

# PAY NOW OR PAY (MORE) LATER?



MAKING THE MOST OF  
YOUR RESERVE STUDY AND  
MAINTENANCE BUDGET



**FirstService**  
RESIDENTIAL

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## MAKING THE MOST OF YOUR RESERVE STUDY AND MAINTENANCE BUDGET

The kinds of maintenance and capital improvements performed at different properties vary by community type. For instance, a high-rise may require updates to its mechanical components, whereas a master-planned or condo community may require landscaping and pool maintenance and the upkeep of other common amenities.

Nevertheless, budgeting for maintenance and capital expenditures is important for the financial fitness and longevity of all types of communities as well as to maintain the lifestyle your residents expect. An in-depth review of your budget and reserves can help determine if your community has the money needed for maintenance and capital expenditures. But how do you protect and ensure upkeep of your community's shared assets? How do you know if your reserve study is accurate or if your reserves are properly funded?

In this article, we will answer those questions and provide best practices for keeping your community in top-notch condition. You will also learn why your budget should include separate allocations for “maintenance” issues—those ongoing upkeep requirements—as well as “capital expenditures”—those more costly, major overhauls that increase the value of your assets.



In **Part One** you will learn why it's important to properly budget for preventative maintenance and repairs and for capital expenditures. You will also learn what is meant by “useful life” and how to mitigate the need for capital expenditures.

In **Part Two** we will explore how both of these budgets should align with your association's reserve study and current preventative maintenance programs.

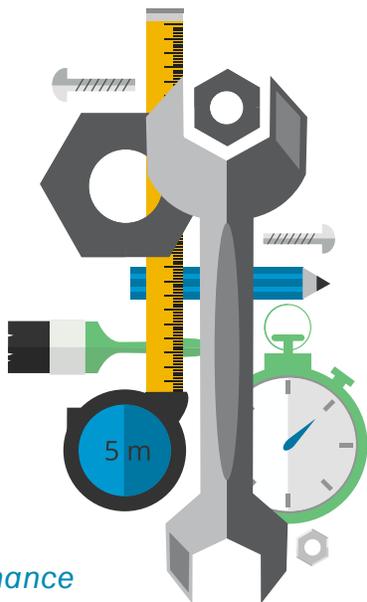
**Part Three** focuses on the importance of having an accurate reserve study and why you may want to consider having an association consultant partner with your property management company to review your reserve study and/or implement an asset management program.

In order to ensure your property is protected at the highest standard, it's crucial that your budget and reserve study match up with your property's preventative maintenance program. When those three aspects of your maintenance budget are aligned, your board can more accurately predict when capital expenditures must be made and mitigate surprise costs.

# PART ONE:

## MAINTENANCE VS. CAPITAL IMPROVEMENTS: WHAT'S THE DIFFERENCE?

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*Maintenance costs are those that keep your assets in their original condition. Routine and preventative maintenance restore assets and equipment to a specific operational standard.*



**B**efore you can budget appropriately, you need to be able to differentiate between maintenance costs and capital improvements, and you need to understand how they relate to each other. To do this, here's what you'll need to know.

### 1. Terminology is important.

Three terms are especially relevant:

**Maintenance costs:** Strictly speaking, maintenance costs are those that keep your assets in their original condition. (You'll find them in your budget under "Repairs & Maintenance" or "R&M.") Routine and preventative maintenance restore assets and equipment to a specific operational standard. They also prevent deterioration and involve replacing parts that are at the end of their "useful life."

**Capital improvements:** These are the major projects or total replacements that increase the value of your asset. A capital improvement will increase the value of an asset beyond its original valuation. Such improvements enhance the quality of service provided to residents or are made to reduce future operational costs. For example, modernizing your building's elevators, upgrading your motors, or installing LED lighting are improvements that enhance value.

**Useful life:** This refers to the lifespan of a system, piece of equipment, paint job, or other component. Every part of your community—from security and mechanical systems to the asset as a whole—has a useful life. The length can be affected by normal wear and tear, environmental conditions, obsolescence, or changes in compliance requirements. Useful life can be extended with preventative maintenance.

**2. Sometimes a maintenance job can turn into a capital improvement.**

You've seen this happen: A small job turns into a big job. A good example is a leaky roof. After inspection, the roofing experts deem that the roof cannot be repaired but must instead be replaced. Thus, a maintenance issue becomes a capital improvement.

**3. Preventative maintenance can often mitigate the need for capital expenditures.**

Unfortunately, most maintenance is conducted reactively—when a repair already needs to be made—rather than proactively. Investing in a preventative maintenance program for the assets at your community may initially require you to increase your maintenance budget, but it can also help extend the useful life of your equipment so that you don't need to put as much into your replacement reserves and capital expenditures budget.

**4. Each case is different.**

The way you categorize an expenditure can have a profound effect on your budget. To make the right call, consider the intention of the work that's being performed—that is, whether it's restoring the asset to the original condition or actually enhancing it. Overall, you'll want to consider the scope of work, the result of the work, and how the work affects the asset's ultimate value.

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**LUMINA**  
San Francisco

# PART TWO:

## WORKING THE RESERVE STUDY

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**N**ow you understand your regular maintenance budget and your capital improvements budget. So how does the reserve study fit in?

Chances are, you received a reserve study as part of the documents that were turned over by the developer when the association assumed control of the community. In California, the developer is required to create an approved budget before the sale of homes begins.

Reserve studies aim to minimize surprise expenses. They identify the association's predictable common area repair and replacement projects and allow the association to prepare financially to meet those costs over the course of many years. The goal of the reserve study is to predict when capital expenditures may need to occur. However, as Riepenhoff states, "Too often board members take the reserve study at face value and don't realize that they can ask for hard data to give them a better picture of the condition of their equipment and amenities."

Remember that your reserve study can be questioned. Most reserve studies are created by financial professionals—not engineers. That means that the reserve study specialists haven't looked beyond the date of installation and the replacement costs of the asset to create their estimates. They assume that every component will reach its maximum useful life without considering whether preventative maintenance is being done to keep the asset in shape. But what happens if a costly motor has an alignment issue that is slowly wearing it down and reducing its life from 20 years to 12 or 13? Premature equipment failure and the failure of components initially unaccounted for in the reserves can cost associations thousands of dollars in surprise costs.

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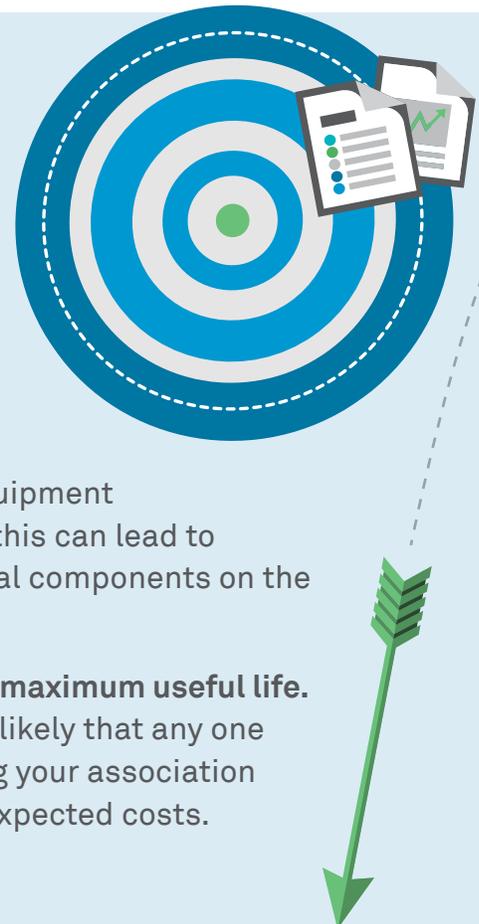
*Premature equipment failure and the failure of components initially unaccounted for in the reserves can cost associations thousands of dollars in surprise costs.*

Many board members don't realize that their community management company can recommend specialized engineering services that are tied directly to the reserve study. Ideally, you would review the study periodically alongside your property preventative maintenance program so that you could determine the actual useful life of your assets and adjust the reserve study so that it's more practical and workable. For instance, specialized vibration testing, thermal imaging scans, and other strategic preventative maintenance services help predict the life expectancy of components and identify impending issues that can't be seen by the naked eye. Conducting such tests enables you to address problems before they become bigger issues that you can only resolve through major expenditures.

The best community management companies partner with an engineering consultant to compare your reserve study to the actual condition of your property and assets. By reviewing your reserve study, these consultants can help your association mitigate unexpected costs, balance your reserves, and save money over time.

## DO YOU KNOW THE TWO MOST COMMON CAUSES OF RESERVE STUDY INACCURACY?

- 1. The reserve study specialist's lack of background in engineering.** Time and again reserve study specialists leave out components simply because they don't have the expertise to parse out individual assets from a group. For instance, it is common for specialists to group all HVAC equipment together as one line item on the reserve study; however, HVAC equipment consists of boilers, pumps, and more. Unfortunately, this can lead to mistaken estimates for the cost of replacing individual components on the reserve study.
- 2. The assumption that all components will reach their maximum useful life.** If preventative maintenance is not performed, it is unlikely that any one component will reach its maximum useful life, leaving your association with equipment that fails prematurely and major unexpected costs.



# PART THREE:

## HOW ASSET MANAGEMENT CAN HELP

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**A**s a board member, you take great pride in your community and your property. By partnering with your community management company and association consultants, you can do even more to protect your assets. Asset management and engineering consulting services are upgrades that some community management companies can provide. These services complement HOA management and help to ensure that your association's shared assets and amenities are protected and continually supported through strategic programs.

Asset management involves conducting specialized testing on major components at your property and comparing their condition with the useful life prediction in the reserve study. It also involves setting up the preventative maintenance programs to keep your property and equipment in good shape. Keeping track of equipment performance through documented web-based maintenance programs can help you gain a more accurate picture of the useful life of your equipment, systems, roofs, paint jobs, and other major components. This will help you understand how much you are going to get out of those assets, how much you should budget for regular maintenance and capital improvements, and when you should expect to need to spend money.

Today's board members overseeing residential properties of all types need to ensure that their assets are fully protected. HOA management services provide the foundation, but specialized engineering knowledge and asset management services create the premium assurance. Be sure to partner with a property management company that can thoroughly assess the needs of your community and connect you with the right people to manage your assets before emergencies arise.

For even more valuable tips and suggestions, contact FirstService Residential.

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PLAYA VISTA  
Los Angeles

An aerial photograph of a large residential development, likely Playa Vista in Los Angeles, during the "blue hour" of dusk. The sky is a mix of orange, pink, and blue. The buildings are modern, multi-story structures with light-colored facades and dark roofs. The streets are visible, and some lights are beginning to glow from the buildings and streetlights. The overall scene is a dense, planned community.

## About FirstService Residential

FirstService Residential is North America's property management leader, partnering with 8,000 communities across the U.S. and Canada. HOAs, community associations, condos and strata corporations rely on our extensive experience, resources and local expertise to maximize their property values and enhance their residents' lifestyles. Dedicated to making a difference, every day, we go above and beyond to deliver exceptional service. FirstService Residential is a subsidiary of FirstService Corporation (FSV), a North American leader in the property services sector. Find out how we can help your community thrive.

For more information, visit [www.fsresidential.com/california](http://www.fsresidential.com/california).

## About FirstService Association Consulting

FirstService Association Consulting collaborates with national and local builders and developers, as well as FirstService Residential clients, to provide comprehensive and insightful association planning for the sustainability of planned HOA developments. FirstService Association Consulting expertise includes budget preparation, financial planning, engineering services, asset management, and consulting for properties of all types and sizes. For more information, visit [www.fsassociationconsulting.com](http://www.fsassociationconsulting.com).



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