



# Four Mistakes to Avoid When Budgeting Reserves

by Matthew C. Kuisle, P.E., RS, PRA

**A**ccording to the *Oxford Dictionary of Proverbs*, the oldest written version of the saying “what you don’t know can’t hurt you” comes from 1576, in *Petit Palace* by G. Pettie. “So long as I know it not, it hurteth me not.” In present day terms, this statement is synonymous with ignorance. Unfortunately, what association boards don’t know can hurt them. As you begin to review the reserve portion of the budget this fall, here are four common mistakes to avoid:

## **Unrealistic Replacement Cost and/or Useful Life Estimates**

After spending hours, days, or weeks working on the operations portion of the budget, don’t get lazy when it comes to the last, but sometimes most important section, the reserve analysis. Too often, budget estimators simply subtract one year off the life of each reserve component and manipulate the existing cost estimate to fit their “gut feel” for changes in material and labor costs from the year before. However, what they fail to acknowledge is that the previous year’s estimates may not have been accurate to start with. Many associations are surprised when they take on a replacement project, only to find that the cost is significantly higher than shown on their reserve schedule. Similarly, when a project like roofing becomes

necessary after 20 years, the board is caught completely off guard because the reserve schedule indicated the roof should last 30 years!

When these boards look back, it becomes evident that the association's reliance on unrealistic estimates put them in this difficult situation. Now they are obligated to pass a special assessment, go to the bank for a loan, or even worse, defer replacement of a critical common element because funds are not available. Do not rely on the developer's estimates of replacement cost and useful life. Do not rely on estimates from previous budgets, unless there is good reason to have faith in those estimates. Remember, contractors and developers can be biased, so be sure to corroborate their estimates with independent opinions. Also, developers can use replacement costs that are unrealistically low because they often receive costs that only contractors can get, but an independent board cannot. Additionally, some replacement costs can vary over often short periods of time. Examples include asphalt shingle roofs and asphalt pavement. The replacement cost of these oil-based products can fluctuate greatly, similar to the roller-coaster retail gasoline prices.

Replacement cost and life estimates should be reviewed on an annual basis to ensure accuracy. A key point to remember is that the more years that pass, the less reliable your cost and life estimates are for future projections and budgeting. Relying on estimates that are more than two or three years old can lead to shaky ground on which to plan for the future.

Associations should seek customized information for their association's common elements. Your community may spend more on higher quality materials in order to achieve a longer useful life. Conversely, you might experience a shorter useful life of some components due to heavy use or extreme exposure to salt, air, or the harsh Florida environment. There is no one-size-fits-all approach for reserve estimates—they must be tailored and realistic to your association.

#### **Omitting Major Common Elements or Restoration Projects**

Too many associations fail to plan for major replacement projects by excluding them from their reserve analysis. The following major reserve components are frequently missing from reserve schedules:

- Concrete Restoration
- Elevator Modernization
- Fire Alarm System
- Plumbing Replacements or Relining
- Electrical System Upgrades
- Drainage System Repairs
- Balcony Railings

Whether left off the list intentionally or simply overlooked, a failure to plan for these items is misleading to the owners and undermines the board's efforts to maintain the physical and financial health of the association. Prudent associations enlist the help of experts to ensure there are no major components missing from their reserve schedules.

**Inadequate budget disclosures**—reserve analysis disclosure requirements vary depending on the type of association and your individual governing documents. At a minimum, it is a best practice to list the following data items in the reserve analysis portion of your budget:

- Common Element Name
- Estimated Replacement Cost (in today's dollars)
- Estimated Useful and Remaining Useful Life
- Projected Reserve Balance at the Beginning of the Budget Cycle
- Required Annual Funding

Associations should consult an accountant familiar with community associations to ensure compliance with disclosure requirements.

**Not obtaining necessary votes to "pool" or move reserve funds**—this applies to all condominium associations and homeowner associations that have "restricted" reserve items or categories. Florida statute 718.112(2)(f)3. states:

*Reserve funds and any interest accruing thereon shall remain in the reserve account or accounts, and shall be used only for authorized reserve expenditures unless their use for other purposes is approved in advance by a majority vote at a duly called meeting of the association.*

Even though the Florida Administrative Code and Statutes allow pooling of the reserve items, a majority vote must be obtained before moving any existing reserve funds into a pooled reserve or other account.

Inadequate use of the reserve funds can and has resulted in large fines and landed many associations and boards in hot water. Oftentimes, the board is stuck needing to "borrow from Peter to pay Paul" because of inadequate planning in the first place. Pooling the reserves allows adequate funding, typically at a lower assessment level. However, boards cannot move any existing funds into a pooled reserve until they get the approval of the owners.

Don't be left in the dark ages this budget season; remember, what you don't know can hurt you!

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