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RESERVE STUDIES:

Their Benefits and Shortfalls

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Reserve studies are excellent tools for community associations to plan for their long-term repair and replacement needs. They have been used by many community associations to budget for repairs and assess the need for financial reserves.

For condominium associations, the Illinois Condominium Property Act (the "Act") requires establishing a "reasonable reserve for capital expenditures and deferred maintenance for repair or replacement of the common elements" unless two-thirds of an association votes to waive the reserve requirement. There is no legal formula for determining what is a reasonable reserve. However, the Act provides that the Board shall take into consideration certain factors which include, among others, an independent professional reserve study. For all other community associations, such as townhomes and homeowners associations which are not governed by the reserve requirement of the Act, the declaration and by-laws may require establishing a reasonable reserve. In any event, a prudent Board of Directors should seriously consider

establishing a reasonable reserve, even if not required by the governing instruments in order to discharge their fiduciary obligations.

Unfortunately, sole reliance on reserve studies to budget for major repairs and associated financial obligations can result in several problems for community associations.

Reserve studies are typically based on a cursory review of the building components. Such cursory review does not uncover underlying problems that can severely reduce the service lives of many building components. In some cases, reserve studies merely assume average service life for building components, such as roofs, facades, parking lots, etc... As such, if underlying problems with building components are not detected, assumptions of service life and longevity of building components used in the reserve study may be false and result in unrealistic time lines for repairs, maintenance and replacement. This will lead to major unexpected financial problems when repairs and replacement of building components are needed a few years earlier than predicted by the reserve study.

Another issue with reserve studies is the method of estimating repair and replacement values. In most cases, average unit prices are used to estimate such costs. However, particular building configuration and specific needs of the project may result in significantly different costs. As an example, replacement of a roof on a high rise building in downtown Chicago can cost several times more than a similarly sized roof on a three story suburban building. Often reserve studies do not appropriately account for such major variations.

The combination of the above factors can result in major difficulties in financial planning for major repair or replacement projects. However, reserve studies are still needed to get a baseline for required work.

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