

# CONDO CONSTRUCTION AND RENOVATION REVIEW

## Capital Reserves

Planning for Peace of Mind

By John Reddy

*Over 20 years of  
Capital Reserve  
Studies,  
Construction Project  
Management  
and  
Administration  
Experience*

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Capital Reserves are funds set aside for the future repair, renovation or replacement of major common area items. Capital Reserves are the insurance of a secure future as they provide the assurance that when the time comes to undertake a major replacement, repair or renovation, the funding will be in place negating the need for any special assessment.

### RESPONIBILITIES OF GOVERNING BOARDS

The governing board of a condominium or community association has the responsibility to act in the best interests of the association. The governing documents of most associations clearly define the authority and responsibility of the board in the by-laws of the association. In many documents, the powers and duties of the board are enumerated and cover almost any given situation. Every board member should carefully read these provisions to better understand the expectations of the position.

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#### Overview

*“ . . .a condominium association . . . is responsible to operate the association for the benefit of the owners. ”*

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#### THE CONCEPT OF TRUST

In Massachusetts, some Condominium Associations are called Condominium Trusts. In practice, all community associations are trusts. They are organized for the benefit of the individual owners. Regardless of what they may be called, all directors of a condominium association are trustees in deed if not in name. They are responsible to operate the association for the benefit of the owners.



#### PRESERVATION OF PROPERTY/PROPERTY VALUES

The trustees are responsible for the preservation of the property. That responsibility takes precedence over any other interests. The trustees have an obligation to raise adequate revenue to insure the proper operation and preservation of the property. As difficult as it may be, consideration of whether some owners may not be able to afford the cost can not be taken into account. Allowing the property to decline in value to placate some unit owners is not fair to the remaining unit owners.

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#### Fiduciary Duties

*“ If a special assessment is needed for repairs or replacements of major items, it usually means that the board of directors has, in the past, failed in its fiduciary duties. ”*

#### FIDUCIARY DUTIES

Preservation of the property includes the proper funding of the property to insure that funds are available for current operations and future needs.

This includes maintaining an adequate reserve fund. If a special assessment is needed for repairs or replacements of major items, it usually means that the board of directors has, in the past, failed in its fiduciary duties.



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#### FAIR SHARE FUNDING

Fair share funding is the same as pay-as-you-go. It means that each owner should be contributing his fair share to the capital reserve fund annually. If an owner buys into a condominium in its 10th year and finds that he has to immediately pay into a special assessment to replace a roof that has never been properly funded, the fair share concept has failed. The previous owner has obviously not been assessed annually for his share of the replacement cost.

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#### Capital Reserve Analysis

*“ The amount to be funded should be based on solid, factual information rather than selecting some percentage of the budget or other random number. ”*

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#### PRIORITY OF RESERVES

In the preparation of each annual budget, capital reserves must be included. Most governing documents authorize or even obligate the trustees to provide a capital reserve fund. The amount to be funded should be based on solid, factual information rather than selecting some percentage of the budget or other random number.

#### CALCULATING RESERVE REQUIREMENTS

In order for a reserve fund to have a realistic basis, an association must know what physical assets it owns, a list of physical assets must be compiled and the quantity of each individual asset must be determined. For example, to plan for roof replacement, the type and amount of all roofing must be known.

This information is obtained by conducting a capital reserve analysis.

#### The analysis consist of three parts:

- ◆ A listing of all of the major capital assets of the association including type and quantity.
- ◆ A determination of the cost of repair, renovation or replacement of each asset.
- ◆ An estimate of the remaining life of each of the items listed in the capital reserve schedule based on present condition and other factors.

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#### Value of the Reserve Professional

*“To the untrained eye, a flat membrane roof may appear to be in good condition where it actually has serious defects.... For this reason it is in the best interest of the association to engage the services of a reserve professional.”*

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The first two items are relatively easy to compile. Physical measurements and descriptions can determine quantities. Diligent research can provide an accurate estimate of replacement costs. The third item, the evaluation of the condition of a reserve item, and an estimate of its remaining useful life requires significant experience and knowledge. To the untrained eye, a flat membrane roof may appear to be in good condition where it actually has serious defects which will considerably shorten its useful life. For this reason, it is in the best interest of the association to engage the services of a reserve professional.

After all of the measurements, calculations and estimates are completed, there are a few more steps to determine the bottom line number, that is the amount that should be put into the capital reserve fund each year. Consideration has to be given both to inflation and to previously accumulated funds. Each of these can be handled in various ways in the best judgment of the reserve professional.

**ADDITIONAL TOPICS** Other items to be considered include:

- ◆ Saving and investing capital reserve funds
  - ◆ Tax treatment of funds and interest
  - ◆ Spending reserve funds
- It can be more complicated that it seems. Proper and timely maintenance to insure longevity of reserve items. All of these issues should be addressed in a professionally prepared capital reserve analysis.

**John Reddy is President of Continental Building Consultants.**