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You Must Fund Your Re$erves 7 Rea$ons Why

by Richard Tippett

Funding the increasingly common major maintenance projects such as walkway or balcony replacement, repaving or replacing waterlines (to name some typical ones) is becoming more and more important. Again and again, associations are learning that deliberately keeping maintenance and reserve assessments low was a mistake. The result is a lack of ready money when the association is faced with the need to rebuild.

Here are several solid reasons to increase assessments now before the inevitable happens.

1. Fiduciary Responsibility

Attorneys are better at explaining this little subtlety, but in everyday language it is roughly this. When you bought your unit, you accepted the responsibility for providing a portion of the funds necessary to preserve and protect the value of all parts of the association property held in common, or the common areas, just as did your fellow owners.

These areas generally include roofs, walls, paving, water lines and landscaping; it may also include pools, decks, balconies, plazas, walkways, fountains, tennis courts and only God knows what else.

All of it needs to be regularly inspected, mowed, washed, cleaned, sealed, painted, replaced, repaired and otherwise be kept in serviceable condition for the good of every member. If these components parts are not regularly cared for on a preplanned schedule, they will and do deteriorate. The more that each component deteriorates, the more costly it is to restore it to serviceable or "like new" condition.

Part of fiduciary responsibility is not to waste other people's money or assets. Failure to properly fund and then spend money on regular maintenance wastes those assets and is therefore irresponsible.

Recently enacted legislation requires that all new associations receive a complete maintenance manual detailing all of the types of inspections and repairs required for regular maintenance. If the association neglects the maintenance spelled out by the builder/developer in the manual, this neglect can absolve the builder/developer from responsibility for leaks or deterioration of those areas that weren't maintained.

Say, for example, you have a leak at a wall that causes interior damage (perhaps mold growth). You file a claim with your insurance carrier to repair the problem. If your carrier determines that the leak (and damage) was due to a failure to do maintenance in the form of painting and caulking on a proper schedule, they can deny the claim.

The reality is that most owners forget that they have a mutual responsibility. Most boards don't want to antagonize owners by raising assessments. This leads to all kinds of problems that are easily avoided by facing the responsibility head-on.

2. The Tipping Point

There is a point where deferred maintenance and postponed painting begins to detract from the appearance of the complex. At this point the increase in value of your units slows and may even begin to depreciate. The units become harder and harder to sell for what owners believe they are worth. Rather than sell for less than they want, owners move elsewhere to places that better meet their desires, and their units often become rentals.

Rent from units becomes income for the owners of the units that allows them to live elsewhere, possibly even to retire. As a result, these absentee owners become reluctant to reduce their income stream by spending money on maintenance, thus resulting in higher assessments.

As the number of rentals increases, it is more and more difficult to get owners to agree to increased maintenance and reserve assessments.

Once several units become rentals, the trend tends to accelerate: more and more units become absentee-owned. When the number of rentals reaches 40 percent, banks become reluctant to provide new buyers with conventional mortgages. This lack of mortgage money dries up sales, depreciates the property value and further increases the trend towards rental.

At this point, only very assertive action by the remaining resident owners and the board of directors will ensure that money is made available to keep the property up.

3. Maintaining Is Cheaper Than Replacing

Maintenance can't be avoided. It can only be deferred. If you don't change the oil in your auto, the engine will quickly wear out. The same is true for every component of your complex.

It costs $0.07 per square foot to slurry seal a driveway every four years. If the slurry seal work isn't done, it will cost your association $2.00–3.00 per square foot to replace that same driveway when it wears out after fifteen years. That replacement cost is ten times the cost of simple maintenance.

Similarly, it costs $1.00 per square foot to re-caulk and repaint a plywood or pressed wood wall every four or five years, or $7.00 to replace that same square foot of wall if it is only painted every ten years. Here the replacement cost after 20 years is twice the cost just to keep things looking nice.

Gutters can be kept clean at a yearly cost of $.50 per linear foot or can be replaced every 10 to 12 years at a cost of $8.00 per linear foot.

Roofs and flashings can be repaired and kept clean at an average cost of $0.05 square foot/year or can be replaced after 15 to 25 years a at cost of over $3.00/square foot—three times the cost of simple maintenance.

Decks and balconies can be kept clean, potted plants kept on stands and coated decks can be regularly recoated at nominal cost; or the decks can be rebuilt regularly every twelve years at costs of up to $60 per square foot, or $5,000 per deck or balcony.

The cost of maintenance deferred is far greater than the interest accrued on money not spent. If adequate amounts of money are not placed in reserve and used to maintain the property, the work will cost still more when interest has to be paid yearly to the bank that may have to eventually fund it.

4. It Takes Money to Borrow Money

Let's say that your association has a need to do roughly $800,000 worth of balcony repairs, siding repairs, rotted wood replacement and painting (a fairly average occurrence). Let's also say that the need for rotted wood replacement and balcony repairs only became known when your association asked for bids for repainting and one of the painting contractors pointed out the problem. Let's say further that your association's reserves for painting and wood replacement are only about $150,000.

This creates a budget short fall of, apparently, $650,000. We say apparently, because 20+ years experience tells us that if the cost to correct the visible problems is estimated at $800,000, the cost to correct the damage concealed behind the visible problems will be at least 30 percent more. Add to those costs the cost of a bank loan (roughly 10 percent interest per year), management company and legal costs and, if you're prudent, the fees of a construction manager to control job costs and quality, and what appeared to be an $800,000 problem turns out in reality to be a problem that will probably cost your association closer to $1,200,000 to correct.

Suddenly that $150,000 in reserves isn't even adequate to attract lender attention. Most banks want to see a commitment on an association's part of at least 20 percent of the proven cost (based on contractor bids) of the work to be done. Your association, for working purposes, needs to have roughly $250,000 in hand before seeking a loan.

Where will your association get the additional $100,000 to start the process?

5. The One Percent Rule

Private homeowners know that their residences also need regular maintenance and repair. Individual houses need to painted inside and out, driveways coated, roofs replaced, gutters cleaned, waterlines re-piped, decks repaired, walkways leveled, trees pruned, the occasional trim board replaced and caulked, carpets replaced, worn out sliding glass doors replaced, damage from any leaks repaired, worn out lighting upgraded, walkways rebuilt, tile replaced, termites dealt with, and on and on and on.

All individual homeowners quickly learn what generations before them also learned and that financial talk show hosts are fond of reciting; each year it costs roughly one percent of the value of the home to maintain it and keep it looking good.

This one percent maintenance cost is on top of the cost of operating the home; paying for garbage, telephone, electricity, water, lawn mowing, drain cleaning, and so forth. The full one percent isn't spent every year. Some years, nothing is spent. Other years, major work or painting may be required.

Condominium and planned development associations should annually be reserving roughly half that amount for common area maintenance and repairs: 0.5 percent of the value of the property. You won't spend it every year or even every other year, but when it is needed, it has to be there. Fiduciary responsibility requires it.

Clearly, a condominium in a high-rise building in San Francisco will have reserve needs very different from a condominium unit in a wooden triplex in the same city. Likewise, condominiums with stucco walls will have different maintenance needs from units with pressed wood siding. Beachfront units will have different needs from units in Sacramento.

Still, a half per cent of the value of the unit, particularly if the units are 15 to 25 years old or older, is a good number to use to begin to weigh the adequacy of your present assessment.

6. You Can't Cover Up the Problem and Avoid Spending Money Forever

Water-damaged decking and siding doesn't go away; it just keeps letting water get through to the framing, which in a short time also becomes water damaged.

Putting new caulking over old doesn't stop the leakage. As the old caulking and old paint age and become brittle and shrink, they pull the newer caulking away from the wood and the leak reopens. Painting over deteriorated wood and caulking only colors the problem. Paint is not waterproofing. It will not stop water from entering joints between boards, or splits in plywood siding veneer, or the joints between wood and windows, or between wood and stucco.

If 30+ years in construction have taught us anything, it is this:

- Temporary repairs are only temporary.
- The second temporary repair of a problem never lasts as long as the first temporary repair.
- Poor quality work costs less than good quality work.
- There are always two or more ways to do a project correctly, and all the correct ways cost approximately the same.
- If you keep making temporary repairs, you will spend more to fix the problem than if you had fixed it correctly when it was first discovered.

7. Community Membership

Associations are communities. Most are fairly close-knit groups where residents are more than just neighbors, if less than close friends. The ambience is similar to that of a small village. The problems that each association faces are also similar to those faced by villages and other small communities.

When you bought your units, you agreed to accept a share of responsibility for the operation and maintenance of the whole complex. This agreement is enforceable in court.

We know of an owner in one complex who repeatedly sued his association over maintenance assessments. He lost every suit. The work he didn't want to pay for had to be done. Not only did he have to pay his own legal fees; he had to pay his pro rata share of the association's cost of defending against his repeated claims.

If you don't want to be part of a community, what was your reason for buying into one?

More than once we've heard "I don't care about the maintenance. In ten years I won't be here." Here's a news flash—if you don't maintain the complex as a whole, in a very few years you won't be able to sell your unit for what it is really worth! Here's another; if you don't maintain the complex as a whole, you deprive your friends and neighbors as well as yourself.

Do you really want to be forced into doing what is right and necessary? Is that really the legacy you want to leave?

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