on her home!**

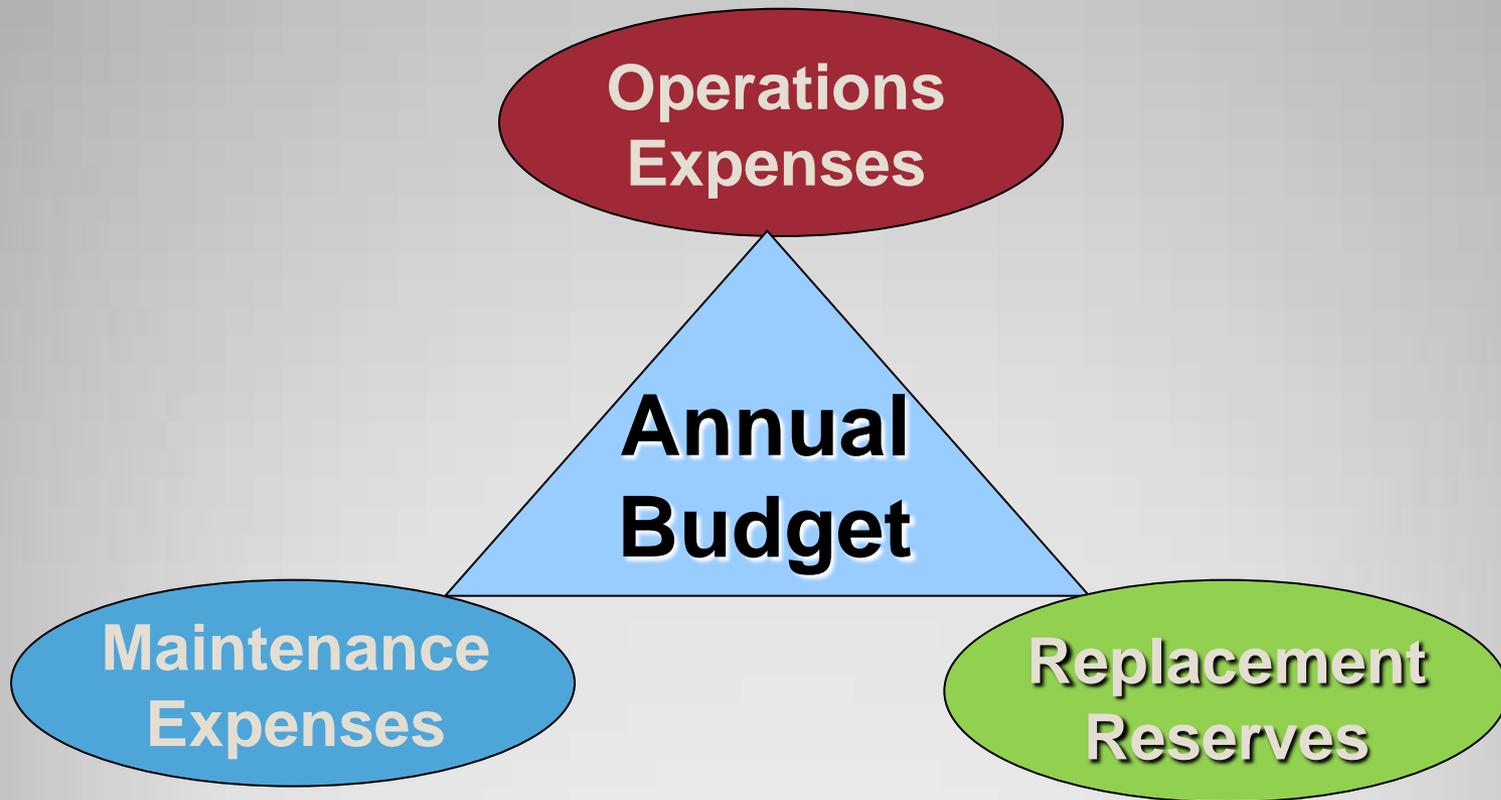


# How Could This Happen?

## Lack of Planning!

- Resulted in a Special Assessment, or
- Resulted in precipitous increases in Normal Assessments!

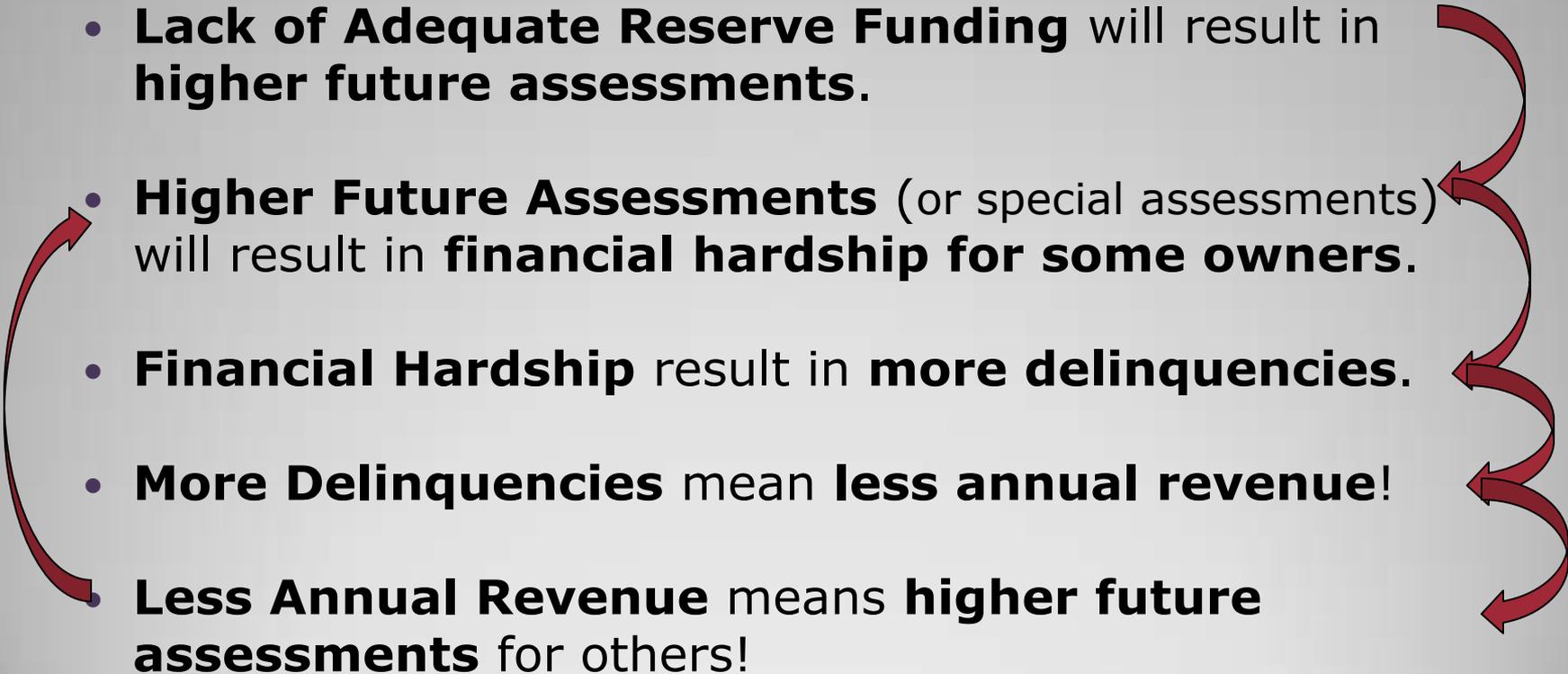
# Annual Budget



# Lack of Planning?

- **Inadequate Operations budget** did not plan or allow for use of professional consultants!
- **Inadequate Maintenance budget** resulted in premature deterioration!
- Inadequate planning by the Board resulted in **inadequate 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!
- 

# Reasons for a Reserve Study

- **Legal Aspects**
- **Financial Aspects**
- **Ethical Aspects**

# Legal Aspects

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

# Financial Aspects

- **Vital data for budgeting process;**
- **Independent professional opinion**
- **Institutionalizes decisions**

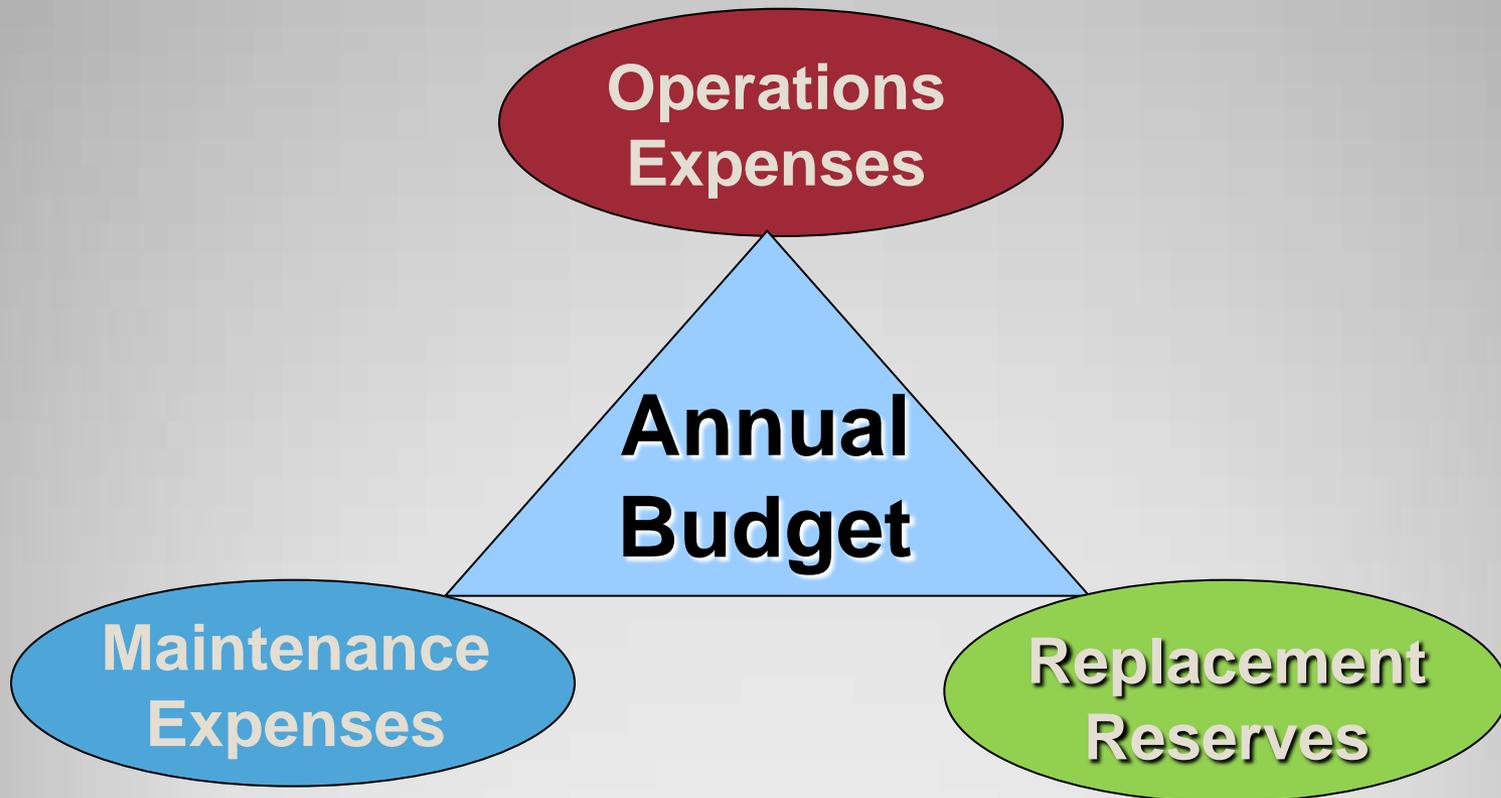
# Ethical Aspects

- **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!

# Financially Sustainable Community

- Acknowledging and functioning within the economic realities of the present without limiting the financial abilities of the future.
- Balancing the need for adequate budget (assessments) against the exigencies of the housing market.

# Financially Sustainable Community



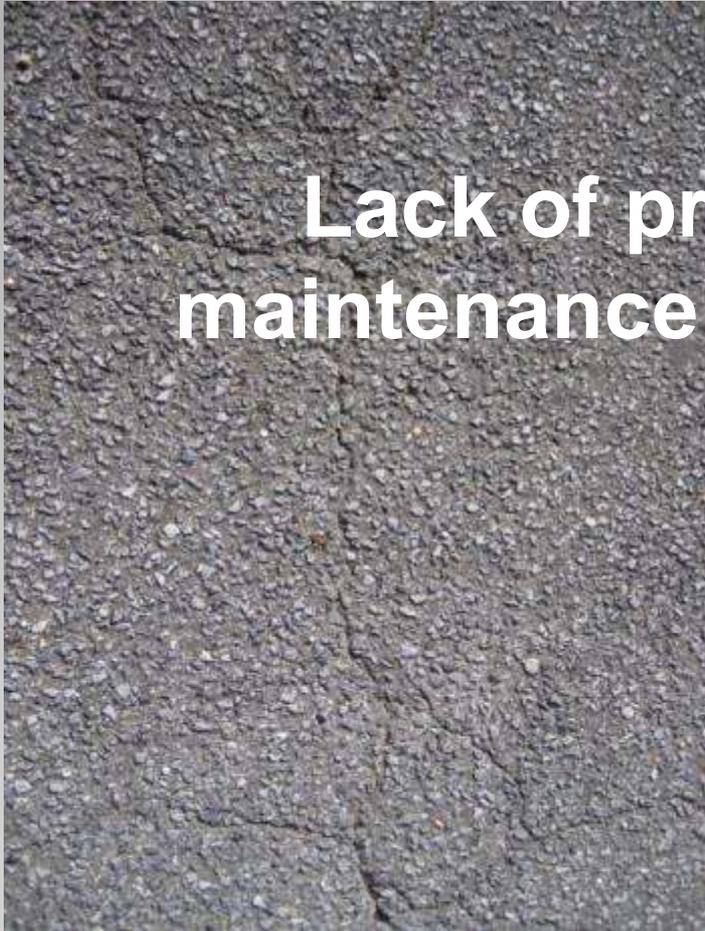
# **Financially Sustainable Community**

- **Annual Budget is balanced and adequate...**
- **Normal Assessments are stable..., not stagnant!**
- **Normal Assessments increase appropriately each year.**
- **Property Values are Protected, Preserved & Enhanced!**
- **Your community is Financially Sustainable!**

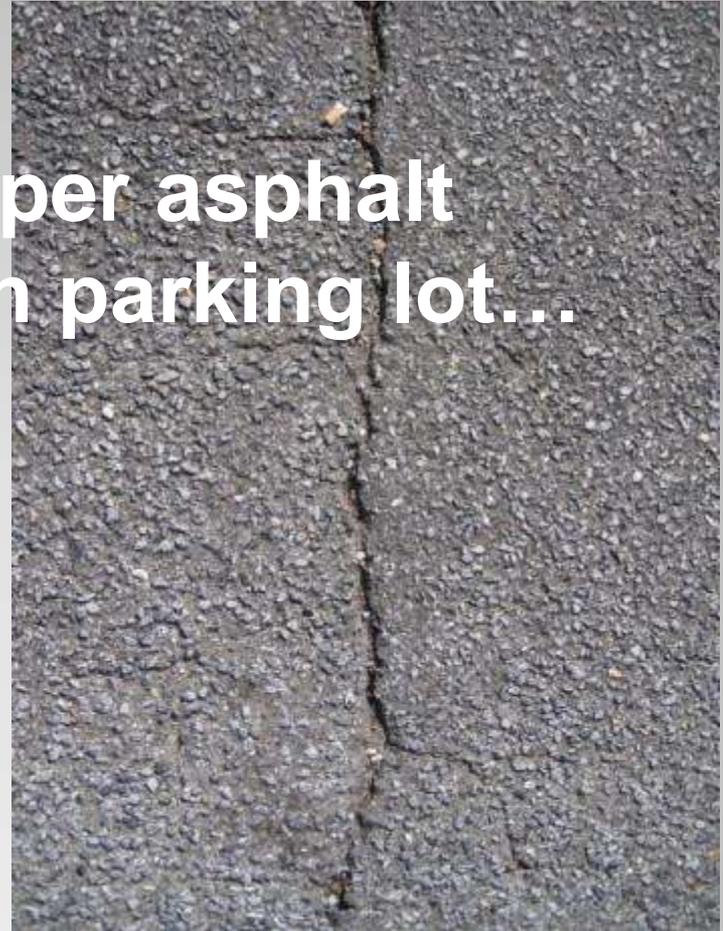
# Five Truths!

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

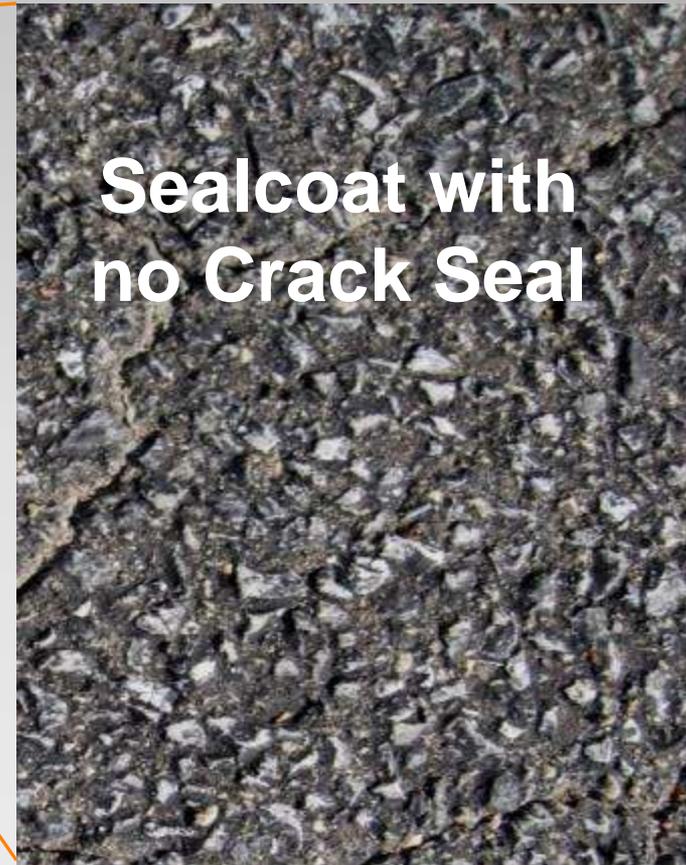
# Example #1



Lack of proper asphalt  
maintenance in parking lot...



# Example #1



# Example #1



# Example #1



**Asphalt Failed  
at 15 years!**

# Example #2



# Example #2



**Reclaimed Cypress Siding on  
Clubhouse not maintained**

# Example #2



**Mold**



**Termites**

# Example #2



**Lack of  
maintenance**



**Inappropriate  
materials**

# Example #3



# Example #3



# Example #3



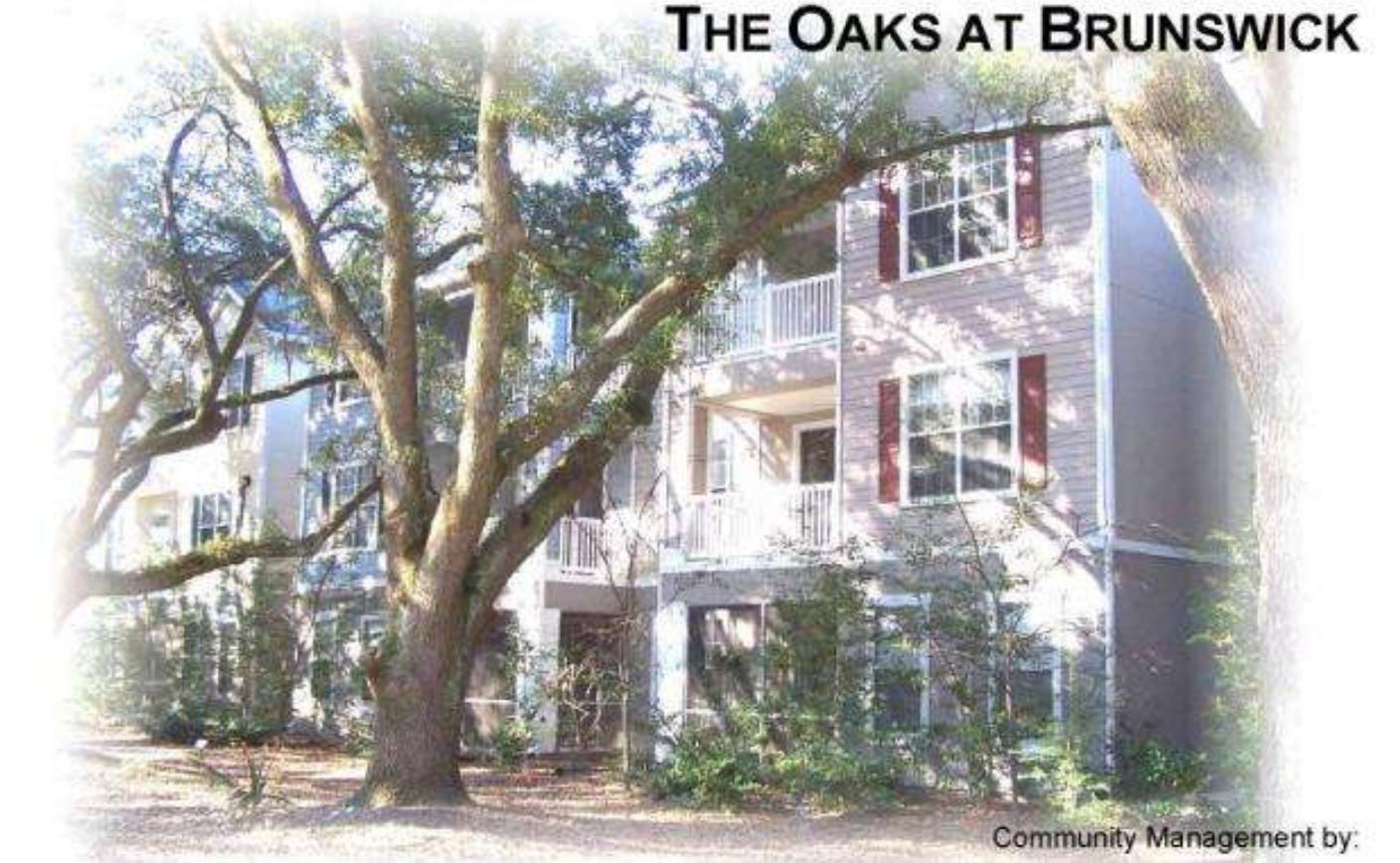
She has spent **\$9,000** on condo  
association fees over **five years.**



She had to come up with **\$12,000**  
more in **three months.** She couldn't.

# Sample Reserve Study

REPLACEMENT RESERVE REPORT FY 2015  
**THE OAKS AT BRUNSWICK**



Community Management by:



**Townhouse Condo  
216 Units  
Built in 2007**

**Current Reserve Funding: \$90,000**

**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	8	\$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
<b>GENERAL SITE IMPROVEMENTS - Replacement Costs - Subtotal</b>							<b>\$542,734</b>

**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
<b>SWIMMING POOL - Replacement Costs - Subtotal</b>							<b>\$162,244</b>

**PROJECTED REPLACEMENTS - YEARS 4 TO 6**

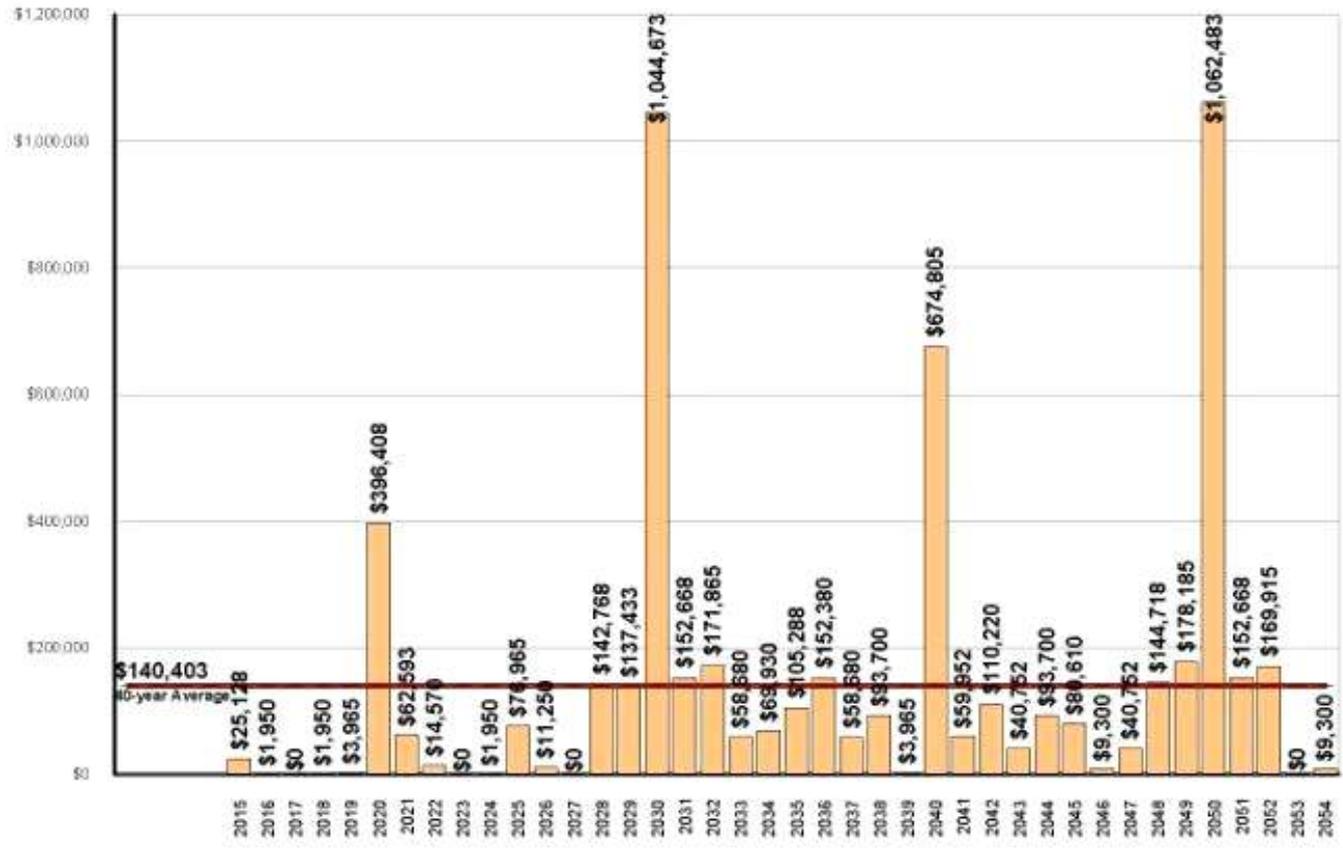
Item	2018 - YEAR 4	\$	Item	2019 - YEAR 5	\$	Item	2020 - YEAR 6	\$
78	Swimming pool furniture (50	\$1,950	67	Swimming pool - finish	\$3,465	2	Seal coat asphalt	\$25,128
			80	Spa finish	\$500	11	Dumpster gates	\$1,000
						27	CB EIFS coating	\$344,960
						69	Swimming pool pump (2 - 5	\$3,200
						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
<b>Total Scheduled Replacements</b>		<b>\$1,950</b>	<b>Total Scheduled Replacements</b>		<b>\$3,965</b>	<b>Total Scheduled Replacements</b>		<b>\$396,408</b>

**PROJECTED REPLACEMENTS - YEARS 25 TO 27**

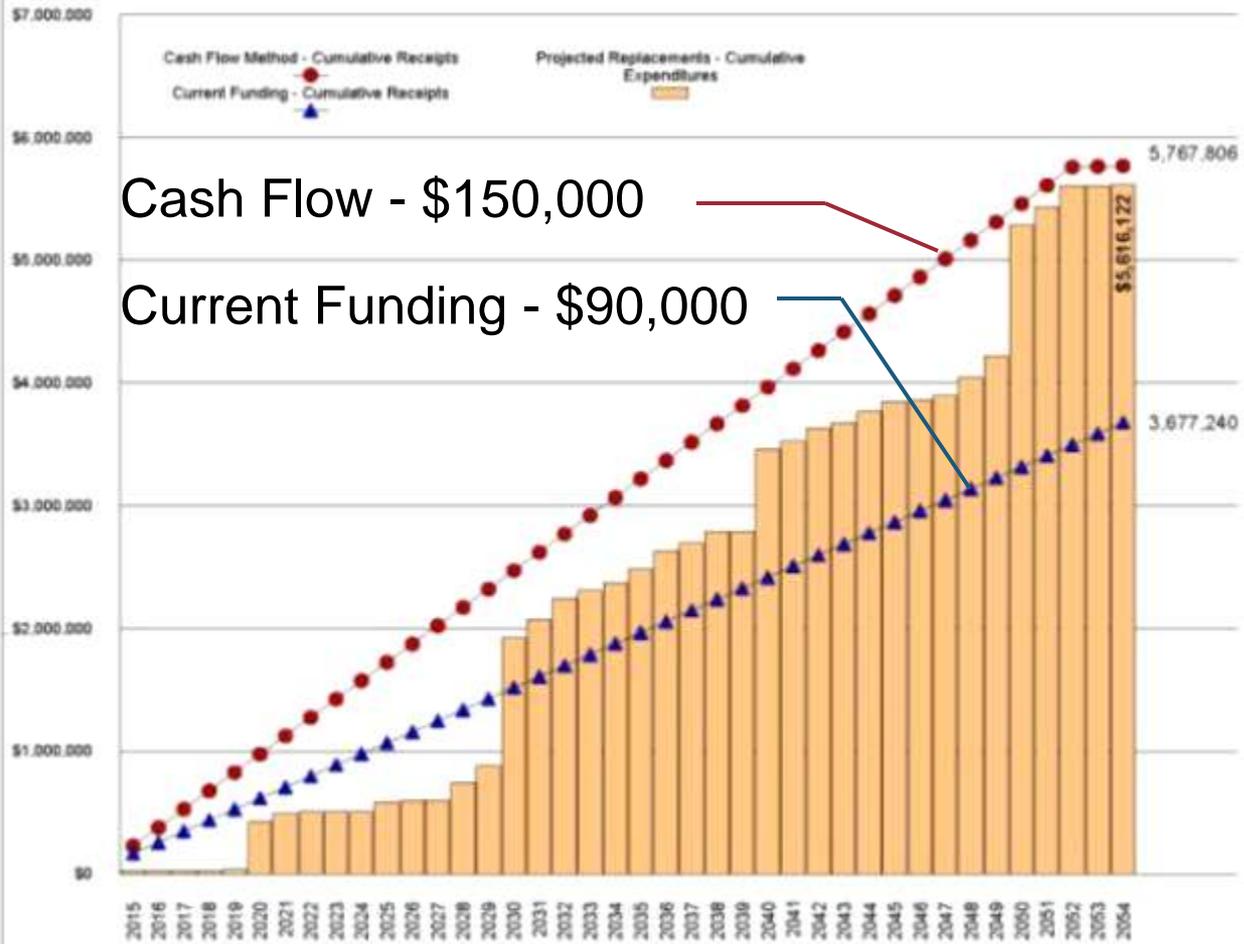
Item	2039 - YEAR 25	\$	Item	2040 - YEAR 26	\$	Item	2041 - YEAR 27	\$
87	Swimming pool - finish	\$3,485	2	Seal coat asphalt	\$25,128	29	CB Vinyl siding, 20%	\$40,752
80	Spa finish	\$500	5	Sandblasted wood signage	\$1,200	76	Swimming pool deck coating	\$19,200
			11	Dumpster gates	\$1,000			
			12	Site 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			
			80	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			
<b>Total Scheduled Replacements</b>		<b>\$3,985</b>	<b>Total Scheduled Replacements</b>		<b>\$674,805</b>	<b>Total Scheduled Replacements</b>		<b>\$59,952</b>

## #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 Calendar of these expenditures.



#1 - Cumulative Replacement Reserve Funding and Expenditures Graph



Cash Flow - \$150,000

Current Funding - \$90,000

# OK! Now What?

- 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 report!

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

**Holy Cr@p!**

That's a \$60K annual increase!

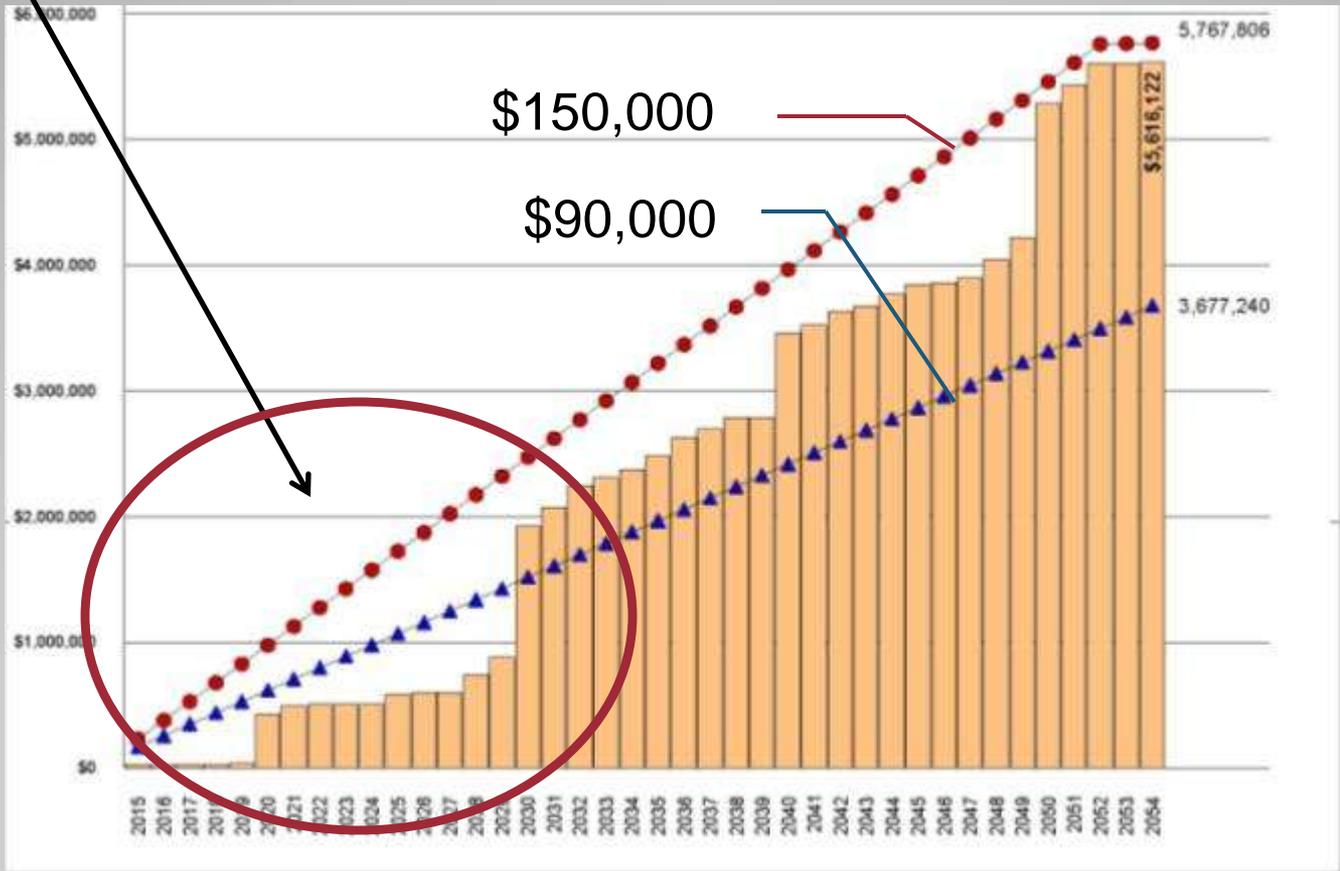
# What Are Your Alternatives?

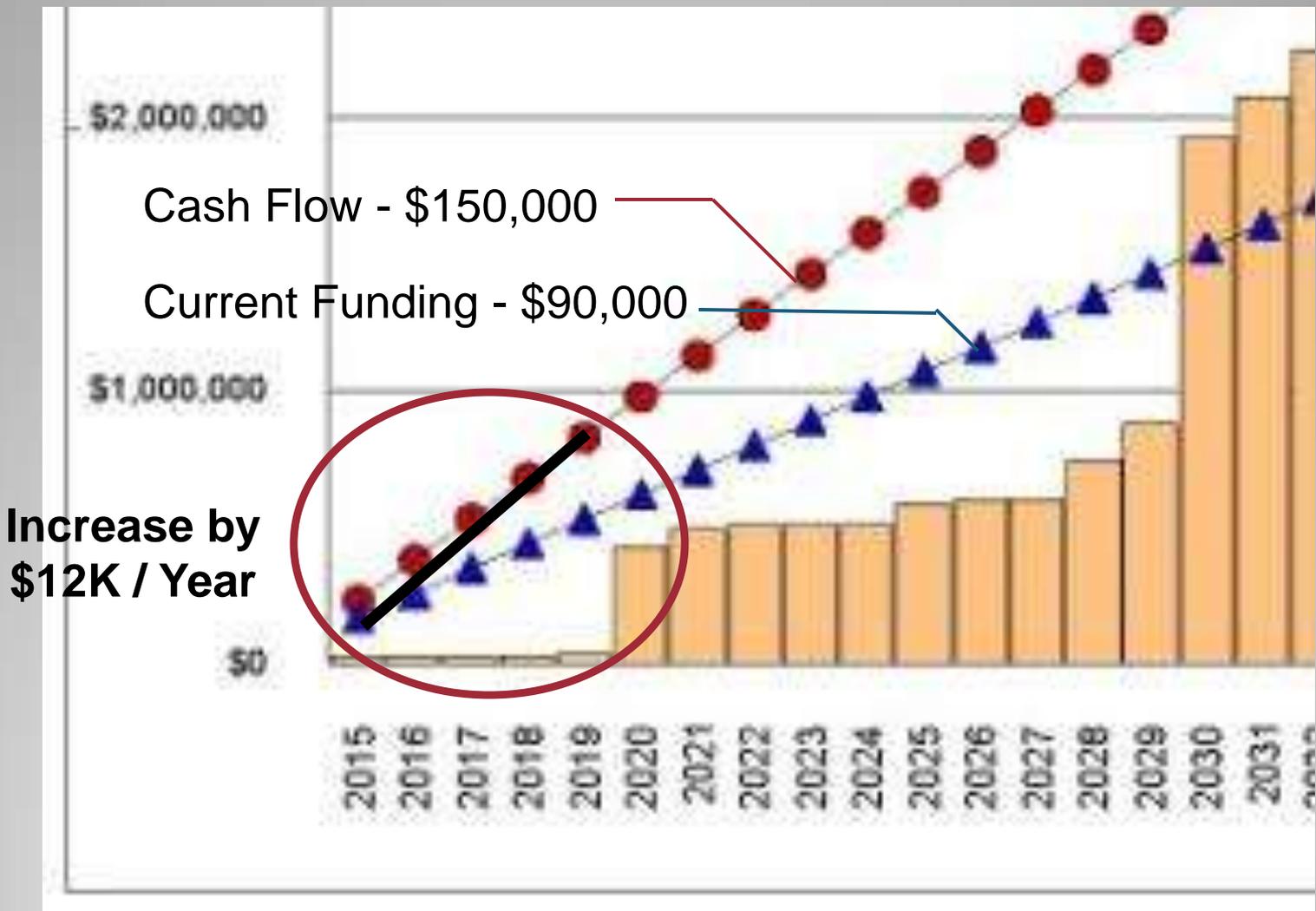
- **Increase Normal Assessments**
- **Special Assessment**
- **Commercial Bank Loan**

# Next Steps in this process:

1. Review inventory data.
2. Re-think replacement priorities.
3. Check Cash Flow margins.
4. Develop **Strategic Funding Plan.**

This association has the leeway to “ramp up” rather than have one large increase





# Strategic Funding Plan #1

Ramp Up Annual Funding over five years:

Year 1: \$90K to \$102K

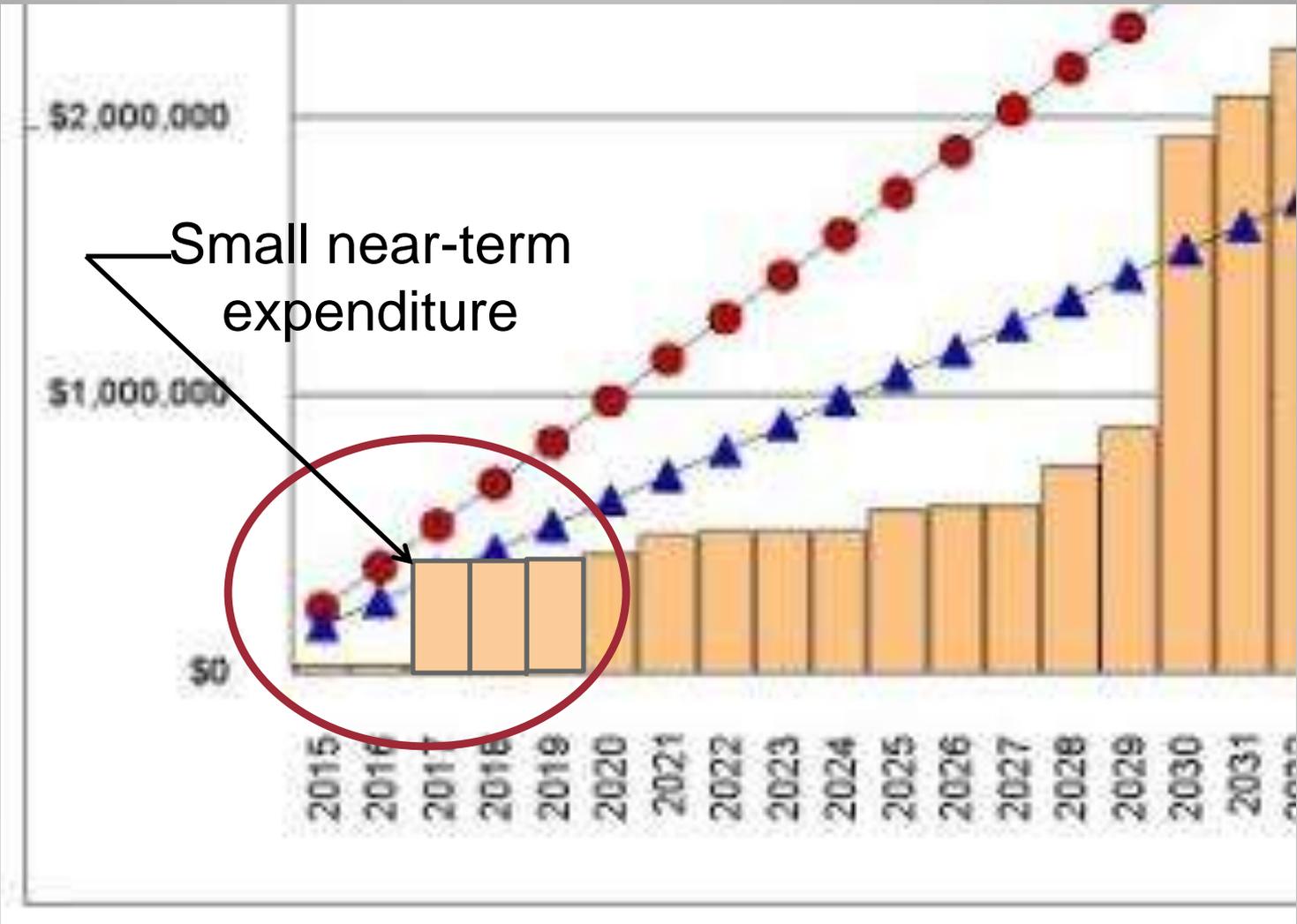
Year 2: \$102K to \$114K

Year 3: \$114K to \$126K

Year 4: \$126K to \$138K

Year 5: \$138K to \$150K \*

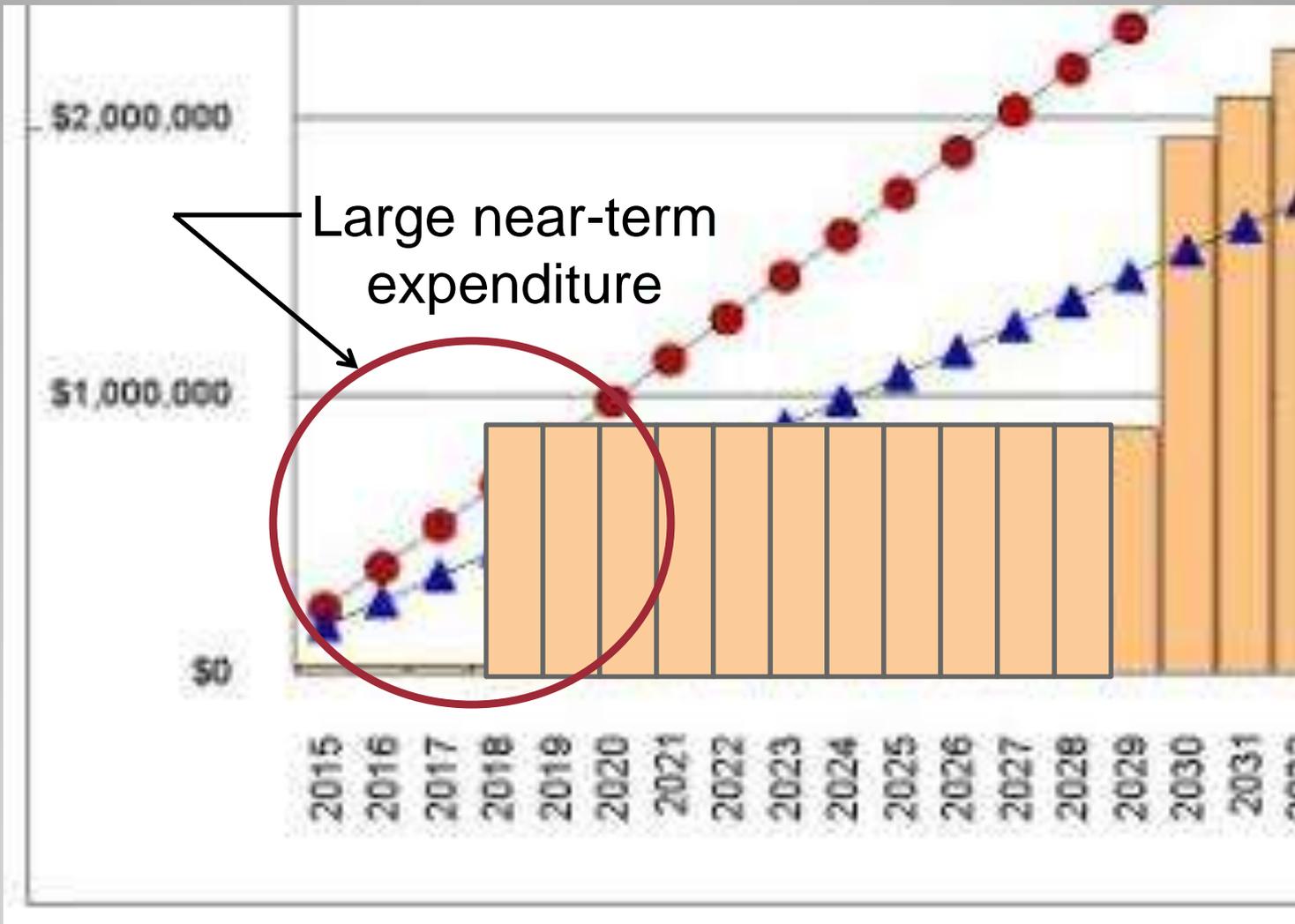
\*Year 5 would bring Reserve Study update and would adjust for inflation, underfunding, changed conditions.



# Strategic Funding Plan #2

## Small Near-term Expenditure

- Increase Normal Assessments as planned,
- Plan Small Special Assessment,
- Combine Special Assessment with Bank Loan..
  - Pay up front, or
  - Pay with interest from bank loan



# Strategic Funding Plan #3

## Large Near-term Expenditures

- Increase Normal Assessments as planned,
- Fund large expenditure with Bank Loan.
  - Bank Loan term can be 3 to 10 years

# Final Thoughts:

- Most financial crises result not from an event, but from lack of planning!
- Adjust and revise the Reserve Study to meet the community's needs and desires!
- Use one or more funding alternatives to develop a **Strategic Funding Plan** that works for the community!

# Questions

**Thank You!**