Funding Reserves - The Story of Jack and Jill

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Jack and Jill bought a nice condo (on a hill). They are both retired, empty-nesters, and they chose to "downsize" from their large family home to a more affordable condominium for which they paid cash from the proceeds of the home's sale. Their new condo is in a ten year old condominium community with a beautiful entrance gate, nice winding private streets, and a clubhouse with a pool and tennis courts.

Jack and Jill were also excited about the fact that the *Association* was responsible for taking care of the outside of their own house - the roof, siding and trim, the driveway and even the deck on the back. "What a relief!!" said Jack as he walked up the hill to his new home. In his last house *he* had to take care of all these things.

While Jack and Jill thought of themselves as savvy buyers, who looked quite a while before they found the location, neighborhood, amenities, and *price* that was right for them, they were not experienced at buying in a condominium. Their last home was in a community with a Homeowner Association, but the community had few amenities. They paid a small quarterly assessment and otherwise, the Association left them pretty much alone.

It turned out that their new Association left them pretty much alone also. One of the nice things about the price of their new home was that the condo fees weren't too high compared to other condominiums that they visited. So life was good. It continued to be good for about five years until one day a letter arrived in the mail from their Association. It seems that some homeowners were experiencing roof leaks in their units, others were complaining about the condition of the pool, and an engineer had told the Board that the fancy front gate had been improperly built and needed to be taken down and re-built with an adequate foundation.

Jack had to admit that he had noticed the gate had been sagging. But *his* roof wasn't leaking and neither he nor Jill used the pool (except to occasionally fetch a pail of water).

And then there were the roads. Jill had noticed the cracks and the dips. Jack did too when during a morning exercise run, he actually fell down the hill and broke his....well that's another story. And what was that strange hole that had appeared in the ground next to the storm sewer? It seems that the roads needed re-surfacing and there were also some underground drainage problems that would require parts of the roads to be re-built.

The shock came at the end of the letter. The Association needed $10,000 from Jack and Jill right away in order to fix these things. And they needed the same from every other homeowner. It was called a "Special Assessment".

"But..." Jack protested. "The Association is supposed to fix these things, not me! That's why I bought here in the first place." It seems that the association *did* have some money socked away for repairs - about one hundred thousand dollars. But the repairs were going to be over a million dollars. It was time for Jack and Jill to learn more about their Association.

The first lesson came from Tom, the property manager, whom Jack had called to complain. After listening to Jack rant about what the Association was supposed to be doing about this, Tom said: "But you understand don't you, Jack, that <u>you</u> are the Association - you and your neighbors. Not me, and not anybody else. You have a board of directors that are also your neighbors, and they meet every month to do the Association's business. And you are invited to those meetings, Jack. And every year they tell you what the budget is going to be and they ask you to vote on it."

"Well, sure..." Jack said. "But I figured that they know a lot more about these things than I do." The Board of Directors did, in fact, know that they needed to save money for major capital expenditures, called Capital Reserves. They even commissioned a study from a Reserve Specialist, certified by the Community Associations Institute. And the study told them that they weren't saving enough money to take care of future expenses like these.

But there was this problem. The original dues were set low when the community was built and first sold, and everybody assumed at that time that whoever set the dues rate knew what the costs of maintaining the community would be. Well, whether the future costs were known or not, the most important part of getting sales going was to make the dues structure low enough to not scare away potential buyers. So when the reserve study showed that dues would have to be raised to meet these future expenses, the Board balked. They knew that the owners would all get upset if they proposed an increase in the dues and they didn't want that. Besides, several Board members subscribed to that old adage "If it ain't broke, don't fix it". Everything looked fine to them and they decided to leave this "future" problem to somebody else.

Suddenly, it seems, when no one was looking - the "future" arrived. It brought with it a new adage: "If it breaks, fix it RIGHT NOW!" Jack and Jill's next door neighbor was trying to sell his condo, but the leaky roof was a real problem. So was the increasingly shoddy appearance and condition of the community, that the owners had sort of gotten used to, but which immediately turned off buyers.

Suddenly, Jack and Jill realized that the "asset" that they thought they had paid 100% for, actually included much more than just their own home; and increasingly, parts of it were turning into liabilities. Experienced property managers know that this story, unfortunately, is not a fairy tale. Some version of this story is happening to communities every year.

There is no law that requires communities to actually *fund* their reserves. That decision is up to the Board of Directors. If you are a Board member, you need to focus not only on your community's short term maintenance needs but on long term replacement needs as well. Some Boards, and many owners, take the view that long term replacement costs will not be their problem. It will be the next owners' problem. But homebuyers are learning from real life stories like the one above, and they are asking to see a community's reserve plan as well as the operating balance sheet. Lack of proper reserve funding can negatively impact present owners when they try to sell their homes.

Do you know whether your community's assets are slowly turning into liabilities? Peace of mind comes from knowing that your future problems as well as your present needs are essentially paid for. That's why communities have capital reserve accounts. Jack and Jill learned the hard way. You don't have to.

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