Homes

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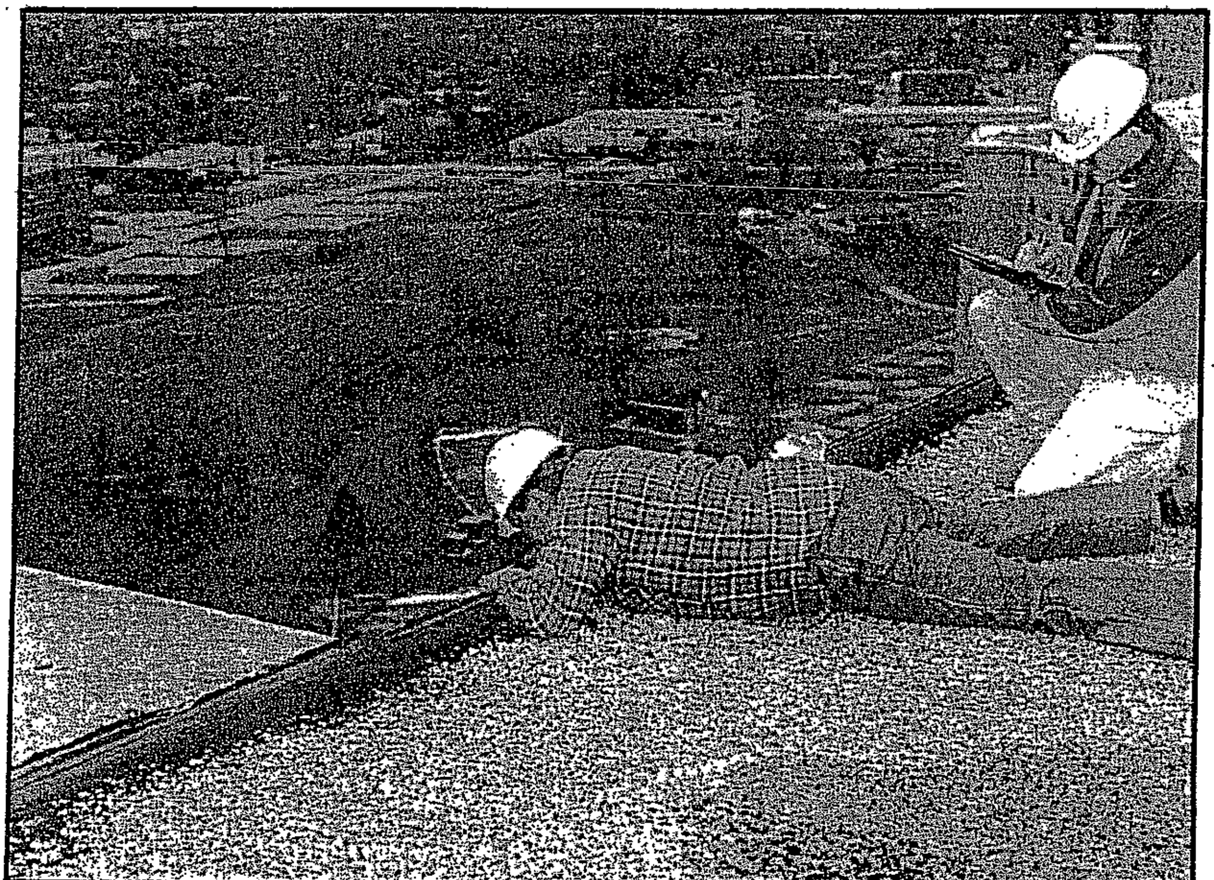

Photo for the Tribune by Hank DeGeorge

Architect Peter Majewski checks the masonry on a North Side condo building as Peter Shannon takes notes.

Condo cushion

Does your building have enough cash in reserve?

By Bryan Miller

The Illinois General Assembly has decreed that all condominium associations maintain "reasonable reserves" for major capital expenditures that will arise in the future. But how do you decide what's reasonable?

One tool now being used by many condo boards is a reserve analysis, in which an architect or engineer takes a look at all the common areas of a building—from mechanical and electrical systems to parking garages, and on down to the carpeting in the hallways—and presents an educated guess as to how long they will last, and what the cost of replacing them in present-day dollars will be when they go. When you've got those figures, you have a handle on how much you need to set aside each year.

Shirl Tole, president of Tole & Associates, a Chicago condominium management firm, says she started urging her clients to get reserve analyses eight years ago; she feels strongly that they're necessary. When condos first became popular in the mid-1970s, she says, "too many associations didn't think, 'How do we plan for the future?' but rather 'How do we keep our assessments as low as possible?' And in the early '80s, it came back to bite 'em. Boilers don't last forever—and they just weren't prepared. A lot of associations got hit with a lot of big bills."

The alternative to keeping a healthy reserve fund is to charge each unit owner for a special assessment whenever there's a major expense. "You can't always go back to the homeowners with a special assessment," asserts Tole. "People need to plan, too." Special assessments, she notes, are particularly hard on those with fixed incomes.

A marketing tool?

An analysis makes good sense from a business standpoint, she says. "Buyers want to know about these things—your plans for the future, your reserve funds. The reserve analysis is a marketing tool for the homeowners: They can show buyers the plan, what's in it, what's not in it and whether it's adequate. People say they prefer to have [the board] come to them when they need a special assessment, but they don't realize they're dead in the water when buyers come to look if you don't have adequate reserves."

And, more and more lenders are demanding healthy reserves before they'll issue a mortgage, putting still more pressure on condominium associations to have an analysis performed.

Mark Pearlstein, an attorney who writes the Condo log column in the Sunday Tribune Real Estate section, says he doesn't think studies will ever be required by law, but he thinks they're a very good idea, particularly for larger buildings. Even if you don't have a formal study, he says, "you should in all cases hire an outside professional to determine what you will need."

The first step in getting a condominium reserve analysis done, says Steve Huberger, president of Villa Management Ltd. in Libertyville, is to get bids from several firms. He recommends getting an architectural or engineering company—"probably any architectural or engineering firm in the Yellow Pages can do it; it seems to be a trendy kind of industry to be in"—rather than a general contractor. "There's a danger in going to a general contractor. He may want to sell you a new roof, or a new

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swimming pool, or a new boiler. Get a neutral opinion."

Huberger says he likes to work with a "time line" of probable replacements.

"We use 60 years in our company. Everything dies at least one time in 60 years. Once we have all the figures, we run them through the computer, looking for the 'magic constant number,' so that there's no deficit in any year. We add a 5 percent factor for error; these can't be precise estimates. And we make the assumption that the interest earned will cancel out inflation. Historically, that's been true."

The cost factor

In Huberger's experience, the cost estimates for reserve analyses vary greatly. "They're contingent on a number of factors. One is the number of components in the study. If you've got 20 components, it's not too expensive; if you've got 100 c[illegible]onents, it could be very ex[illegible]. It also depends on the [illegible] you use. I have seen phenomenal price variations; a lot of it is simply what the traffic will bear.

"Some of the costs depend on the firms' overhead—silk-stocking architectural firms [and] silk-stocking engineering firms cost more, just like silk-stocking law firms or silk-stocking CPA firms. You're paying for the partners' time as well as the person who's actually doing the study."

Huberger says he prefers to work with smaller firms, where every decision doesn't have to be approved by multiple honchos, and where you're likely to get the owner of the company doing the work.

Alan Yore is president of Alan R. Yore and Associates in Arlington Heights, an architectural firm specializing in services to condo associations. While he cautions that reserve analyses "are not gospel," he says, "I believe firmly that they're a necessary working tool."

Yore says the time and cost of an analysis varies widely according to the type of condo association he's dealing with. "A high-rise is a lot different from a townhouse development. I like to start with the building plans. And I need the condominium declaration; I need to know what is and is not a common area. From those, I prepare a list of elements—mechanical, electrical and so on. At the site, I do a visual analysis, and try to judge if things have been appropriately maintained. And then I try to arrive at the remaining useful life and the replacement cost, in today's dollars."

Yore's analysis extends 20 years down the road, "but in practice, it's only good for 5 to 10 years; it takes a crystal ball to go beyond that." Ideally, he says, associations should update their studies every five years—a much cheaper process, he notes, if the firm that did the original analysis is called back for the subsequent checkups.

Associations can save some money, he points out, if they have their paperwork together—the building plans and maintenance reports—because that saves the consultant time. "I normally get information by sitting down with the managing agent, and finding out when things were last repaired, and what it cost." And post-analysis, he suggests, a maintenance log should be kept, at least on the major equipment.

What do you get?

What do associations get for a study that's going to cost a minimum of a couple of thousand dollars, and can go on up from that base? "We deliver a chart that addresses each of the items, carrying the costs forward at least 25 years, using today's dollars," says Peter Majewski, an architect and consultant with Wiss Janney Elstner, with offices in Northbrook and Chicago. With the new law in place mandating "reasonable reserves," he points out, deciding how much in the way of reserves an association needs "is a heavy burden for a board to take on." The reserve analysis helps with that re-

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sponsibility. Furthermore, Majewski points out, "we can often recommend maintenance to prolong the life of the equipment. The board can save money; it's an added benefit."

Notes Jerry Heilbrunn, a property manager with Draper & Kramer, "It's not always the most in-depth, detailed reports that are the best ones; they're not user-friendly. You don't want the report to be so detailed and so cumbersome that it's not usable. It needs to be detailed enough to cover all the bases, and not so cumbersome that it's intimidating."

Are reserve analyses necessary for all condo associations? From downtown high-rises to sprawling multibuilding developments in the suburbs, Majewski believes they are. The only exception he offers is the very small association.

"It's different when you have four or six homeowners. The time is almost equal to the time you spend on a high-rise. You have to go through the same effort for six as for 200. But when you have only six people to pay for it, it's very expensive."

Janet Leonhardi agrees. The owner of one unit in a six-unit building on the North Side, she says, "We wouldn't consider doing one. We keep our reserves up, and we keep our costs down by doing our own maintenance. We don't have a management company advising us; we do it all by the seat of our pants. We're small enough that it works for us."

The whole subject of reserves is one that sparks debates in most associations, says Roberta Skelton. On the board of her middle-sized development in Park Ridge, she finds the new law vague and hard to interpret.

"You have to take into account the ability of people to pay a special assessment; if they are able to pay one, they're very reluctant to see their money sitting in a reserve. If they move, they won't get their money back, so they'd rather pay as they go. People in more straitened circumstances want big reserves, paying a small amount each month. It's a very emotional subject, and the owners constantly bicker about it."

Her association hasn't done a reserve analysis. "These firms charge a great deal of money to do something we could probably do ourselves," she says. "If we see a major expense coming, we build our reserves to pay for it. If we have to replace the swimming pool, or repave the driveways, we work out a special assessment and increase the monthly charge. Of course, people complain that once the assessment goes up, it never goes down."

Photo for the Tribune by Tim Boyle

"Reserves are like having money in a cookie jar," says realty executive Shirl Tole. "If it's there, you're far more likely to take care of things when they need it."

A dissenter on the reserve analysis issue is Michael T. Frost, a longtime board member and former president of Harbor Point Condominiums in downtown Chicago. "The problem is that our wondrous state legislature passed some legislation that required ... adequate reserves; unfortunately, it isn't too specific as to what constitutes proper reserves. People are wondering what to do. So all of a sudden, all kinds of consultants are springing up. It's the latest condo scam. The methodologies, the state of the art, have really not proven to my mind to be adequate."

For instance, he points out, consultants typically look at the cost of replacing an item with its current equivalent. "But by the time you replace it, the technology has changed drastically. If you have a big boiler, you will not replace it with the same kind you put in the building. You'll put in three or four smaller ones, so you can run just one or two in the summer, for more efficiency. We had pneumatic controls for our co[m]mon area heating and vent[ila]tion; they cost $20,000 a year [to] maintain. We ripped them [out] and replaced them with [a] microprocessor that doesn't [re]quire maintenance.

"Buildings do have to ren[ew] themselves over time, but y[ou] find that everything is changi[ng] rapidly. You have all these co[m]puter-controlled devices that [are] getting cheaper every year a[nd] they bring a payback in efficie[n]cy and maintenance. There [are] new toppings for roadways a[nd] treatments for concrete that [make] them last longer. You can't ta[ke] the traditional approa[ch] anymore."

Finally, he notes that, as n[ot-]for-profit organizations, the i[n]terest condo associations earn[ed] on their reserves wasn't taxabl[e]. But the federal government h[as] now changed that rule.

But, says Heilbrunn of Drap[er] & Kramer, the condo reserv[e] analysis "is one of the best too[ls] we have to use in the budgetin[g] process. There's nothing wors[e] for a building than to wake u[p] one day and find you need som[e] major repair—and you don'[t] have the reserves."

"Reserves are like havin[g] money in a cookie jar," say[s] Shirl Tole. "If it's there, you'r[e] far more likely to take care o[f] things when they need it. If you[r] cookie jar is empty, you're mor[e] likely to procrastinate, and put i[t] off until it's *really* expensive. And then you're in real trouble."