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Talking Condo Funds; Managing Capital Reserves

By ANDREE BROOKS

THE roof shingles will deteriorate, the driveway will need a new surface and even the corridor carpeting will wear thin. But unlike a co-op corporation, which can easily borrow funds for capital outlays to repair such conditions, the condominium is not so fortunate; banks are still wary since the condominium association has no collateral to pledge. And a special assessment creates too much individual hardship and internal strife.

''Raising the possibility of a special assessment is the best way I know to get lynched,'' said Bob Kirkland, president of Professional Property Managers Inc. of Virginia Beach, Va., which manages 72 associations.

No wonder more and more condo associations are beginning to place greater emphasis on establishing and financing a well- thought-out capital reserves program.

A recent survey by the Commmunity Associations Institute of Alexandria, Va., a national network of condominium officers and their advisers, showed that in 1989 the need to build up reserves was the major cause of an increase in monthly common charges. The use of the special assessment fell from 25 to 16 percent of the 230 associations surveyed in a nationwide random sampling.

A planned program of capital reserves is essential today for other reasons, too, said Douglas Kleine, director of research for the institute. The secondary mortgage market - investor pools that buy individual mortgages - now insists on assurances that such a program is in place. This means a local mortgage officer will require the same verification before approving a loan on an individual unit.

Further, California, Florida and other states have passed laws requiring an association to provide unit owners with details of its capital reserve program on an annual basis. More states may follow. And the American Institute of Certified Public Accountants is creating new guidelines that will require the inclusion of a capital reserve program in any audit of an association.

The basic tool to set up a program that will be acceptable to lenders and regulators is the reserve study - a blueprint for action that takes into account engineering factors, like the anticipated life of a roof or heating system, plus financial projections that compensate for inflation and the fluctuating rate of return on invested reserves.

A handful of companies, among them Association Reserves of Calabasas, Calif., and Erickson Associates of Orlando, Fla., and San Diego, are beginning to specialize in this burgeoning field, combining engineering and actuarial expertise to arrive at an accurate figure for the amount of money needed and a timetable for expenditures. If such a company takes over the job, expect to pay around $600 for under 40 units and up to $10,000 for 500 units or more, said Robert M. Norlund, president of Association Reserves.

Most condominiums, however, will begin by simply getting an engineer's report. Mr. Kirkland recommends using only a licensed professional engineer, since specialized knowledge will be needed. Ideally, he said, the person will also have had experience compiling reports for buildings or developments that were being converted from rental status, since the work closely parallels the kind needed for a reserve study.

Condo officers should not rely solely on the cost estimates for replacement provided by such a study, say managers. It is wiser, they say, to get a more precise figure by putting the items out for local bids.

''Each contractor usually knows his particular job and specialized local conditions much better,'' explained Rhonda Major, senior manager with Bay Area Property Management of Clear Lake City, Tex. By contrast, many engineering companies, she maintained, base their projections on national or regional averages. Thus their figures do not necessarily reflect the views of the local contractors who will be doing the work.

THE rule-of-thumb is to have such a report updated every three years. After this, if the association does not have a management company accustomed to making up the funding and expenditures projections, the officers could use a computer program. The Community Associations Institute favors one written by Craig Gilbert, an accountant in Atlanta. Called ''Community Reserves,'' it costs $195 (call 404-231-0349 or write: Front Row Systems, P.O. Box 550346 Atlanta, Ga. 30355).

Some cautions should be observed when making the projections. For example, Mr. Kirkland said that if a roof would cost $100,000 to replace this year and still has a useful life of 10 years, the association would need to set aside far more than $10,000 a year. Assuming only a 5 percent yearly inflation, the cost 10 years hence would reach $163,889, due to compounding.

Further, it is normally assumed that the interest earned on the money as it accumulates will make up the difference. But if $10,000 were set aside each year at an interest rate of say, 8 percent, only $134,805 would be available at the end of the 10th year, Mr. Kirkland warned.

Ms. Major, like others, also favors an unallocated amount of around 3 percent of the total to cover such variables as a shorter-than-anticipated life of a particular system, or perhaps an upgrade to a product that is technically or esthetically more appealing.

''One time I remember we planned for one coat of paint,'' she said. ''But when the painting came due there was so much flaking and rot we needed two coats.'' Thus, in addition to that unallocated amount, she favors maintaining a contingency fund of around 5 percent of the total.

Making certain ongoing maintenance chores become part of the capital reserve progam also helps. ''A generous amount allocated to the regular budget for maintenance can do a great deal to avoid sudden and unplanned capital expenditures,'' Ms. Major said.

Do not forget to amend that reserve plan to factor in sudden and unanticipated changes in costs, Mr. Kleine added, like new regulations that can add hundreds of dollars to any replacement project.

More detailed planning information is available in ''Reserve Study Guidelines'' a 120-page book costing $32.95, and ''Reserve to Preserve,'' a booklet costing $9.50; both are from Community Associations Institute. Write: 1423 Powhatan Street, Alexandria, Va. 22314, or call (800) 342-5224.

Good investment management of the funds is a further complex topic. C.A.I. has a new newsletter for this purpose, called The Ledger Quarterly. The annual subscription for members is $36, for nonmembers, $48.

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