

Condo Insights

#62 – Understanding the Capital Reserve Study Part 1

On January 8th, 2024 New Jersey Governor Phil Murphy signed into law S2760/A4384, commonly known as the Structural Integrity Act (the “Act”). This legislation requires that almost all condominium associations have capital reserve studies prepared every five years, defines and requires adequate funding levels; expands the scope of reserve studies to include any major projects that could arise in the coming 30-year timeframe and that preventive maintenance schedules be included as part of the reserve studies. The Structural Integrity Act is causing a lot of confusion amongst Boards and unit owners – it is also a source of financial discipline moving forward to address past funding shortcomings.

Why is the Structural Integrity Act important? According to the United States Census Bureau, in 2024 there are almost 3.5 million multi-family housing units in New Jersey. Over 85% are in buildings that are over 25 years old. Over 63% are in buildings more than 45 years old. As buildings get older, they are likely to require more attention to periodic maintenance and replacement of roofs, windows & doors, elevators, and to essential mechanical equipment such as plumbing, electrical, fire alarm & fire suppression systems.

Prior to the Act, associations were not required to have a reserve study. Many of those that have had a reserve study were not following the funding recommendations in their study. The Act requires the reserve study to be prepared by a licensed professional engineer or reserve specialist and for associations to adequately fund their reserve account for future repairs and major maintenance projects. Periodic maintenance and replacement of capital assets require significant financial investment. The Act is intended to ensure that condominium associations no longer have underfunded reserves and that multi-family residential buildings are regularly inspected and properly maintained.

What exactly is a capital reserve study? A capital reserve study (“CRS”) is a comprehensive report that analyzes a property's physical condition and financial health, specifically focusing on the long-term costs of repairing and replacing common area components and recommends a funding plan to ensure those costs can be met. In short, a CRS determines an estimate for the amount of money an association needs to have saved for future capital expenditures, such as roof replacement, paving, or replacement of association equipment such as elevators, HVAC, fire systems and recreational facilities. A CRS looks ahead to what can be expected to be replaced, renovated or rehabilitated in the upcoming 30 years.

A CRS includes both a physical analysis of the property's common elements (inventory, condition, remaining useful life) and a financial analysis of the reserve funds and projected costs. It involves creating a detailed list of common area components, including their quantities, ages, conditions, and estimated useful lives. The study helps determine the estimated timing of when components will likely need to be replaced or repaired, based on their condition and estimated remaining useful life. It provides an estimate of the costs associated with repairing or replacing those components over the long term. The study aims to determine the necessary funding level for the reserve account and recommends a funding plan to ensure sufficient funds are available when needed.

The purpose of a reserve study is to help associations anticipate and plan for the future costs of repairing and replacing major common area components by providing an estimate of these expenses and when they are likely to occur. Reserve studies provide a roadmap for future capital projects, making it easier for the board and residents to understand the association's financial situation and long-term plans. Reserve studies help ensure that associations have sufficient funds to cover major repairs and replacements, preventing unexpected financial strains and large assessments. By identifying potential problems and planning for future needs, reserve studies help mitigate the risk of unexpected and potentially costly repairs or replacements.

Board members throughout New Jersey are now tasked with engaging a qualified engineering firm to prepare a capital reserve study for their association, many for the first time. Prior to the Act, the time frame from engaging the engineering firm, site visit, preparation of the initial draft of the CRS, review and approval of the final CRS was a few months. The Act has caused a surge in demand for new CRS business for engineering firms, and subsequently, the time frame for the process takes much longer than it had prior to the Act.

Even though the Act requires associations to have had their CRS prepared by the end of 2024, due in part to procrastination on the part of some associations and backlog of work for engineering firms, some associations are still waiting for a first draft as we approach the halfway point in 2025. Historically, engineering firms have been very efficient and accurate in preparation of draft reserve studies. Board members are advised to review the draft reserve studies closely to make sure all information is accurate before finalizing the CRS for their association.

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

Jim Yost owns Elite Management and Advisory Services, LLC and is co-owner / Managing Partner for Ocean Property Management Corporation, based in Wildwood. The firms provide management and advisory services to numerous community, condominium and homeowner associations in southern New Jersey. He can be reached at yostopmc@comcast.net.

Karim Kaspar, Esq. is Senior Counsel with Lowenstein Sandler LLP. He serves as general counsel to numerous community and condominium associations throughout New Jersey. He specializes in complex commercial litigation and real estate matters and has been active and instrumental in the firm's pro-bono activities. He can be reached at kkaspar@lowenstein.com.

The entire Condo Insights series of articles is available online at www.oceanpropertymgmt.com.