

# Long-Term Planning: The Key to Successful Properties

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## Long-Term Planning: The Key to Successful Properties

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## Our Agenda



- Introduction to Long Term Planning
- The Long Term Planning Process
  - Physical Analysis
  - Financial Analysis
  - Developing the Plan
  - Funding
- Final Reminders

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## Long Term Planning – Why?

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## Long Term Planning

- Properties should be run like any other business
- A long term strategy is necessary for all businesses
- Dealing with people's homes rather than business facilities
  - Options to build a new structure in separate location severely limited
  - Long term strategy even more crucial

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## Long Term Planning – Factors

- Fiduciary responsibility
- Sophisticated prospective purchasers
- Availability of financing for purchasers
- Changes in property values and funding availability

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## Long Term Planning – Benefits

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- Enhances property value
- Reminder of long term projects to come
- Benefits are physical as well as fiscal
- Satisfaction of fiduciary responsibilities and/or legal and professional requirements
- Helps avoid scrutiny of significant deficiencies required to be reported by CPA

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## Long Term Planning - More Good News

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- Tax benefit for unit owners
- Helps document that arbitrary provision is unnecessary

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## Long Term Planning - More Preliminary Thoughts

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- Condominiums generally have inadequate long term funding
- Apportionment in the operating budget for long term funding attracting renewed support

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*Every community association requires a different amount of cash in reserves to complete repair or replacement projects on schedule without special assessments or loans.*

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## Resources

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- Best practices are available from:
  - Community Associations Institute (CAI) - [www.cairf.org/research/BPRS.pdf](http://www.cairf.org/research/BPRS.pdf)
  - Guide for association practitioners on reserve funds
  - Why community associations need reserves
  - How to accomplish the goal

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## The Long Term Planning Process

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## Components of Long Term Planning

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- Two types of analysis are required
  - Physical
  - Financial

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## Utilizing the Right Provider

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- Level of service
- Credentials of the individual preparing the report

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## Utilizing the Right Provider

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- Provider of physical analysis needs to be familiar with
  - State and local law
  - Construction standards and techniques
  - Local conditions and standards
  - Alternatives to existing construction
    - New types of materials/equipment
  - Repair and replacement component costs

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## Physical Analysis

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- Study will be
  - A reflection of the information provided
  - Assembled for the association's use
- Not for purposes of
  - Performing an audit
  - Quality and / or forensic analysis
  - Background checks of historical records
- Study is not a project audit or quality inspection

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## Physical Analysis

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- Reserve study provider evaluates the association's major common area components
  - Roof
  - Elevator
  - Boiler
  - Plumbing
- Consider major components that may be unit owner responsibility

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## Physical Analysis

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- Component study
  - Condition assessment
    - Current physical state
    - Remaining useful life estimates
    - Expected time frame
  - Valuation estimate
    - Repair and / or replacement cost

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## Physical Analysis

- Narrative
  - Discussion of material issue
  - Details of how the on-site observations were performed
  - Reliance on
    - Validity of prior reserve studies
    - Information provided by the association's representatives

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## Physical Analysis

- Narrative details may include
  - Representative sampling vs. all common areas
  - Destructive testing or not
  - Field measurements vs. drawing take-offs

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## Financial Analysis

- Only assesses the association's reserve balance or fund status
- Determine a recommendation for an appropriate reserve contribution rate (funding plan)
- Measured in cash or as a percent funded

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## Financial Analysis

- Existing financial structure
- Funds presently available
- Cash flow projection anticipating expenditures and contribution requirements over twenty to thirty years
- Projected investment returns

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## Financial Analysis

- Potential limitations in governing documents
  - Mortgages, investment alternatives, etc.
- State and local law which may affect and / or override governing documents

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## Financial Analysis

- Review descriptions of the assumptions utilized
  - Interest rates
  - Inflation
  - Taxes
  - Other outside factors

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## Developing the Plan

- Summary of association
  - Including number of units, physical description, financial condition of the reserve fund
- Projections of
  - Starting balance
  - Recommended reserve contributions
  - Expected reserve expenses
  - Ending balance after 20 to 30 years

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## Developing the Plan

- Reserve Schedule
  - Financial summary of the reserve study
  - Format depends on funding method used
- Tabular listing of
  - Component inventory
  - Component quantity or identification
  - Useful life
  - Remaining useful life
  - Replacement cost

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## Reserve Schedule

- Determine if the component is
  - Part of the common elements
  - Covered under a maintenance contract
  - Included in another part of the budget
  - A piece of mechanical equipment
- Review community documents and statutory requirements to determine

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## Reserve Schedule

- Consider if
  - Useful life of component is within the selected time frame
  - Replacement cost below the operating budget threshold
  - The item is a reserve item or not
    - If not, it should be on the preventive maintenance schedule

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## Disclosures

- Description of methods / objectives utilized to compile the information
- Sources of component repair or replacement cost estimates
- Actual or perceived conflicts of interest

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## Funding Plan

- After establishing funding goals, select an appropriate funding plan
- There are four basic funding strategies
  - Full funding
  - Baseline funding
  - Threshold funding
  - Statutory funding

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## Funding Strategies

- Full funding
  - Attain and maintain the reserves at or near 100 percent
  - Example, if an association has a component with a 10-year life and a \$10,000 replacement cost, it should have \$3,000 set aside for its replacement after three years

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## Funding Strategies

- Baseline funding
  - Keep reserve balance above zero
  - While each individual component may not be fully funded, the reserve balance should not drop below zero during the projected period
  - Change in remaining useful life can result in a deficit in the cash balance
    - Need for conducting annual reserve updates that include field observations.<sup>32</sup>

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## Funding Strategies

- Threshold funding
  - Similar to baseline funding concept, but the minimum reserve balance is set at a predetermined dollar amount
- Statutory funding
  - Specific minimum amount as required by statutes

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## Funding Strategies

- Check for requirements to accumulate funds
  - State statute
  - Governing documents

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## Funding Strategies

- Rely on your professionals to determine the best one
- Consult with
  - Financial advisor to determine the tax implications of selecting a particular plan
  - CPA about AICPA reporting requirements

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## AICPA Reporting Requirements

- AICPA CIRA Accounting Guide for future major repairs and replacements require disclosures
  - Whether or not study was conducted
  - Requirements to accumulate funds

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## AICPA Reporting Requirements

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- AICPA CIRA Accounting Guide for future major repairs and replacements required disclosures
  - Funding policy including sources of funds
    - Amounts assessed in current period
    - Information on special assessments
    - Annual maintenance / common charge provision
    - Shareholders paying for use of components

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## Sources of Funding

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- Sources of funds
  - Portion of monthly carrying charges
  - Special assessment
  - Mortgages, loans or refinancing
  - Transfer / license fees
  - Reinvestment of interest
  - Rental income for extra space
  - Recovery of benefits of tax abatements

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## Sources of Funding

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- Sources of funds
  - Sale or rental of common space
  - Roof and developmental rights
  - Sale proceeds for unused or rental areas
    - Professional offices
    - Storage or parking space
    - Other common areas
    - Long term rental revenue
    - Air rights

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## Developing an Investment Policy

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- Establish standard practice and procedure by considering
  - General policy
  - Goals and objectives
  - Appropriate investment strategy
  - Policies for investment securities' selection criteria and review

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## Final Reminders

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- Review
  - State laws related to reserves
  - Association documents regarding reserves
- Consult with professionals
- Conduct periodic reserve policy reviews
  - Yearly, if possible

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## Final Reminders

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- Preventive maintenance
  - Failure to maintain the components will affect their full useful life
    - Components not included in the schedule may require replacement
    - Components may need to be replaced earlier, resulting in a shorter period to collect for replacement cost
      - May result in special assessments

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## Upcoming Webinars



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### Winter & Spring 2012

Mar. 5, 2012	7 pm	Understanding Condominium Financial Statements
Apr. 18, 2012	7 pm	Board Member Responsibilities
May 25, 2012	6 pm	Understanding Cooperative Financial Statements

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## Questions?

- Send an email to: [info@czarbeer.com](mailto:info@czarbeer.com)
- Put "Long Term Planning" in the subject

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