

R E S E R V E S T U D I E S



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What is a Reserve Study?

A reserve study is a financial planning tool that aids a Common Interest Realty Association (i.e. condominium/ townhouse association, home-owners association, planned unit development, cooperative, time share association, etc...) in determining the amount of funds required for future repair and replacement of common elements.

Why Perform a Reserve Study?

The basic premise upon which all Common Interest Realty Associations (CIRA) are founded is that they have the responsibility for maintaining common property as defined in their declaration and covenants. Maintaining and preserving the common property is the primary duty of the CIRA and its governing Board of Directors. The Board of Directors has the fiduciary responsibility to ensure that the property is adequately maintained, and that a plan is in place to accumulate funds for future expenditures. Without a reserve study, the association could be over-funding, in which case the owners of today would be paying more than their share of the common elements. On the contrary, if not enough money is being collected, then eventually this would result in deferred maintenance and/ or the requirement that reserve studies be performed. The American Institute of Certified Public Accountants (AICPA) Audit Guidelines identifies the following advantages to accumulating funds in advance through periodic assessments:

- Funds are available to make repairs and replacements when needed, thus helping to avoid the dreaded special assessment.
- The current and future owners equally share in the repair and replacement costs. In other words, the owners are paying for the use of the common elements during their tenure.
- The market value of units or shares is preserved.

Conversely, the lack of reserves or inadequate funding for major future repairs or replacements has significant disadvantages such as:

- It may adversely affect the ability of unit owners to sell because of concerns that a prospective buyer may have.
- It may adversely affect the unit owner's ability to refinance because of federal or quasi-federal lending restrictions.
- It may require the board to levy special assessments to fund needed repairs or replacements.

What are the Legal Requirements for Reserves?

The Florida statutes 718.112(f)(2) states: "In addition to operating expenses, the budget shall include reserve accounts for capital expenditures and deferred maintenance. These accounts shall include, but are not limited to, roof replacement, building painting, and pavement resurfacing, regardless of the amount of deferred maintenance expense or replacement cost, and for any other item for which the deferred maintenance expense or replacement cost exceeds \$10,000. The amount to be reserved shall be computed by means of a formula which is based upon estimated remaining useful life and estimated replacement cost or deferred maintenance expense of each reserve item. The association may adjust replacement reserve assessments annually to take into account any changes in estimates or extension of the useful life of a reserve item caused by deferred maintenance. This subsection does not apply to an adopted budget in which the members of an association have determined, by a majority vote at a duly called meeting of the association, to provide no reserves or less reserves than required by this subsection. However, prior to turnover of control of an association by a developer pursuant to s. 718.301, the developer may vote to waive the reserves or reduce the funding of reserves for the first 2 fiscal years of the association's operation, beginning with the fiscal year in which the initial declaration is recorded, after which time reserves may be waived or reduced only upon the vote of a majority of all non-developer voting interests voting in person or by limited proxy at a duly called meeting of the association. If a meeting of the unit owners has been called to determine whether to waive or reduce the funding of reserves, and no such result is achieved or a quorum is not attained, the reserves as included in the budget shall go into effect. After the turnover, the developer may vote its voting interest to waive or reduce the funding of reserves."

What should be considered to determine Reserves?

The reserves shall be computed by means of a formula which is based upon:

- Estimated repair and replacement cost of the common elements
- Estimated useful life
- Deferred maintenance expenses

Since building inspection engineers have a vast amount of experience and knowledge of how building systems and components wear with time, many Boards of Directors choose to contract with a building inspection engineering firm.

Are there Standards for Reserve Studies?

Yes. The Community Associations Institute publishes the National Reserve Study Standards, which lists the following minimum content to be included in a Reserve Study:

- A summary of the association's number of units, physical description, and reserve fund financial condition.
- A project of reserve fund starting balance, recommended reserve contributions, projected reserve expenses, and projected ending reserve fund balance for a minimum of 20 years.
- A tabular listing of the component inventory, component quantity or identifying descriptions; useful life; remaining useful life; and current repair or replacement cost of each element.
- A description of the methods and objectives utilized in computation of 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 is prepared.
- The fiscal year for which the reserve study is prepared.

What is involved in a Reserve Study?

1. Field Assessment

The Field Assessment involves a general visual inspection to inventory the common elements (i.e. quantify and identify materials) and assess their present condition (i.e. useful life, remaining useful life, and observed deficiencies).

2. Reserve Analysis

The Reserve Analysis determines a recommended funding plan based on a schedule of future repair or replacement costs of each common element.

How often should a Reserve Study be performed?

The annual contributions made to the reserve fund are a means for an association to compensate for the difference between the ongoing deterioration of a property and its finances. Since elements deteriorate at varying rates and the finances of the association are typically changed early, the need to maintain this balance between the two is an ongoing process. In order to maintain this balance, it may be appropriate for the association to have the reserve study updated.

When considering an update to a study, the association should bear in mind and answer the following questions:

- Has there been a significant departure (i.e. 2% to 3%) from the anticipated rates for interest, inflation, and construction cost increases previously assumed?
- Have any major elements been added or replaced since the previous study?
- Have any elements sustained premature deterioration due to unseasonable weather or lack of maintenance since the previous study?
- Has the association accelerated or deferred any repairs or replacements from the estimated schedule previously generated?

If the answer is "yes" to one or more of the above questions, then the association should strongly consider having an update to their previous reserve study.

Generally, an association that is relatively new in age and is not performing any major repairs or replacements should have the reserve study updated approximately every 3 years to maintain the validity of the estimates. However, if the association is older and is experiencing major repairs or replacements, then the study should be updated on an annual basis.

An update to a previous reserve study can typically be performed for a percentage of the original cost of the study. The re-evaluation can include a field survey of the property, or simply an update to the tables.

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Sarasota - Naples

5100 Tamiami Trail N., Suite 127
Naples, FL 34103

Phone 239.417.4458

Toll-Free 877.557.7100

Fax 239.417.4478

Ft. Lauderdale

Phone 954.577.3779

Headquarters

6497 Parkland Drive, Ste. C
Sarasota, FL 34243

Phone 941.727.2600

Toll-Free 877.557.7100

Fax 941.758.5012

www.delta-engineers.com