

Condo Insights

#63 – Understanding the Capital Reserve Study Part 2

Part 2 in this series will look at the components of a capital reserve study.

The Community Association Institute (“CAI”) is the trade organization for community, condominium, and homeowner’s associations. According to CAI, a capital reserve study should include the following: a summary of the association’s number of units, physical description of the property, reserve fund financial condition; a projection of reserve starting balance, recommended reserve contributions, projected reserve expenses, and projected ending reserve fund balance for a minimum of 30 years; a listing of the component inventory, component quantity or identifying descriptions, useful life, remaining useful life and current replacement cost; a description of methods and objectives utilized in computing the Fund Status and development of the Funding Plan, source(s) utilized to obtain component repair or replacement cost estimates; a description of the level of service by which the reserve study was prepared and the fiscal year for which the reserve study is prepared.

A physical description of the common areas and infrastructure (e.g., roofs, siding, landscaping, common buildings) is essential for identifying areas of association responsibility, potential areas of concern and estimating future repair and replacement costs. This allows the reserve study to accurately assess the condition of the assets, identify potential problems, and develop a realistic plan for addressing them.

A reserve study includes a schedule of association assets including a component inventory, quantity, estimated useful life, estimated remaining useful life, and replacement cost to provide a structured, comprehensive, and easily understandable overview of the association's capital assets and future needs. A table allows for easy comparison and identification of different components, their current condition, and their estimated future needs.

The tabular format facilitates long term analysis of the association's reserve fund status, funding needs, and the timing of potential replacements. A clear and transparent overview of the association's assets and responsibilities promotes accountability and informed decision-making. By identifying the useful life and remaining useful life of components, the reserve study can help the association anticipate future costs and plan for necessary repairs or replacements. The tabular format allows the association to determine the current replacement costs, which is essential for developing a sustainable funding plan for the reserve fund. In many states, reserve studies are legally required to provide this level of detail to association members and prospective purchasers.

The reserve fund is the savings account for the association, used to cover repairs and replacements for association assets. A reserve study must analyze the current balance in the reserve fund, future contributions, and projected expenses to determine if the fund is adequately funded and to develop a sustainable funding plan. An adequately funded reserve fund allows the association to cover unexpected expenses without resorting to special assessments. Regular maintenance and timely repairs, funded by the reserve fund, help maintain property values and prevent costly deferred maintenance. The reserve study provides the board with the data needed to make informed decisions about budgeting, maintenance, and capital projects.

A reserve study includes projections of the starting balance, recommended contributions, expenses, and ending balance to help associations plan for future major repairs and replacements, ensuring adequate funding and minimizing the need for unexpected special assessments. A starting fund balance establishes the current financial status of the reserve fund, serving as the baseline for projections. The study estimates timing and future costs for major repairs and replacements of common area components, such as roofs, paving, and other infrastructure. The study analyzes the association's financial needs and recommends the necessary annual contributions to the reserve fund to ensure the association is adequately funded for future expenses. The CRS includes a projected annual ending reserve fund balance which allows the association to monitor its financial health and make adjustments as needed.

Reserve studies are designed to help associations plan for future expenses, so specifying the fiscal year for which the study is prepared ensures that the recommendations are relevant to the association's budgeting cycle. Reserve studies are often used as a long-term financial planning tool, and specifying the fiscal year helps the association track progress towards their reserve funding goals. Some jurisdictions or lenders may require reserve studies to be prepared for a specific fiscal year, so specifying the fiscal year ensures compliance with any applicable requirements.

Reserve studies help associations plan for the long-term maintenance and replacement of common area components, ensuring the property remains well-maintained and valuable. By setting aside funds in advance, associations can avoid unexpected financial shocks when major repairs or replacements are needed, minimizing the need for special assessments. Proper reserve planning helps protect the long-term value of the property by ensuring that major repairs and replacements are addressed in a timely and sustainable manner. Governing boards have a fiduciary duty to manage association funds and property, and a reserve study helps them fulfill this duty by providing a clear understanding of the association's financial condition and future needs.

Part 3 in this series will look at the different levels of reserve studies, and how associations should approach their first reserve study.

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