



Deferred Maintenance & Reserve Funding: Are Your Buildings Aging Gracefully

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Deferred Maintenance & Reserve Funding: Are Your Buildings Aging Gracefully

- I. What is a reserve study?
- II. Statutory treatment of reserve studies
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- VI. Difference between repairs and capital expense
- VII. Financing of repairs/maintenance
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WHAT IS A RESERVE STUDY?

A physical review of the association's common elements or common areas, and the associations financials by a professional designed to provide the association with an understanding of the costs and expenses associated with the eventual replacement of those portions of the property.

A financial tool used to assist in determining reserve funding.



STATUTORY TREATMENT OF RESERVE STUDIES

Illinois Condominium Property Act

- Section 9 (c) (2)
- Section 19 (a) (10) – Document Inspection – reserve study

Common Interest Community Association Act

- Section 1-30
(i)(1)(viii) Document Inspection – reserve study

OBLIGATION TO FUND RESERVES

CONDO ACT

All budgets adopted by a board of managers on or after July 1, 1990 shall provide for reasonable reserves for capital expenditures and deferred maintenance for repair or replacement of the common elements. To determine the amount of reserves appropriate for an association, the board of managers shall take into consideration the following:

- (i) the repair and replacement cost, and the estimated useful life, of the property which the association is obligated to maintain, including but not limited to structural and mechanical components, surfaces of the buildings and common elements, and energy systems and equipment;
- (ii) the current and anticipated return on investment of association funds;
- (iii) any independent professional reserve study which the association may obtain;
- (iv) the financial impact on unit owners, and the market value of the condominium units, of any assessment increase needed to fund reserves; and
- (v) the ability of the association to obtain financing or refinancing.

OBLIGATION TO FUND RESERVES

- Review the Association's Governing Documents
- Many non-condominium properties require reserve funding in declaration or bylaws

CONNECTION BETWEEN RESERVE STUDIES AND RESERVE FUNDING

- Step one to any reserve study is identifying the components of the property
 - Step two is identifying the life expectancy or cycle of the component
 - Step three is identifying the amount of funds in the association's reserve accounts
 - Step four is creating a schedule of the anticipated cost of replacement of the component, with inflation
 - Step five is setting reserve funding schedule consistent with the replacement schedule
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- The intention is that the reserve account is a forced saving account so the association will always have necessary funds in its accounts to pay for maintenance, repair or replacement of components of the property.
 - If executed properly and correctly the association should have no need to either specially assess or borrow funds.

FIDUCIARY OBLIGATIONS

- All board members are charged with the duties of a fiduciary, which are the same as what is charged to a trustee
- It is the highest duty imposed by law and it involves exercising rights on behalf of others
- Fiduciary obligation includes several components: i) the duty of attention, ii) duty of loyalty, iii) duty of obedience, and iv) duty of care
- Duty of due care requires that board members perform their duties in good faith, and in the best interests of the association
- Duty of obedience requires board members to perform their responsibilities in accordance with the law and the association's documents
- Failing to follow statutory requirements, association declaration/bylaw requirements or the recommendations of a reserve study could be a breach of the duty of due care and/or obedience
- Keeping assessments low, while often an admirable platform, cannot be the sole focus of a board
- If, by keeping assessments low, the association either doesn't have enough money to meet ongoing obligations or it must specially assess or obtain financing in order to address capital concerns, that board has likely breached its fiduciary obligation to the association and its members

DIFFERENCE BETWEEN REPAIRS AND CAPITAL EXPENSE

REPAIR:

- modification to keep running efficiently
- restoring to prior condition
- protecting component through routine maintenance

CAPITAL EXPENSE

- extends the useful life of the component
- fixes a defect in the component
- rebuilds the component after its useful life
- replaces the component after its useful life
- adds a new component to the property

FINANCING OF REPAIRS/MAINTENANCE

What happens when an association has not properly reserved for repairs and replacements?

Choice – 1 *“Do nothing and hope to get additional years of life.”*

Choice -2 *Specially Assess*

- Condominium Property Act (Sections 18 and 18.4)
- Common Interest Community Association Act
- Limitations/Requirements with the Association’s Governing Documents
- Disclosures to new buyers

Choice 3 – *Borrow Funds*

- Bank Loan
- Repayments
- Disclosures
- Authority under documents and Acts to borrow funds

ANTICIPATED LEGISLATIVE CHANGES

Community Association Institute has adopted the following Public Policy regarding reserve funding:

CAI supports legislation which mandates reserve funding for community associations, including condominiums, housing cooperatives, and planned communities with major shared components in buildings containing dwellings. Include practical legislative process for community associations to comply with funding requirements. CAI understands the need for communities to maintain a certain amount of money in reserve funds but that it may not be feasible for some communities to immediately procure those funds. Therefore, CAI supports and recommends mandates for community associations to comply with any funding requirements resulting from a reserve study legislation, while still allowing communities to slowly catch up to that amount.

ANTICIPATED LEGISLATIVE CHANGES

States throughout the country have proposed following legislation:

- Requires a reserve study and mandates reserve funding consistent with study
- Establishes task forces or work groups to study laws requiring structural integrity studies, reserve funding and maintenance, repair and replacement of capital components
- Provides tax incentives to associations who perform safety and façade inspections

ANTICIPATED LEGISLATIVE CHANGES

Florida 2022 Legislation

- Requires condominium associations and cooperative associations to complete a structural integrity reserve study every 10 years for each building in an association that is three stories or higher in height.
- Requires associations existing on or before July 1, 2022, that are controlled by non-developer unit owners to have a structural integrity reserve study completed by December 31, 2024.
- Defines “structural integrity reserve study” as a study of the reserve funds required for future major repairs and replacement of the common elements based on a visual inspection of the common elements.
- Requires the study to include a visual inspection, state the estimated remaining useful life, and the estimated replacement cost of the roof, load bearing walls or other primary structural members, floor, foundation, fireproofing and fire protection systems, plumbing, and any item with a deferred maintenance or replacement cost that exceeds \$10,000.
- Requires the visual inspection to be performed by a person licensed as an engineer or an architect. However, any qualified person or entity may perform the other components of a structural integrity reserve study.
- Requires a developer to have a structural integrity reserve study completed for each building in the association that is three stories or more in height before turning over control of an association to the non-developer unit owners.
- Provides that it is a breach of a board member or officer’s fiduciary duty if an association fails to complete a structural integrity reserve study.
- Requires that a phase one milestone inspection must commence within 180 days after an association receives a written notice from the local enforcement agency.
- Requires a phase two milestone inspection if there is evidence of “substantial structural deterioration” as determined by a phase one inspection.
- Specifies the minimum contents of a milestone inspection report.
- Requires inspection report results to be provided to local building officials and the associations, and requires an inspector-prepared summary to be provided to unit owners by mail and by email to unit owners who have consented to receive notices by email.
- Requires that the contract between an association that is subject to the milestone inspection requirement and a community association manager (CAM) or CAM firm must require compliance with those requirements as directed by the board.