

WHAT'S NOT IN YOUR RESERVE STUDY

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You've probably read many articles and heard discussions of what should be in your community's reserve schedule and why. This article is NOT about that. On the contrary, this article will discuss what may NOT be in your reserve schedule and why. Understanding what's not in your reserve schedule is very important and will help keep your community out of trouble.

Reserve funds are intended to pay for major repairs and replacement of common elements when they reach the end of their useful lives. The first step in determining reserve funding requirements is to develop a component inventory, which consists of a list of individual components that will be included in the reserve schedule. This process is not as simple as developing a list of all common elements in the community. There are many factors that affect whether a common element is included in the reserve schedule or not.

Some factors regarding inclusion/exclusion of common elements are relatively hard and fast rules, while others are subject to recommendations by the reserve provider and decisions by the community's board. However, the board and management should always understand what items are not reserve components and why.

Following is a discussion of some of the reasons that items may be excluded from your community's reserve schedule:

Ownership

Reserve components must be common elements of the association, including limited common elements. A typical example is windows and doors. If windows and doors are part of an individual unit, then they should not be considered to be reserve components.

CONTINUES ON PAGE 18

WHAT'S NOT IN...

from page 16.

Capital Improvements (As Opposed to Capital Replacements)

If a community is planning to add a common element that did not exist

before, such as a basketball court or a gym, that would be a capital improvement. Because that component did not previously exist and has not depreciated, funding contributions for its replacement have not been made in the past. Therefore, funding of such a project can not be taken

from reserves. A new component cannot be added to the reserve schedule until after it is put into service.

Predictable Useful Life

To be a reserve component, an item must have a predictable useful life, so that its replacement can be anticipated and funding can be budgeted accordingly. Infrastructure items, such as storm drainage structures, are common examples of common elements that may not have a predictable useful life. If properly installed, storm drainage systems could last 50 or 100 years. Generally, there is no reliable way to predict and budget funding for such items. Therefore, they would not typically be reserve components.

Time Horizon

In determining whether or not to include a component in a reserve study, the length of the item's predicted useful life must be considered. Items that are predicted to be replaced beyond a selected "time horizon" are typically not included as reserve components. Typical time horizons considered are 20, 30 or 40 years. If a 30-year time horizon is used, vinyl siding with a 40-year remaining useful life may not be included in the reserve study.

Some words of caution are warranted here. Although new components may initially have useful lives which are beyond the selected time horizon age, they eventually will come within the selected replacement time horizon, at which time they should be incorporated into the reserve funding plan. These items, such as cladding, roofs or retaining walls, tend to be expensive replacement projects.

CONTINUES ON PAGE 20



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WHAT'S NOT IN...

from page 18.

Using a 20-year horizon, funding for these large projects must be accomplished in 20 years, rather than over their total 30 or 40-year initial useful life. This can dramatically increase reserve funding requirements as communities age. If not understood and implemented properly, time horizon cut-offs can lead to unanticipated increases in funding requirements.

Maintenance Contracts

Certain common elements may be covered under maintenance contracts, which cover costs for replacement of those components. Elevators are a typical example of this situation. If the cost of replacement of the parts of an elevator system is covered under

a maintenance contract, those parts of the elevators should not also be included in the reserve schedule.

Funding from Operating Budget

If replacement of components is funded from a community's operating budget, those items should not also be included in the reserve schedule. As an example, various parts of an irrigation system may be replaced on an as-needed basis annually within the landscape budget, with most of the system being replaced over time piece by piece. In this scenario, the irrigation system would not be a reserve component.

Maintenance Items

Reserve funds should only be used for major repairs and replacement of

common elements. Work that is considered maintenance, such as painting, staining, and caulking, should not be included in a reserve schedule.

Communities should have a deferred maintenance schedule to assist in budgeting for their maintenance costs.

Construction Defects or Damage

Reserve funds are not typically used to correct construction defects or to replace defective materials. This issue often arises in reroofing projects. Reserve funds for a roof project typically account for the cost of removal and replacement of shingles/membrane, underlayment, and flashings. If the roof was originally constructed with defective roof sheathing or inadequate venting, these deficiencies must be addressed as part of the roof replacement project. However,

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the cost of correcting those defects may not be included in the reserve schedule.

Another example relates to pavement projects. The estimated cost in a reserve schedule for a pavement project would typically account for removal and replacement of the pavement's asphalt surface course, along with some limited repairs to base-course, curbs and catch basins. However, if the existing pavement has extensive areas of failure of the full depth of the pavement, those failed areas require repair before the new surface course can be installed. The cost for extensive full depth repairs may not be accounted for in the reserve schedule.

Funding from Other Sources

Sometimes a community faces a major project that, due to inadequate

CONTINUES ON PAGE 46

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WHAT'S NOT IN...

from page 21.

funds, can't be paid from reserve funds and alternate funding must be used. Alternate funding can include special assessments or a loan taken by the association. In such situations, the reserve report should reflect what funds, if any, from reserves will go toward the project, and what the funding requirements will be after the project is complete.

As noted above, it is important for an association's board to understand what common elements are not in their reserve schedule and why, as well as how the exclusion of such items can impact the community in both the long and short term. With each reserve update, excluded components should be reviewed to confirm that their continued exclusion from the reserve schedule is appropriate. ■

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