


Challenges & Solutions

Select challenges and proposed solutions

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Presented by Mike McDermott, PRA
President APRA
Browning Reserve Group



Reserve providers face many common challenges some of which are met with unlike solutions and processes that may yield dissimilar results. Member suggested solutions with examples related to earlier session topics will be presented. Through investigation, discussion and debate, today's unlike solutions will evolve into tomorrow's unified best practices.

Challenge: Insurance Deductible

- Association's loss is covered but there is a deductible.



- How do reserves deal with deductibles?

Insurance Deductible Questions

- Should reserve funds be expended for the deductible?
- Should there be an insurance deductible component?
- What are the Useful Life and the Remaining Life estimates?

Insurance Deductible Drawbacks

- Regularly scheduled reoccurring losses might be frowned upon by the insurance provider.
- While deductibles have known cost, their Useful Life and Remaining Life are unknown, so deductibles fail the basic criteria for a reserve component.

Insurance Deductible Solution

- No deductible reserve components.
- Maintain a reserve fund balance threshold that is at or above the insurance deductible amount.
- If the reserve fund minimum balance already exceeds the deductible amount, there is no impact.
- If the deductible amount exceeds the minimum reserve fund balance, modify the funding plan to increase the minimum balance.
- If the reserve fund balance is too low, an emergency assessment may be required to make up the shortfall.

Challenge: Partial Replacement

- Example - Concrete flatwork



- Settling cracks, tree root lifts, freeze-thaw spalling, etc.

Portland Cement Concrete

- Properly mixed and installed Portland Cement Concrete flatwork generally has a long useful life.
- Small failure areas are expected due to settling, tree roots, flooding, seismic, truck/equipment damage, etc.
- In alpine climates, salt may lead to scaling and the freeze/thaw cycle may cause spall which may require large area replacements.
- As trees mature, tree root lift damage accelerates.

Cement Concrete Expectations

- Little work is anticipated during first 10-15 years after which ongoing work is anticipated every 3-5 years.
- Extent of work expands in later years.
- Total replacement is not typically expected all at once. However, total replacement over a long time span may be necessary.

Partial Replacement Solution

- Create a periodic replacement allowance component with a short Useful Life such as 3-5 years.
- Set the allowance to some percentage ranging from a fraction of a percent to 5-10-25+ percent of the quantity depending on circumstances.
- If the component exhibits a carefree early life such as concrete, i.e. new concrete, delay the component's start by extending its remaining life to 10-15 years.

Be Prepared for Client Questions

- Clients may ask why such a short Useful Life and such a small \$ amount to replace the entire component.
- The component only replaces some portion on a periodic basis. Total replacement take decades depending on the applied percentage.
- 5% every 5 years at \$5,000/year is equivalent to 100 year Useful Life and \$100,000 current cost.

Challenge: Onetime Only Expense

- Plywood roof deck installation during conversion from shake to composition shingle.



- Plywood deck installation will not be required again!

Onetime Only Approaches

- Deny their existence.
- Put it into the funding plan without a component.
- Create a regular component with 100+ year useful life.
- Simply leave the onetime cost in the ongoing component.
- Create a onetime component that is excluded from FFB/PF calculations.
- Create a onetime only component that is included in FFB/PF calculations.

Onetime Only Perspectives

- Different approaches generate potentially different FFB/PF results which makes the approach critical to FFB/PF values.
- Different approaches generate potentially different Component Method funding plans which makes the approach critical to the Component Method.
- Different approaches have little or no impact to Cash Flow.

Onetime Only Questions

- Do onetime only reserve expenses exist?
- Should onetime only expenses be dealt with as a funding plan adjustment or as a component?
- Should onetime only components be included in FFB/PF calculations?
- What is the Useful Life of a onetime only component?
- What motivations or underlying principals drive the answers to the above questions?

Onetime Only Useful Life

- Set UL to some maximum value (100+ years).
- Set UL to age since component was initially installed.
- Set UL in relation to remaining life ($RL + 1$ year).

Onetime Solution

- Create a onetime only component.
- Include the component in FFB/PF calculations.
- Set Useful Life to Remaining Life + 1.

Challenge: Warranty/Settlement

- Failed roofing product replaced under tiered schedule.



- “Lifetime” roofs failed within 10 years.

Warranty/Settlement Scenario

- Roofing failed within 10 years and was replaced.
- Replacement roofs also failed within 10 years.
- Manufacturer stopped making this product.
- Manufacturer agreed to install architectural comp.
- Since up to 20 years of service was provided, replacement cost was shared between manufacturer and client under a tiered schedule which increased the client's share by approximately 2% per year.

Warranty/Settlement Challenge

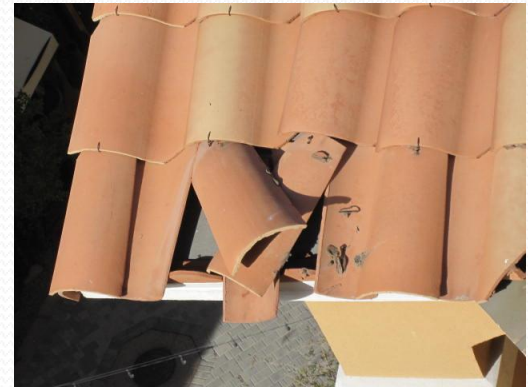
- Initial cost share was 80% v. 20% manufacture v. client.
- Client cost share increased 2% each year.
- The 20% to 22% share increase in the second year equals a 10% cost increase to the client.
- Reserve Study provides for a single cost that grows at the overall inflation rate and not at the settlement's graduated rate.
- So any roof that lasted longer than expected wouldn't be adequately funded.

Warranty/Settlement Solution

- Each roof was given 2 components.
- The first component assumed a short remaining life with its cost set to the percentage anticipated in that replacement year.
- The second component assumed a standard (non defective product) remaining life with its cost set to the remaining percentage (100% minus the sort term component's percentage).
- With an assumed replacement of 24% in two years, the second component provided the remaining 76% in the future. Both components are adjusted annually.

Challenge: Observed Hazards

- Some things just can't be ignored.



- Stair flange into dry rot, failed deck, falling tiles, ...

Safety Hazard Considerations

- Do we have the required expertise to recognize hazards?
- Do we have ethical, moral or legal obligations to report?
- What if we report some but not all?
- Are we liable if we don't report?
- Are we creating a client liability if we do report?
- Studies are produced weeks after the site visit.
- Clients don't always exhaustively review the study in a timely manner - if ever.

Safety Hazard Solution

- Reserve site visits are explicitly not safety inspections.
- Clearly disclose in contracts and studies that the Reserve Study is not a safety report.
- Do not explicitly label hazards in Reserve Study.
- Do describe conditions and adjust components to address the immediacy of the necessary repairs.
- Immediately report serious undeniable hazards to management or primary contact, and recommend that appropriate experts evaluate the perceived hazard.

Challenge: Defect Litigation

- Best-laid plans!



- Backflow in street, detached tiles, sub grade pipes

Defect Litigation Considerations

- Were we informed?
- What stage is the litigation?
- Which components are involved?
- Are impacted component repairs being deferred or handled non traditionally?
- How do we avoid hurting the case?

Defect Litigation Solution

- Ask if construction defect litigation is anticipated or underway.
- Ask which components are involved.
- Avoid contradicting the defect allegation(s).
- Disclose the defect litigation within the study.
- Have client's attorney suggest or review disclosure language.

Generic Litigation Disclaimer

The XYZ association is investigating whether the XYZ development was defectively constructed. This reserve study does not take into consideration whether the development was defectively constructed. Replacement costs for components of the development may vary substantially if it is found that the development was defectively constructed.

Challenge: Beginning Balance

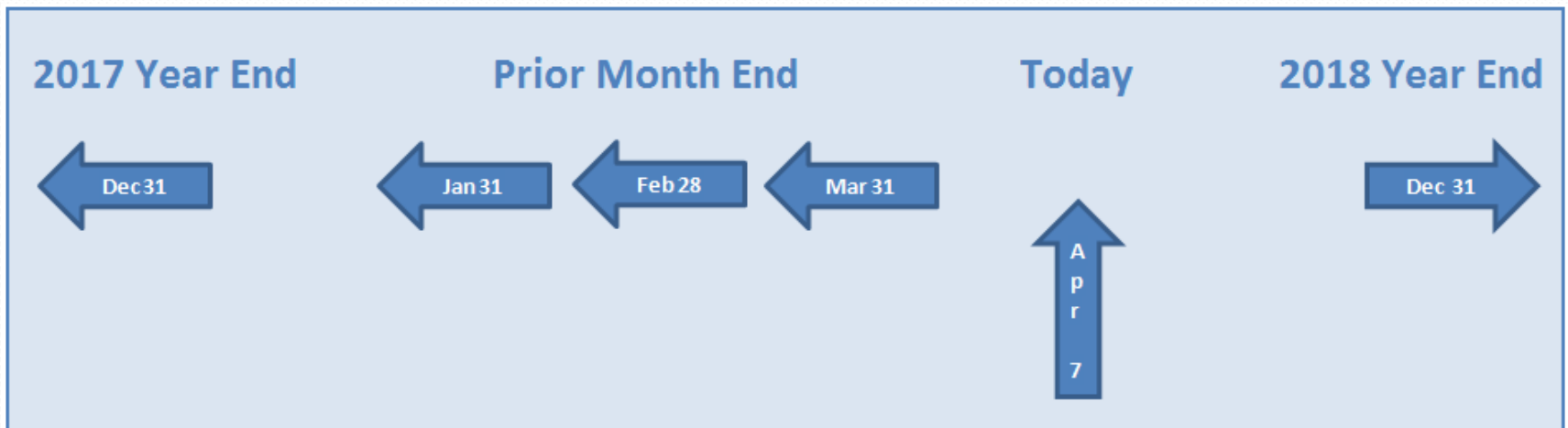
- Every funding plan has a beginning balance.



- How is beginning balance determined?

Balance Starting Points

- Where to start?



- Yesterday, today or tomorrow

Possible Balance Sources

- Request estimated year end balance (Dec 31, 2018).
- Request current balance (Apr 7, 2018).
- Request last month end balance (Mar 31, 2018).
- Request last year end Balance Sheet (Dec 31, 2017).
- Request all or several of the above.
- Request something else?

Balance Source Questions

- Is a current or recent balance estimate reliable?
- Is a recent balance preliminary subject to correction?
- Is a future balance estimate reliable?
- Is the balance from a financial statement?
- Is the balance from an accountant's review or audit?
- Is the balance memorialized for future reference?

Beginning Balance Solution

For a study prepared in 2018 for the Jan 1 – Dec 31, 2019 fiscal year:

- Use December 31, 2017 balance from accountant's year end review or audit Balance Sheet .
- Include 2018 as first year in study to definitely demonstrate how the 2019 beginning balance is generated.

2018 as First Year Advantages

- 2019 beginning balance is estimated **exactly** as every other future balance.
- Generates a defensible 2019 beginning balance.
- Provides source balance “Check & Balance”.
- Provides component expense “Check & Balance”.
- Facilitates cross-checking between study’s and client’s estimated 2019 beginning balances.
- Connects CPA’s review/audit to Reserve Study.

Challenge: Improved Replacement

- Replace old clubhouse



- That's an improvement and not just a replacement

Improvement Questions

- Is this an in-kind replacement or an improvement?
- If an improvement, can reserve funds be utilized?
- If reserve funds can be used, how much?
- Which components exist for the current structure?

Improvement Solution

- Reserve funds available equals sum of existing structure components.
- Determine anticipated reconstruction year.
- Since all existing structure components will be “replaced”, set each of those component’s remaining life equal to anticipated reconstruction year.

Challenge: Remaining Life Clarity

- There's a good reason to use an absolute year (date).

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| I-123 HIGHWAY IMPROVEMENT PROJECT | I-123 HIGHWAY IMPROVEMENT PROJECT | I-123 HIGHWAY IMPROVEMENT PROJECT |
| COST ASTRONOMICAL <hr/> SCHEDULED COMPLETION IN 4 YEARS | COST ASTRONOMICAL <hr/> SCHEDULED COMPLETION 2022 | COST ASTRONOMICAL <hr/> SCHEDULED COMPLETION JUNE 2022 |

- 4 years from when?

Relative Remaining Life

- Reserve Studies deal with Remaining Life in relative terms which occasionally leads to confusion.
- A Remaining Life in years is only valid in one base year such as the year the study was prepared.
- The absolute replacement year (date) is valid anytime.

Remaining Life Solution

- Emphasize to clients the importance of absolute years (dates).
- Develop a discipline to communicate Remaining Life in absolute years (dates).

Challenge: Thirst & Hunger

- But first, any questions?



Thirst & hunger solution:

Grab a drink, enjoy a meal and continue sharing ideas!

Thanks for your participation!