

# THE COMMUNITY BUILDER

## Reserves... Attractive to Buyers and Lenders

Experience has told us that what you don't fix today will still break tomorrow. In some associations, past boards have deferred the funding for necessary capital repairs or replacements and have kept the maintenance fees artificially low. But sure enough, something big will break - like gate components, pool equipment or the buildings will need new roofs or require painting to maintain their value for owners or new buyers. Suddenly all that deferred maintenance needs to be done now, and everyone is complaining. The unfortunate part of this is that with deferred maintenance also comes deferred maintenance fee increases, so not only is the community stuck with broken buildings and equipment, they are now stuck with an increase in assessments and most likely a special assessment to make up for the past error of underfunding reserves. It is not what one would call an attractive investment, for either the owners or for lenders.

During difficult economic times, owners will appreciate a well-funded reserve that pays for these unexpected (but anticipated) expenses, thus avoiding the dreaded special assessment. A special assessment when used to make capital improvements (such as re-landscaping an entrance or refurbishing a clubhouse or lobby) is generally viewed as appropriate. However, a special assessment to do what reserves should have done is generally viewed as a problem, especially by lenders or new buyers. In fact, Fannie Mae and FHA are honing in on condominium loans in particular, addressing reserve funds in their loan requirements. FHNMA requires at least 10% of the annual condo budget be allocated to funding reserve accounts and that there be "adequate funds" budgeted for an insurance deductible. FHA requires that a current reserve study must be performed to ensure that adequate funds are available for the funding of capital expenditures and maintenance.

The first step in prudent planning for eventual replacement of major components should be a Reserve Study from a professional company specializing in reserve studies. While many of the studies will be an exercise in over-evaluating what will require eventual replacement, the major components will be the Board's main focus. The study is based on the condition of your property at the time the study is performed. A current reserve study is important to your community's budget.



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With budget preparation time here, or just around the corner, your community association manager and/or treasurer will begin to prepare and analyze the data in your operating and reserve accounts. A current reserve study is important and in many states, required by law. Most importantly, a current reserve study reflects the current cost and an owner's current rate of contribution to the fund. Board members should support a policy that requires accurate, professional studies. Board members should be cautious when recommending changes to a professional reserve study. Changing the replacement life or replacement cost detailed in the study will most likely create funding problems in the future. Relying on an expert's opinion is defensible, ignoring it may not be.

A well-funded reserve fund also provides lenders with more confidence when loaning to a buyer, another plus during a period when obtaining a home loan has become more difficult. Lenders appreciate that there will most likely be no special assessments to cover common replacement costs or to pay the insurance deductible in the wake of a natural disaster. They are more confident that their lending decision is based on actual costs with a small chance of their buyer depleting their cash or over-extending their credit lines.

The current contribution rate that each owner pays into the reserves is their "fair share" of the cost to replace the assets of the community from which they benefit today - similar to a user fee. And tomorrow, when the roof is in good shape and the buildings are in good repair, a buyer is more likely to look with favor on purchasing a home in your community, which in turn improves your resale value and attracts more buyers.