What your Reserve Study Says You Need…

and

What You Can Actually Afford!

SEPTEMBER 2 & 3, 2015

PRESENTED BY:

PRESENTERS:

JUDY ROSEN, PCAM

PETER B. MILLER, RS

Housekeeping Note …

www.mdaReserves.com

or

CAIHeartland.com

Topics

- Importance of Proper Maintenance
- What are the Best Practices for Managing Common Physical Assets
- How to Prioritize What Needs to be Done
- Strategic Funding Plans for Reserves

Maintenance

There are five different types of maintenance that every community deals with on a continuing basis.

Routine Maintenance:

The regular, recurring upkeep that must be done. **Examples** of routine maintenance include **grass cutting, snow removal, and** the **cleaning** of public restrooms at the swimming pool. This type of maintenance can typically be performed by association staff or by an independent contractor. The job description for a maintenance employee or the service contract is used to define the scope of routine maintenance that is expected.

Preventive Maintenance:

This is the periodic maintenance to:

- avoid disruptive breakdowns,
- reduce the association's carbon footprint
  - by managing utility consumption efficiently and
  - use alternate energy sources,

Preventive Maintenance: (cont)

- This periodic maintenance also helps to **achieve the optimum Useful Life** of the physical asset in questions.

- An in-depth and well maintained preventive maintenance program can **prolong the need for replacement**.

Preventive Maintenance: (cont)

Examples of preventive maintenance include:

- HVAC inspections and maintenance,
- Annual roof inspections to include repairs of minor problems, and
- Quarterly elevator inspections and maintenance.
- Literature from the manufacturer is one of the best sources of information on preventive maintenance for equipment.

Emergency Services Maintenance:

- This is the ability to respond to unpredictable problems.
- Examples of emergency services include:
  - sewer back-ups,
  - elevator entrapment,
  - roof leaks, and
  - frozen pipes.

Requested or Corrective Maintenance:

- This is maintenance requested by the Board, an owner or tenant, recommended by a contractor or identified during a routine site visit of the community.
- Examples of corrective maintenance include, a pothole in the street, replacement of a burned out light bulb, or the malfunction of a treadmill.

Requested or Corrective Maintenance: (cont.)

It's important to remember the following when a request is made:

- Don't let a homeowner "sweet talk" or "bully" you into agreeing to perform work that is not association responsibility.
- Don't assume the association is automatically responsible for a component…check the governing documents!

Scheduled Replacement:

- This consists of planning for the replacement of physical assets as they wear out or break.

- The basis for your scheduled replacement is the Reserve Study and Replacement Fund Budget.

Scheduled Replacement: (cont)

However, the maintenance needs of a replacement item such as a roof or swimming pool plaster may require adjustments in both your Reserve Study and Replacement Fund Budget to allow you to replace the item sooner...or later than originally planned.

Scheduled Replacement: (cont)

Although Missouri is not yet one of them, several states require that Reserve Studies be performed and updated every 3 to 5 years, and for good reason.

Having a qualified engineer or Reserve Specialist update a Reserve Study enables the board and manager to better plan for large cash outlays.

Repair/Replacement Priorities

- Safety First
- Stabilize
- Function
- Aesthetics

Financially Sustainable Communities

Meet Mrs. Jones…

How Did This Happen?

- Fixed Income
- Increasing Normal Assessments
- Large Special Assessment!

Lack of Board Planning!

How Could We Let This Happen?

- Uneducated Board!
- Head in the sand community!
- Misuse of Reserve Fund dollars!

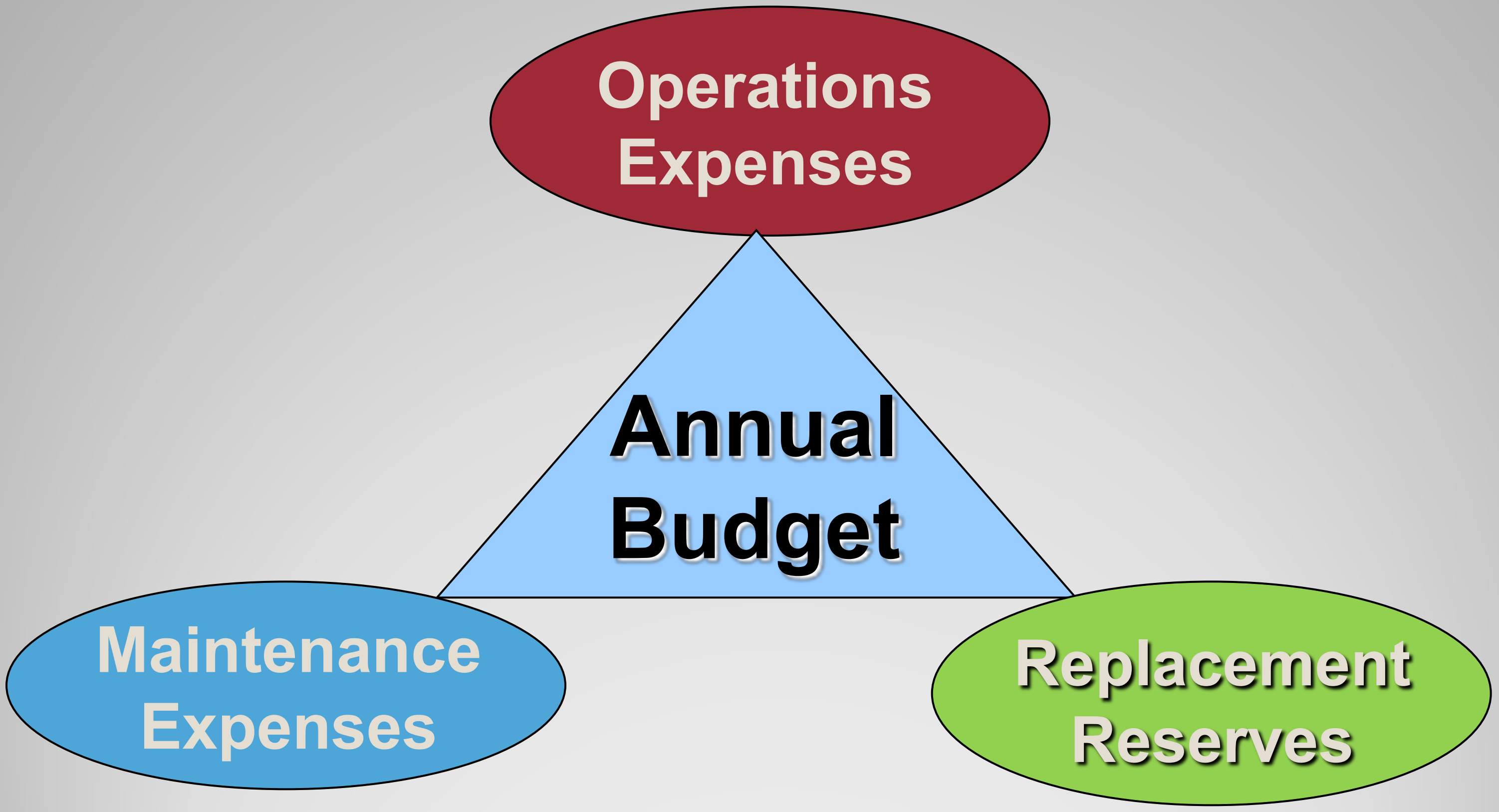
Lack of Board Planning!

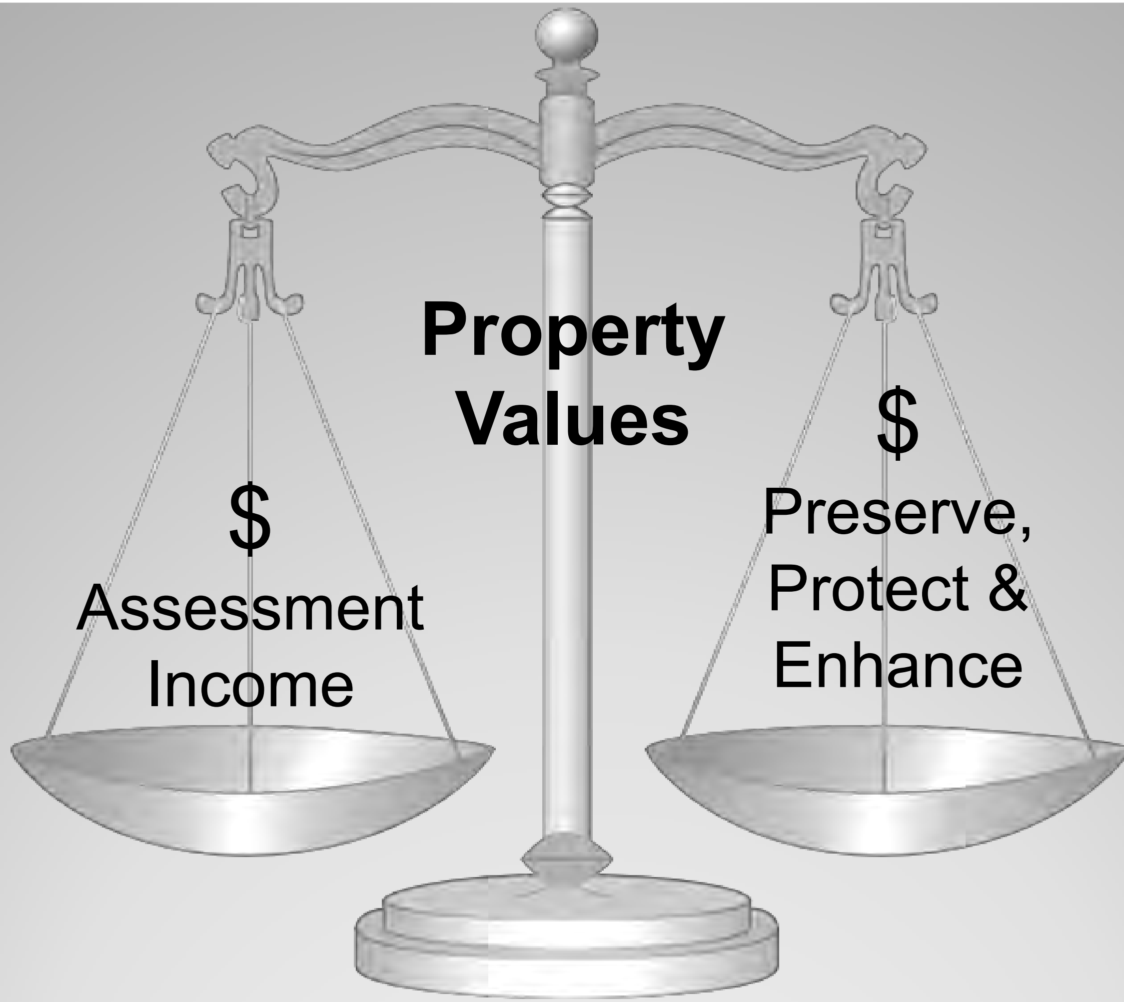

FORECLOSURE
FOR
SALE

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!

Financially Sustainable Community





Property
Values
$
Assessment
Income
$
Preserve,
Protect &
Enhance

Budget

Highest Responsibility

"The highest responsibility of a Board Member is to Protect, Preserve and Enhance the property values within their community."

Robert Lyles, Esq

Kiawah Island, SC

Financially Sustainable Community

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

Financially Sustainable Community

Acknowledge, function and plan within the economic realities of the present without limiting the financial abilities of the future!

The Only Thing Worse …

"The only thing worse than Controversy in a community association is Apathy"

Robert Marvin, FASLA

Hilton Head Island, SC

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.

Reserve Studies

Reasons for a Reserve Study

- Legal
- Financial/Practical
- Ethical

Legal Aspects

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

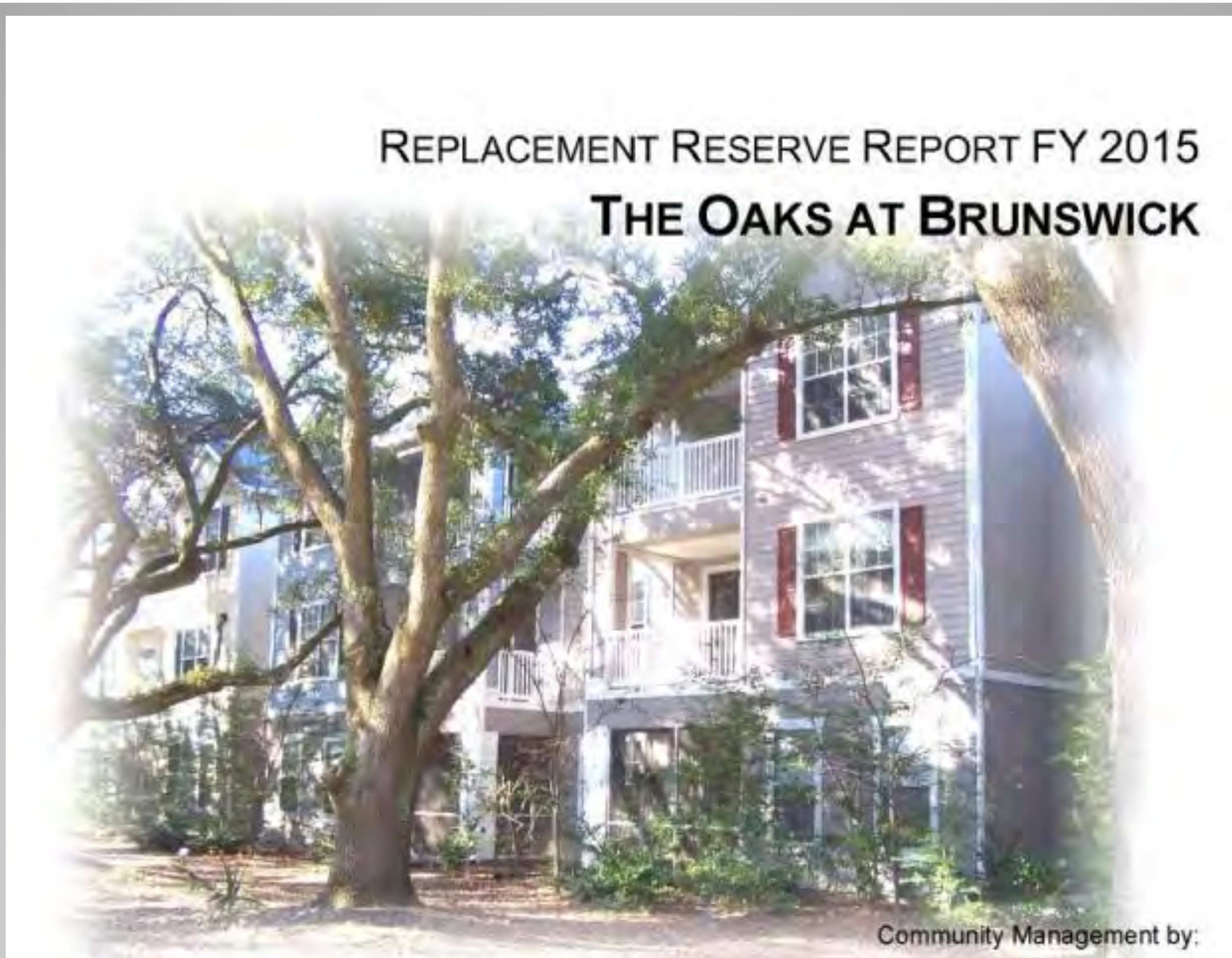
Financial / Practical Aspects

- **Vital data for budgeting process**;
- **Independent professional opinion** with periodic updates (every 3 to 5 years);
- **Institutionalizes 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!

Reserve Study Sample Exercise


REPLACEMENT RESERVE REPORT FY 2015
THE OAKS AT BRUNSWICK
Community Management by:

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

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

Oaks at Brunswick — June 14, 2014

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**

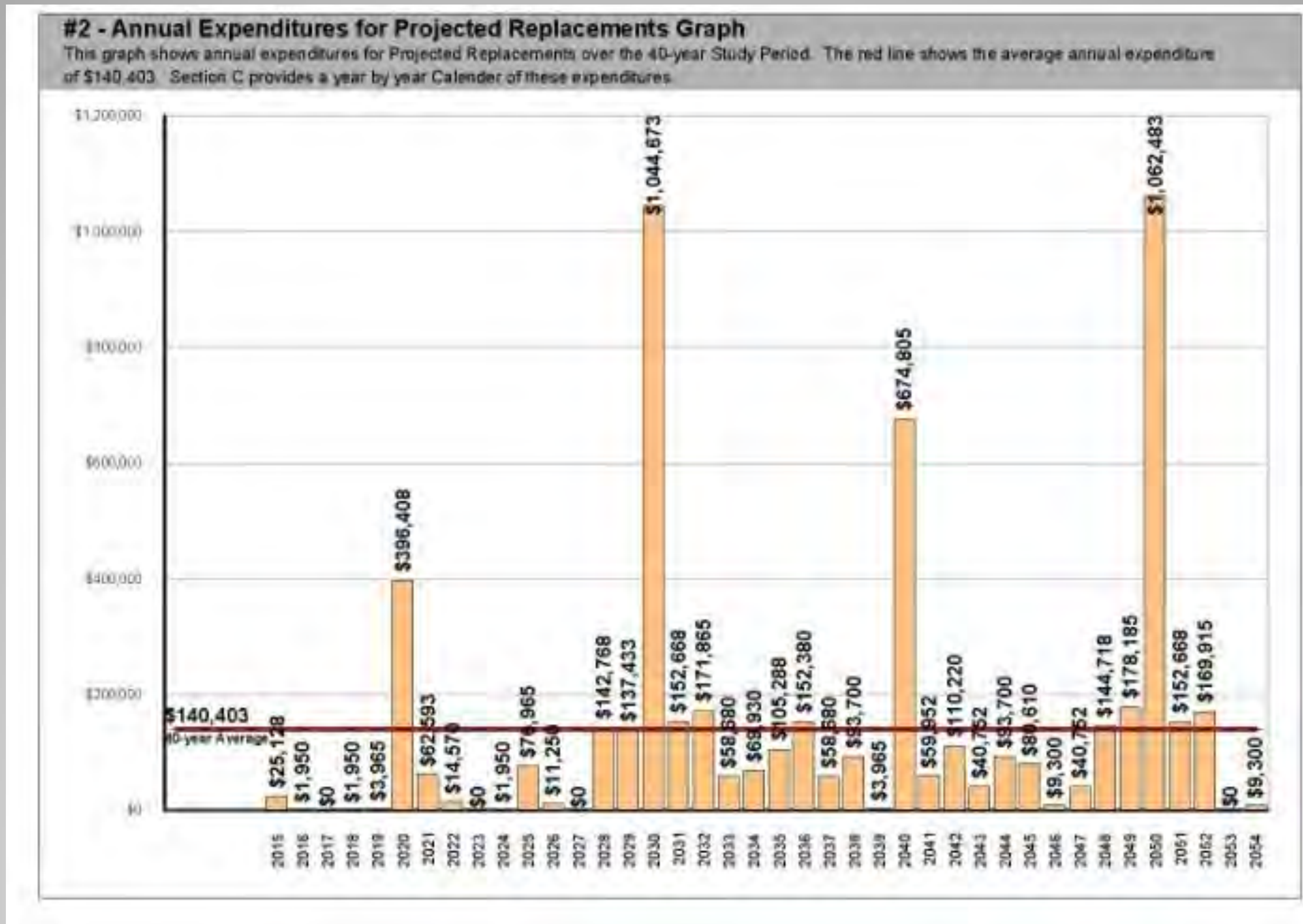
Oaks at Brunswick — June 14, 2014

PROJECTED REPLACEMENTS - YEARS 25 TO 27

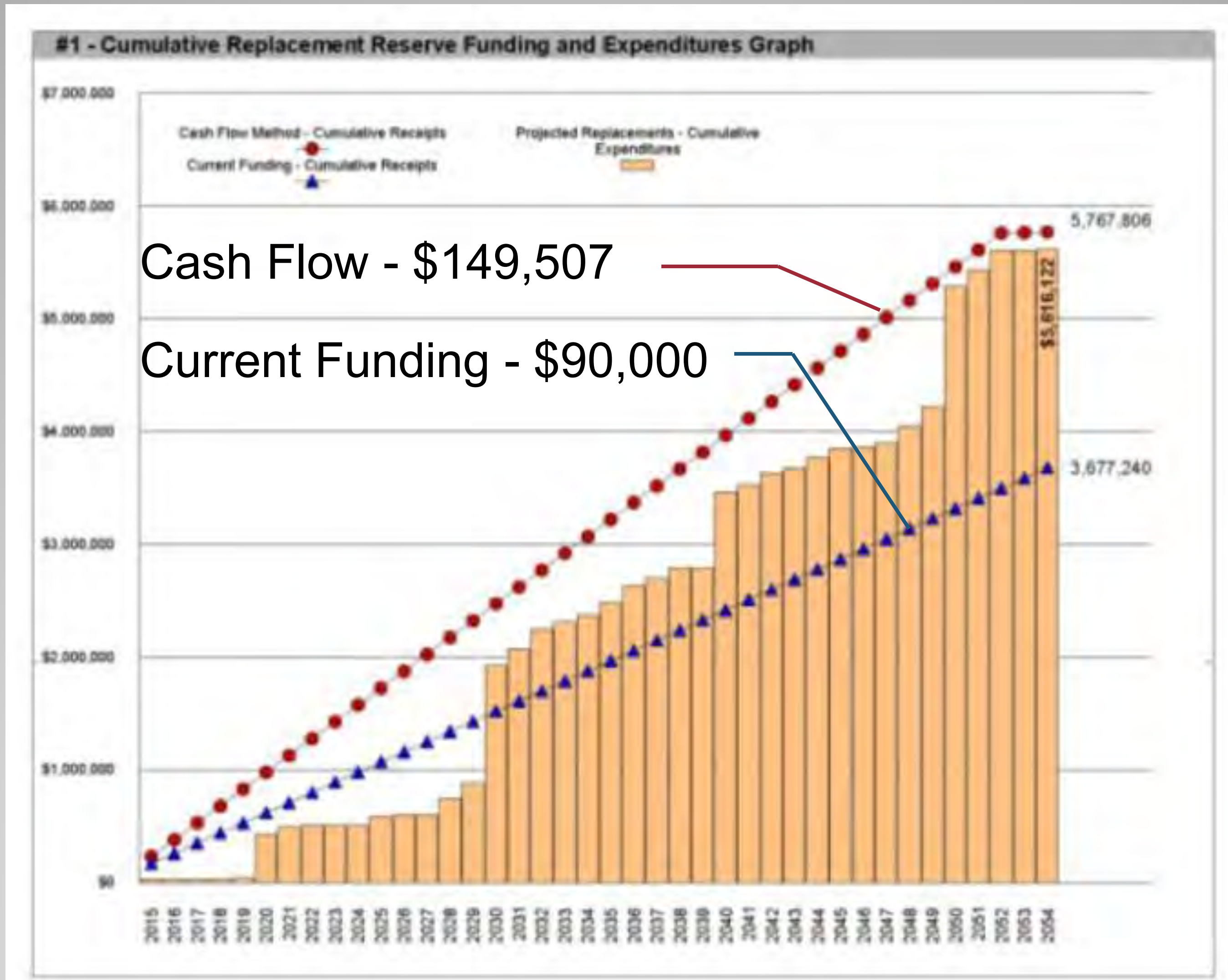
Item	2039 - YEAR 25	$
67	Swimming pool - finish	$3,465
80	Spa finish	$500
	Total Scheduled Replacements	$3,965

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%	$76,120
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.
$140,403
40-year Average


#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
3,677,240
$5,616,122
$7,000,000
$6,000,000
$5,000,000
$4,000,000
$3,000,000
$2,000,000
$1,000,000
$0
2015
2054

What's the Next Step?

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

You just were handed this Reserve Study!

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

Holy Cr@p!

That's a $60K annual increase!

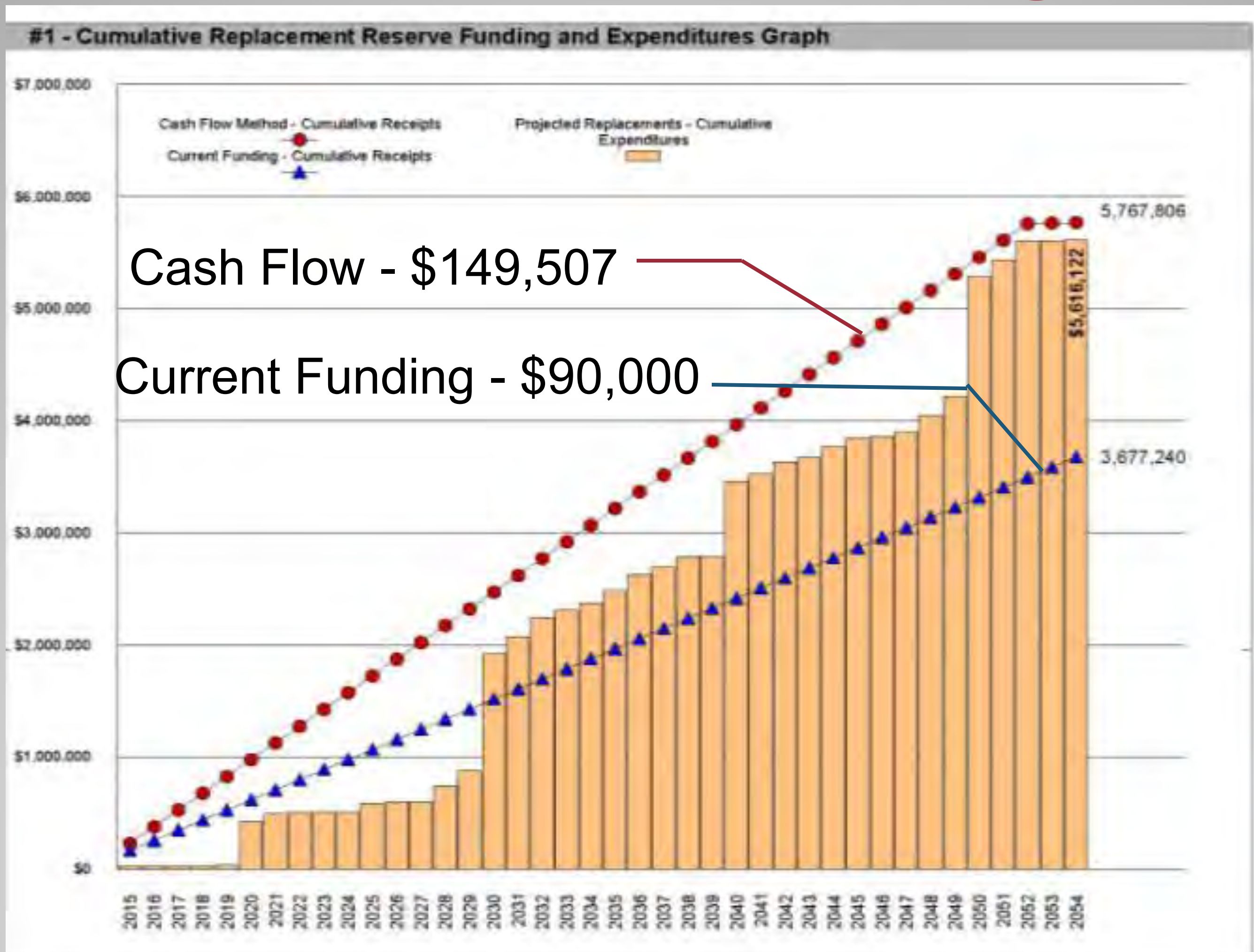
What Are Your Alternatives?

- Increase Normal Assessments
- Special Assessment
- Commercial Bank Loan

Next Step:

- Review inventory data.
- Re-think replacement priorities.
- Check Cash Flow margins.
- Ramp Up Annual Funding in Steps.

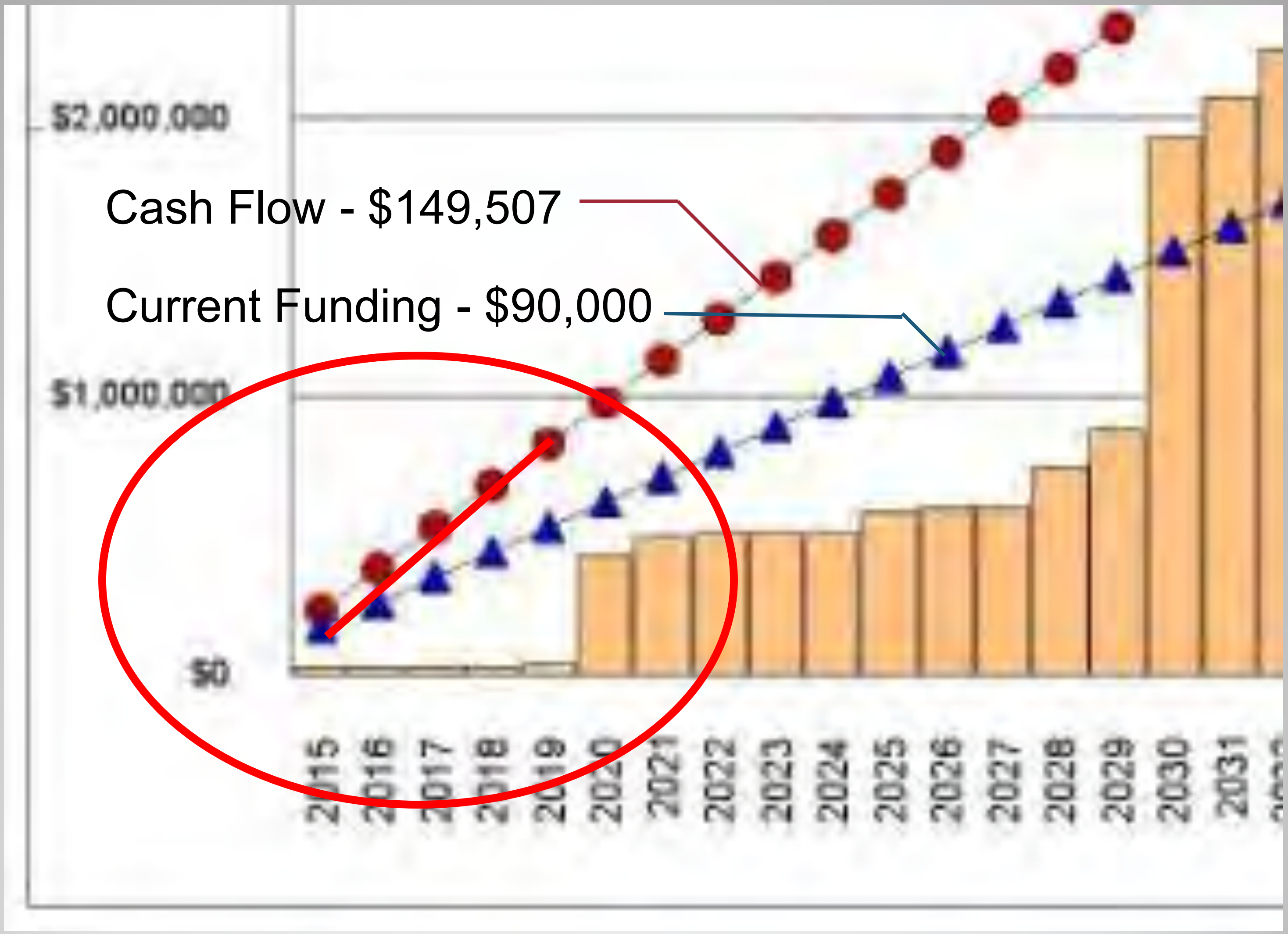
Check Cash Flow Margins



Check Cash Flow Margins

#3 - Table of Annual Expenditures and Current Funding Data - Years 1 through 40

Year	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
Starting Balance	$77,240									
Projected Replacements	($25,128)	($1,950)		($1,950)	($3,965)	($396,408)	($62,593)	($14,570)		($1,950)
Annual Deposit	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000
End of Year Balance	$142,112	$230,162	$320,162	$408,212	$494,247	$187,838	$215,246	$290,676	$380,678	$468,726
Cumulative Expenditures	($25,128)	($27,078)	($27,078)	($29,028)	($32,993)	($429,402)	($491,994)	($506,564)	($506,564)	($508,514)
Cumulative Receipts	$167,240	$257,240	$347,240	$437,240	$527,240	$617,240	$707,240	$797,240	$887,240	$977,240
Year	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**	**2031**	**2032**	**2033**	**2034**
Projected Replacements	($76,965)	($11,250)		($142,769)	($137,433)	($1,044,673)	($152,669)	($171,865)	($58,680)	($69,930)
Annual Deposit	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000
End of Year Balance	$461,761	$540,511	$650,511	$597,743	$550,309	($404,364)	($467,032)	($548,897)	($517,577)	($497,507)
Cumulative Expenditures	($585,479)	($596,729)	($596,729)	($739,497)	($876,931)	($1,921,604)	($2,074,272)	($2,246,137)	($2,304,817)	($2,374,747)
Cumulative Receipts	$1,067,240	$1,157,240	$1,247,240	$1,337,240	$1,427,240	$1,517,240	$1,607,240	$1,697,240	$1,787,240	$1,877,240
Year	**2035**	**2036**	**2037**	**2038**	**2039**	**2040**	**2041**	**2042**	**2043**	**2044**
Projected Replacements	($105,288)	($152,380)	($58,680)	($83,700)	($3,965)	($674,805)	($59,952)	($110,220)	($40,752)	($93,700)
Annual Deposit	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000
End of Year Balance	($512,796)	($575,176)	($543,856)	($547,556)	($461,521)	($1,046,326)	($1,016,278)	($1,036,497)	($987,249)	($990,949)
Cumulative Expenditures	($2,480,036)	($2,632,416)	($2,691,096)	($2,784,796)	($2,788,761)	($3,463,566)	($3,523,518)	($3,633,737)	($3,674,489)	($3,768,189)
Cumulative Receipts	$1,967,240	$2,057,240	$2,147,240	$2,237,240	$2,327,240	$2,417,240	$2,507,240	$2,597,240	$2,687,240	$2,777,240
Year	**2045**	**2046**	**2047**	**2048**	**2049**	**2050**	**2051**	**2052**	**2053**	**2054**
Projected Replacements	($80,610)	($9,300)	($40,752)	($144,718)	($178,185)	($1,062,483)	($152,668)	($169,915)		($9,300)
Annual Deposit	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000	$90,000
End of Year Balance	($981,560)	($900,860)	($851,612)	($906,330)	($994,515)	($1,966,998)	($2,029,667)	($2,109,582)	($2,019,582)	($1,938,882)
Cumulative Expenditures	($3,848,800)	($3,858,100)	($3,898,852)	($4,043,570)	($4,221,755)	($5,284,239)	($5,436,907)	($5,606,822)	($5,606,822)	($5,616,122)
Cumulative Receipts	$2,867,240	$2,957,240	$3,047,240	$3,137,240	$3,227,240	$3,317,240	$3,407,240	$3,497,240	$3,587,240	$3,677,240



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

Strategic Funding Plan

Ramp Up Annual Funding by $12,000 each year over five years:

Year 1: $90K to $102K

Year 2: $102K to $114K

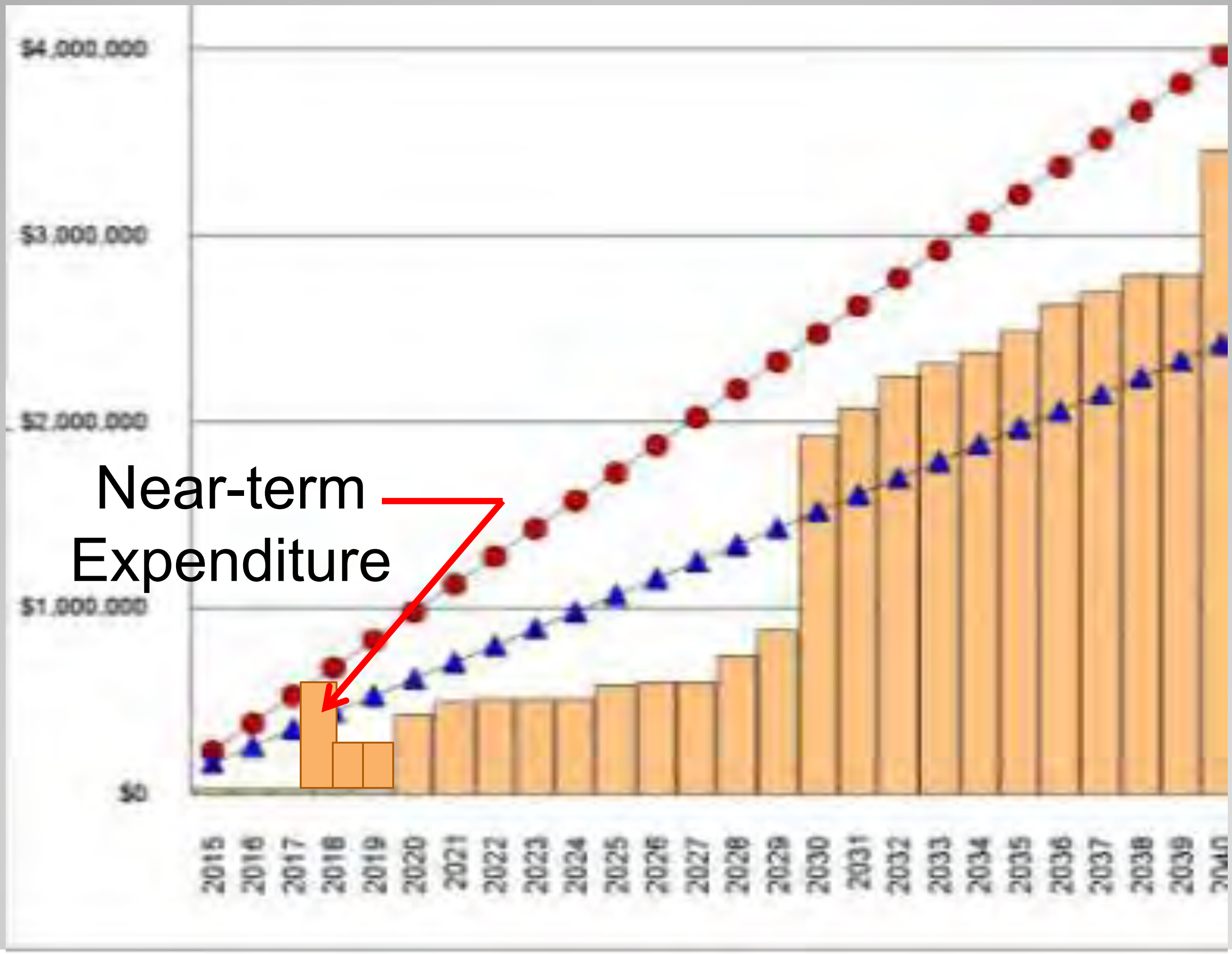
Year 3: $114K to $126K

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.

Funding Alternatives



Strategic Funding Plan

- **Alternative 1**: Increase Normal Assessments and use Bank Loan cover near-term large expenditures.

- **Alternative 2**: Multi-year Special Assessment with Bank Loan backup.

- **Benefit:** Spread pay back over a 3 or 5 or 7 or 10 year term with low interest.

Questions

?

Managing Physical Assets

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!

Strategy for Sound Management of Our Physical Assets

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

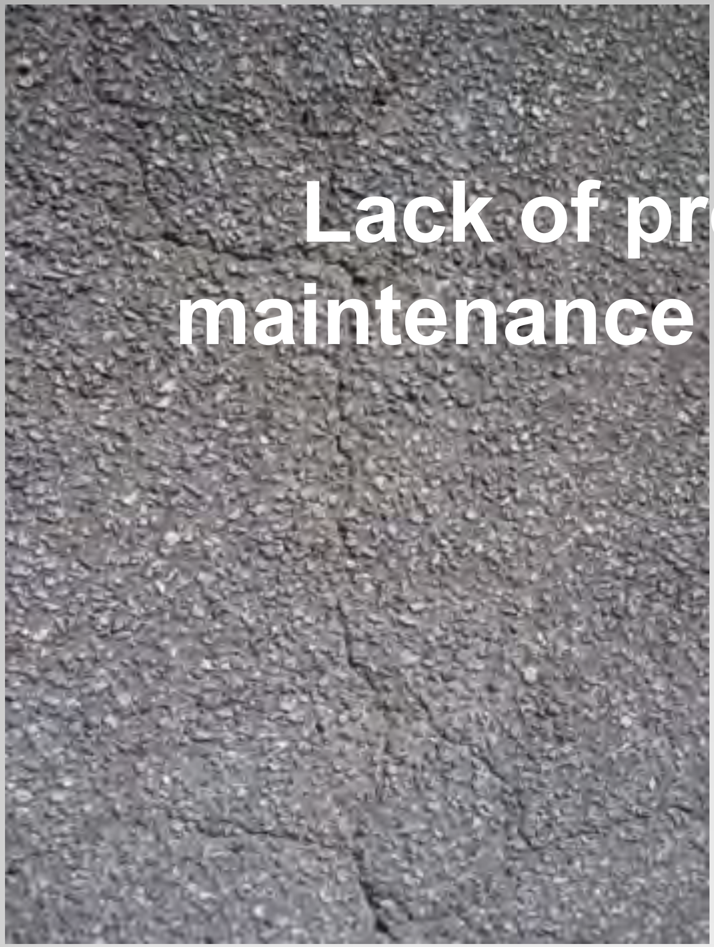
Optimize Economic Life - Maintenance

- Sound preventative maintenance makes sound economic sense!
- The longer an asset (reasonably) stays in service, the less the Replacement Reserve need.
- Saving money on maintenance just to save money is wasting money long-term!

Best Practices - Replacement

- Hire the <u>Best</u> Contractor that you can find!
- Use the <u>Best</u> <u>Appropriate</u> Materials for the job.
  - Upgrade to a better quality, or
  - Consider alternative materials if applicable.
  - Do the necessary prep work before installation.

Example #1

Lack of proper asphalt maintenance in parking lot…

Example #1

Example #1

Example #2

Example #2

Example #2

Example #2

Example #3

1911 Pine Beam (38 r)

2015 Pine Beam (18 r)

Example #3

1911 Pine Beam #2 (58 r)

Example #3

1911 Pine Beam #2

Example #4

Example #4

Example #4

Understand Calculation Methods:

Cash Flow Method

Versus

Component Method

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

Speaker BIO
Peter B. Miller, RS

A Principal in the firm of Miller + Dodson Associates, Peter Miller is considered to be one of the nation's leading experts in the field of Reserve Studies and Strategic Financial Planning for community associations. He holds the professional designation of Reserve Specialist (RS). Mr. Miller is a frequent author and lecturer, and was selected to develop and teach the Community Associations Institute's (CAI) Webinar on Reserves and Reserve Studies.

Peter served as the 2004 President of the CAI Washington Metropolitan Chapter, and was a member of the Board of the CAI South Carolina Chapter. Most recently, he served as the 2014 President of the Southeast Virginia Chapter of CAI. He served as Vice-Chair of the CAI National Reserves Committee, and currently serves on the CAI National Business Partners Council. He has been widely recognized for his efforts in the industry, and has received the CAI National "President's Award" and "Award for Excellence in Chapter Leadership".

Peter is a graduate of the College of Architecture and Urban Studies at Virginia Tech, and is a member of the Urban Land Institute and The Congress for a New Urbanism.