

## **Coldspring Community Association Informational Documents**

### **Reserves**

#### **What are reserves?**



Reserves are money which a condominium board collects regularly from owners to pay large, future expenses which result from the deterioration of the condominium project over time - for example, the costs of repairing or replacing the roof or decks. A board which does not assess the owners regularly for reserves must make periodic special assessments for money to pay for those large expenses.

#### **How does CCA know if its reserves are sufficient?**

Is \$1,000 per unit enough? Is \$500 per unit? Every condominium is different and has different expenses and reserve requirements. Therefore, no specific dollar amount can be given for any condominium. Instead, a board must make a reserve study (or analysis) of the project to determine if the association has sufficient reserves. A reserve study requires the board to determine: (i) which parts of the project the association is responsible for (e.g. walls, roof, parking lot); (ii) when they will need replacement, maintenance, or repair; and (iii) how much that will cost.

Example: A board's reserve study indicates that in 10 years the project roof will have to be completely replaced at a cost of \$100,000. At present, the association has no money to do the work. The board must collect at least \$10,000 a year for the next ten years (\$100,000 divided by 10) to ensure that it has a "full" reserve for the roof (i.e. \$100,000 to replace the roof 10 years in the future). NOTE: The board does not have to collect \$100,000 immediately. The board needs to collect only enough to ensure the association has the necessary amount at the end of ten years. For example, if after 5 years the board has collected \$50,000, its roof reserve should be "full" at that point. The roof will still be 5 years from replacement, so the association will still have 5 years to collect the necessary funds. In 1992, the reserves law was amended to permit an association to set aside a "statutory reserve" of at least 50 percent of a full reserve.

The association must also take into account inflation and interest earned when calculating if its reserves are/will be adequate. Predicting either inflation or interest earned for years into the future may be difficult. Therefore, it may be more practical to simply adjust the projections at the end of each budget year.



### Why are CCA reserves necessary?

Why not wait until the repair or replacement is necessary before collecting the money from owners? Fairness. If all condominium owners lived in the same condominium project for life, the owners would eventually pay all the costs of living in the building. However, condominium owners often move and sell their apartments.

Unless they pay their share while they own in the project, the costs of ownership will be unfairly divided. Therefore, the reserves law requires that owners pay for deterioration of their condominium project every year, on a pay-as-you-go basis.

Example: An association of 50 owners learns that it will need \$100,000 to replace its project roof 10 years in the future. The association has no money now. Instead of collecting \$10,000 a year (as in the example above) for 10 years, the association decides to wait 10 years and collect the money by a special assessment of \$100,000. One of the 50 owners sells her apartment after 9 years and a new owner moves in. One year later, the board is forced to specially assess all owners \$2,000 each (\$100,000 divided by 50) for a new roof because the old one is worn out. Thus, the new owner, who had the use of the old roof for only 1 year, pays for 10 years worth of use (and deterioration). The previous owner, who had the use of the old roof for 9 years pays NOTHING. Under the reserves law, the new owner would pay for only 1 year of use; the previous owner would pay for 9 years of use - a fairer result.

Financial Hardship. Many people who buy a condominium can afford to pay their mortgage and monthly maintenance fees but not large special assessments. Some people could even lose their homes if assessments are too large. The reserves law reduces that risk by reducing the need for large special assessments. Instead, the law requires the association to collect the cost of major repairs and replacements as part of the monthly fee.

Mortgage Requirements. Most people who buy condominium apartments need a loan. Many of those people may not be able to obtain loans unless the unit they plan to buy is in a condominium project with sufficient reserves. The apartment and the project act as the security for the loan. Lenders have come to realize that sufficient reserves increase the value of an apartment and a project and demonstrate the owners' commitment to the efficient operation of the project.

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Owners in condominiums without sufficient reserves may find they cannot sell their apartments. If they can sell, the sales price may be less than it should be because fewer lenders are willing to make loans on the apartments.

**Insurance Requirements.** Insurance companies also realize the importance of reserves to the efficient operation of a condominium. Lack of sufficient reserves can indicate other problems, such as poor maintenance, which, in turn, causes increased hazards and claims.

**Audit Requirements.** New audit guidelines require an auditor to include information about reserves in the audit report.

**Businesslike Operation.** A large condominium is a business and should be run like one. It should not stagger from crisis to crisis. In the past, some boards would adopt budgets and then ignore them. Other boards would learn of the need for reserves but fail to collect them, knowing or hoping they would not be around when the reserves were required. A reserve study allows the board to plan - to anticipate problems and expenses rather than simply react to them. A reserve study also provides continuity for new board members.

### **Won't this reserves law increase the cost of living in a condominium?**

No. The reserves law requires the association to collect short-term AND long-term costs from owners on a regular basis. As a result, some owners may now pay more on a monthly basis but will pay the same overall, because large special assessments should no longer be necessary. Regularly collecting the total cost of operating a project should not change its overall cost of operation.

