

## **Silver Queen West Annual Meeting 2009**

### **Funding of Reserves**

To simplify this presentation, this analysis uses cost calculations based on all 105 units being treated the same. In actual practice the costs would be allocated by unit square footage.

The fundamental purpose of a Reserve Fund study is to determine the amount of money that must be collected monthly to fund forecasted major repairs/restorations. Principal factors in making this determination include the timing and projected cost of major repairs/restorations and their useful life. Other factors include the amount of interest that can be earned on reserve funds held and projected inflation of costs.

Take as an example the SQW roofs. The roofs were replaced in 2002 (Buildings A/B) and 2004 (Buildings C/D). The new roofs are warranted for 15 years and have an expected life of 20 years. In round numbers, the roofs cost \$200,000, or \$10,000 per year, over the 20 year estimated life. Based on 105 units, each owner would contribute about \$100 per year or \$8 per month (not adjusted for inflation). However, regular maintenance might extend the roof life, there may be new roofing options in 20 years, and potential environmental (weather) or unknown installation problems might shorten the life.

The recent boiler replacement reflects a more complicated calculation for the 20 year expected life. A portion of the boiler replacement cost is for plumbing changes that likely will not need to be duplicated in future boiler replacement. The installation of a system using multiple smaller boilers will allow selective replacement of boilers as they fail rather than a complete replacement as currently is in progress with the original single boiler per building.

Development of the components of a Reserve Fund schedule for items such as the roof and boilers, where the quality and installation method is known, is easier than scheduling for repair/replacement of original building components where installation methods and materials sometimes are unknown. An example would be the insulation that may or may not be in the SQW building walls. Regular maintenance is a factor in the reliability of any Reserve Fund plan.

While extending reserve studies to 20 years or longer is a good planning tool, and 10 year forecasts are useful in broad approximations, the most reliable Reserve Fund schedule forecast in the three to five year range.

Historically Reserve Fund contributions for SQW have been the excess of the annual (monthly) assessments over operating expenses. In recent years the Reserve Fund contribution has been further specified to be a specific portion of the dues plus any operating savings. In eighteen years, only in 1998 have the operating expenses of the Association exceeded assessment income. However, sometimes the net income from operations has been below expectations for the contribution to the Reserve Fund from this source.

Reserve Fund contributions and expenditures have been:

		<u>Contributions</u>	<u>Expenditures</u>	<u>Difference</u>
Last five years	total	\$ 435,681	\$ 456,618	(\$20,937)
Last ten years	total	\$ 733,605	\$ 738,467	(\$ 4,862)
Last eighteen years	total	\$ 838,975	\$ 850,656	(\$11,681)

In the most recent five years, about 20% of assessments has been allocated to the Reserve Fund. The 2008/2009 budget allocated \$70,392 or about 16% from assessments to the Reserve Fund. Allocated equally over 105 units, this is \$670 annually or \$56 monthly per unit.

The current boiler replacement and drainage work represents \$500,000 of Reserve Fund expense. The next stage of major Reserve Fund expenditures is building restoration, that may include building siding, concrete, insulation, windows, doors and other components. This restoration is projected to cost about \$1,000,000. This represents a total Reserve Fund expenditure of \$1.5 million. This cost allocated equally over 105 units would be \$14,300 per unit. At an average current unit value of \$200,000, this cost represents about 7% of the unit value.

The difficulty in attempting to deal with major repairs/restorations of this magnitude through regular monthly reserve assessments is the long period, or in the alternative the high monthly amount, required to accumulate the required Reserve Funds. The 2008/2009 budget levied an average monthly assessment of \$284 per unit (again, actual assessments vary by unit size and building). If the \$1.5 million required was collected through monthly Reserve Fund assessments (in addition to the regular monthly assessments required for normal operations and maintenance such as parking lot resurfacing, roof replacement, and other elements requiring repair or replacement), the additional amount necessary would be \$238 per month per unit over five years or \$119 per month over ten years; \$79 per month over fifteen years; and \$60 over twenty years. These numbers do not account for the effect of inflation on costs. Such monthly assessments are not practical because of the difficulty in accurately forecasting required major repairs/restorations over a long period, the inability to delay required major repairs/restorations for such long periods once they are identified with certainty, and the need to keep monthly assessments reasonably in line with the Summit County condo market to preserve property values.

Marketability of units is based in part on the level of the monthly assessment and the ability of owners to pay assessments or new owners to qualify for loans that factor the amount of the assessment into the monthly debt repayment capacity of the prospective purchaser/borrower. SQW assessments are comparable to other Summit County HOAs. It could be argued that SQW provides a better value for the amount assessed, but the current assessment cannot be considered below the current market. An increase in these monthly assessments by the amount necessary to fund the required expenditures in a three to five year period would put SQW assessments into a much higher assessment percentile among the many condominium projects potential buyers have to choose from.

Associations are limited in the types of investments that a Board may make due to the risk of losing owners funds. It is questionable if the best practice for a Board is to accumulate a substantial reserve balance given the requirement that the funds be held in conservative, low risk investments that even in more robust economic conditions return little over the inflation rate.

Based on this information, increasing monthly assessments, either 10 years ago or currently, to cover the cost of these necessary, major replacement/restoration projects is not a practical approach compared to providing sufficient notice to owners of future lump sum assessments. The Reserve Fund balance has not been an issue for SQW in the past because, until recently, Reserve Fund expenditures have been on a pay-as-you-go basis. However, the economics of the current projects underway and being considered, combined with the "routine" Reserve Fund expenditures for things like parking lot repaving and roof replacement, and unanticipated events such as major sewer repairs, do not make a pay-as-you-go approach practical unless lump sum assessments are used for the major replacement/restoration projects outlined above.

Some owners at SQW are in a financial position that makes payment of much more than the existing assessment difficult. The primary purpose behind the recommendation of the 2009/2010 monthly assessment structure is to provide an avenue for owners who do not have the means to pay the special assessment in a lump sum to finance the assessment over a period of 12, 24 or 36 months by maintaining their monthly assessments at the current level while the assessment for unit owners who pay the special assessment in a lump sum will be lower. The same differential would be maintained if monthly assessments change during the payoff period. The interest rate implicit in this financing option is 7%.

In summary, it has not been and is not practicable to build a Reserve Fund of sufficient size to cover the major replacement/restoration projects required to keep SQW a sound and livable property and protect the long term property value of the units. The current lump sum assessment due in March 2010 and the projected additional lump sum assessment of approximately twice that amount expected in three to five years are the most feasible way of dealing with these financial requirements. Owners may save for such assessments, take a home equity loan to fund them with the possible tax benefits of doing so, or take advantage of the payment scheme being offered by the Association of paying a higher assessment than others for an extended period of time.

**SILVER QUEEN WEST**  
**Fiscal Year Ending Aug 31, 2009**  
**12 Months ending August 2009**

	2007/2008	2008/2009	2008/2009			2009/2010	
INCOME	Actual	Budget	Actual	%	Variance	Budget	%
Operating dues	341,381	358,128	358,128	79.8%	0	340,632	39.9%
Other	16,601	19,400	20,113	4.5%	713	19,400	2.3%
Reserve fund dues	70,000	70,392	70,392	15.7%	0	493,000	57.8%
Interest	2,995	1,250	355	0.1%	(895)	600	0.1%
<b>TOTAL INCOME</b>	<b>430,976</b>	<b>449,170</b>	<b>448,988</b>	<b>100.0%</b>	<b>(182)</b>	<b>853,632</b>	<b>100.0%</b>
<b>EXPENSES</b>							
Maintenance	46,202	33,400	36,192	8.1%	(2,792)	30,400	3.6%
Salaries & Wages	93,223	103,200	90,240	20.1%	12,960	107,000	12.5%
Financial and legal	17,996	18,600	16,913	3.8%	1,687	18,900	2.2%
Utilities	165,324	182,553	155,023	34.5%	27,530	161,786	19.0%
Insurance	26,444	27,000	28,877	6.4%	(1,877)	30,000	3.5%
Other	6,544	8,040	8,193	1.8%	(153)	8,300	1.0%
Reserve expenditures	27,897	60,086	118,628	26.4%	(58,542)	480,000	56.2%
<b>TOTAL EXPENSES</b>	<b>383,630</b>	<b>432,879</b>	<b>454,065</b>	<b>101.1%</b>	<b>(21,186)</b>	<b>836,386</b>	<b>98.0%</b>
<b>INCREASE(DECREASE) RESERVES</b>	<b>47,346</b>	<b>16,291</b>	<b>(5,077)</b>	<b>-1.1%</b>	<b>(21,368)</b>	<b>17,246</b>	<b>2.0%</b>
<b>ENDING RESERVE BALANCE</b>	<b>32,798</b>	<b>49,089</b>	<b>27,721</b>	<b>6.2%</b>		<b>44,967</b>	<b>5.3%</b>

