Services

Why do Them?

Reserve Studies and Why We Do Them

Peter B. Miller, Arch., RS

I am still asked by community managers to help them explain, both to their association Boards of Directors and community members, why they should do a Reserve Study or why they should fund their Reserves. While the question seems simple, the reasons and motivations vary slightly depending on whether you are a manager, a Board Member, or a community resident. So in order to discuss these motivations, let’s first look at the basic reason why Reserves exist in the first place.

Protect and Enhance The basic, bottom line, cut-to-the-chase principal here is this: Adequately funding the Reserves protects and enhances the physical assets in the community. It also protects and enhances the investment that each owner has made in buying property in the community. It does this by making sure that funds are available to replace worn out components on a timely basis while avoiding the need for special assessments.

There are a number of other basic and equally important principals that also apply:

Fairness The most fair and equitable means to fund the Reserves is by making sure that everyone is contributing their fair share over the period that they benefit from these commonly-owned assets. “Everyone who lives under this roof pays their fair share towards the replacement of the roof." Without doing a Reserve Study, it is impossible to determine what that "fair share" should be.

Sound Financial Planning As a practical matter, the funding for the eventual replacement of the commonly-owned components should be included in the annual budget. If it is not, then a large and vital part of the community's annual budget is not being addressed. If the Reserve funding is not properly planned, then special assessments will likely be necessary when the funding is eventually needed. This holds the same importance for newer communities as it does for older communities.

Fiduciary Duty Members of the association's Board of Directors have the same fiduciary responsibility to their "stockholders" (association members) as does any corporate Director. As such, there exists a fiduciary duty to operate the corporation using sound business judgment. As a "not-for-profit" corporation, community association Board members are held to the same standard of duty by which any other corporate director is measured, i.e., "did the Directors exercise their duties in the manner consistent with the judgment of a prudent business person?" When considering Reserve funding, ignoring a large and important part of the association's annual budget will not meet the standard of judgment applied here, and therefore Board Members could be held liable for their failure to act as a Breach of Fiduciary Duty.

Contractual Duty Community managers likewise have a contractual responsibility to advise and assist their association clients in managing their communities' affairs. Annual budgets and sound financial planning represent an important aspect of this responsibility. Therefore, if a manager is not emphasizing to their Boards the importance of adequately funding their Reserves, then the question can be raised regarding whether they are fulfilling their contractual responsibility. In fact, several lawsuits have already arisen from this issue of Breach of Contractual Responsibility.

Statutory Duty A growing number of states have passed legislation requiring community associations to do Reserve Studies. These include the Commonwealth of Virginia, whose statutes require reserve studies to be done not less frequently than every five years. The States of Ohio, Illinois, California, Florida, Hawaii, Nevada, and others have similar legislation. And since community associations are now the "development model" preferred by most municipalities, we are sure to see more states develop legislation addressing the issue of Reserve Funding.

In conducting seminars on the topic of Reserves and Reserve Studies around the country, my experience has been that the vast majority of the audience members understand and agree with the principals discussed here. When given the logic and responsibility of the association to adequately fund Reserves, it's difficult to ignore the need for Reserves and Reserve Studies. For those few that refuse to grasp the logic, there is always the Greed Principal which states that "if you don't adequately fund the Reserves NOW, then you end up paying more than your fair share when the roof or parking lot or pool deck fails."

For more information on Reserves, refer to the Community Association Institute's GAP Report #24, Reserves and Investing. CAI online archives also contain many articles by assorted authors addressing both technical, legal, financial, and philosophical aspects of Reserve Funding.

About the Author

Peter B. Miller, Architect, RS, is a principal with MILLER DODSON ASSOCIATES, INC., a consulting firm specializing in Capital Reserve Planning and Transition Warranty Inspections for community associations, country clubs and resorts, and religious and educational institutions throughout the U.S. and the Caribbean. A graduate of the College of Architecture and Urban Studies at Virginia Tech, Mr. Miller began his professional experience with community associations in the early 1980′s.

A frequent author and lecturer on the subject of Capital Reserves, Mr. Miller has earned the professional designation of Reserve Specialist (RS). He was the 2004 President of the Washington Metropolitan Chapter of CAI and has also served on the Board of Directors of the South Carolina CAI Chapter. In addition, he recently served as Vice-Chair of the CAI National Reserves Committee, and in that capacity, maintained a chair on the CAI National Ethics and Credentialing Committees. Mr. Miller was the 2002-2003 Recipient of CAI National's "Award for Excellence in Chapter Leadership", and was one of the recipients of the 2004 President's Award for his work on the CAI Governance Taskforce.

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