

# DAYBREAK AT ISSAQUAH RIDGE

ISSAQUAH, WASHINGTON

FULL RESERVE STUDY

SEPTEMBER, 2013



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## EXECUTIVE SUMMARY

### BACKGROUND:

Name:	Daybreak	Date:	SEPTEMBER, 2013
Type of Study:	Level 1 – Full Reserve Study	No. of Units:	90

Daybreak at Issaquah Ridge is a 90-unit residential community located in Issaquah, Washington. The community consists of 7 wood framed buildings that are three stories. The buildings have vinyl siding and asphalt composition shingle roofs. Construction of the buildings was completed in 2000.

### FINANCIAL INFORMATION:

Reserve Account Balance on 3-31-2013:	\$197,617
Annual Operating Budget:	\$297,706
Component Inclusion Threshold:	\$2,977
Annual Budgeted Contribution Rate (2013):	\$75,096
Remaining Contribution for the Year:	\$56,321
Planned or Implemented Special Assessment:	None
Fully Funded Balance:	\$395,213
<b>Percent Funded at Time of Study:</b>	<b>50%</b>
Funding Status at Time of Study:	Adequately Funded

### RECOMMENDATIONS:

<b>Recommended 2014 Contribution:</b>	\$74,400
Recommended Contribution per Month:	\$6,200
Average Contribution per Unit per Year:	\$827
Average Contribution per Unit Per Month:	\$69
Recommended Special Assessment:	None
Timeline for Fully Funded Status:	67% Fully Funded in Year 30
2014 Baseline Funding Plan Contribution Rate:	\$69,900
2014 Full Funding Plan Contribution Rate:	\$79,100

The recommended reserve contribution represents a Threshold Funding Plan to prevent special assessments over the course of the 30-year study **while maintaining a minimum reserve account balance of one year's annual contribution**. The fiscal year for the Reserve Study is a calendar year.

Cost projection accuracy decreases into the distant future. Assumptions should be reconsidered and updated with each revision of the study.

There is no legal requirement to fund reserves. There is a requirement to have a current Reserve Study to know the recommended reserve contribution rate. Reserve Studies must be updated annually to reflect recent financial information, repairs or replacements, and to adjust for future repair costs. Every three years, the update must be based on a visual on-site inspection conducted by a Reserve Study Professional.

### **ESTIMATED REPAIR SUMMARY**

The following repairs make up the bulk of the Associations' reserve funding requirements. Changing the timing or costs of these items may result in changes to the recommended contribution. Independent design specifications and oversight are recommended for repairs to the building envelope. It is also recommended that the planning stages for these repairs start at least one year before the estimated repair to obtain a scope of repair, select and schedule a contractor, and secure financing for the project.

#### **MAJOR EXPENSES OVER THE NEXT 30 YEARS:**

<b>COMPONENT – REPAIR TO BE MADE:</b>	<b>NEXT IN YEAR:</b>	<b>ESTIMATED COST:</b>
7.4.1 - Roof, Replace	17 (2030)	\$349,636
6.1.2 - Decks, Repair	18 (2031)	\$304,638
6.1.2 - Decks, Re-Coat	6 (2019)	\$143,470
6.2.2 - Siding, Repair	10 (2023)	\$44,495
7.4.1 - Roof, Repair	7 (2020)	\$35,151
16.6.1 - Exterior Lighting	7 (2020)	\$29,089

## INTRODUCTION

### PURPOSE OF A RESERVE STUDY:

The purpose of a Reserve Study is to recommend a reasonable annual reserve Contribution Rate made by an association to its reserve account. Reserve accounts are established to fund major maintenance, repair, and replacement of common elements, including limited common elements, expected to be necessary within the next thirty years. A Reserve Study is intended to project adequate funds for the replacement or major repair of any significant component of the property as it becomes necessary without relying on special assessments. It is a budget planning tool which identifies the current status of the reserve account and a stable and equitable Funding Plan to offset the anticipated future major shared expenditures.

Each reserve component is evaluated to determine the current condition, the remaining useful life, and the estimated replacement cost. This information is combined into a spreadsheet to determine funding requirements and establish the annual contribution rate needed to minimize special assessments. All costs and annual reserve balances are shown in constant dollars, and with adjustments for annual inflation and interest earned. Ideally, an even level of contributions is established that maintains a positive balance in the reserve account over the timeline the study examines.

A Reserve Study also calculates a “Fully Funded Balance”. Fully Funded Balance is the sum total of the reserve components’ depreciated value using a straight line depreciation method. To calculate each component’s depreciated value:

$$\text{Depreciated Value} = \text{Current Replacement Cost} \times \frac{\text{Effective Age}}{\text{Expected Useful Life}}$$

When assessed with the current reserve balance, the Fully Funded Balance yields a Percent Fully Funded. This acts as a measuring tool to assess an association’s ability to absorb unplanned expenses. These expenses could be emergency repairs not covered by insurance, or expenses that differ from the existing Reserve Study in terms of timing or cost.

The Fully Funded Balance is neither the present replacement cost of all of the Association’s reserve components, nor does it have a mathematical relationship to the recommended reserve contribution funding plans. For a detailed explanation, with examples, see “Fully Funded Balance Relationship to the Contribution Rate” appendix.

There are three levels of Reserve Studies:

- The first level, an initial Reserve Study, must be based upon a visual site inspection conducted by a Reserve Study Professional. This is also known as a full **Level 1** Reserve Study.

- At least every three years, an updated Reserve Study must be prepared and based upon a visual site inspection conducted by a Reserve Study Professional. This is also known as a **Level 2** Update with Site Visit.
- Every year, the Association must update the Reserve Study. Except as noted above, the annual updates do not require a site visit. This is also known as a **Level 3** Update without Site Visit.

This study is a **Level 1** – Full Reserve Study.

**GOVERNMENT REQUIREMENTS FOR A RESERVE STUDY:**

The content of a Reserve Study for a condominium is regulated by the Washington State government (RCW 64.34.382 §2). The required content is:

- (a) A reserve component list, including roofing, painting, paving, decks, siding, plumbing, windows, and any other reserve component that would cost more than one percent of the annual budget for major maintenance, repair or replacement. If one of these reserve components is not included in the Reserve Study, the study should provide commentary explaining the basis for its exclusion. The study must also include quantities and estimates for useful life of each reserve component, remaining useful life of each reserve component, and current repair and replacement cost for each component;
- (b) The date of the study and a statement that the study meets the requirements of this section;
- (c) The following level of reserve study performed: (i) Level I: Full reserve study funding analysis and plan; (ii) Level II: Update with visual site inspection; or (iii) Level III: Update with no visual site inspection;
- (d) The association's reserve account balance;
- (e) The percentage of the fully funded balance that the reserve account is funded;
- (f) Special assessments already implemented or planned;
- (g) Interest and inflation assumptions;
- (h) Current reserve account contribution Current reserve account contribution rate;
- (i) A recommended reserve account contribution rate; a contribution rate for a full funding plan to achieve one hundred percent fully funded reserves by the end of the thirty-year study period, a baseline funding plan to maintain the reserve balance above zero throughout the thirty-year study period without special assessments, and a contribution rate recommended by a reserve study professional;
- (j) A projected reserve account balance for thirty years and a funding plan to pay for projected costs from those reserves without reliance on future unplanned special assessments; and
- (k) A statement on whether the reserve study was prepared with the assistance of a reserve study professional.

**The Washington State government further requires the following disclosure in every Reserve Study (RCW 64.34.382 §3):**

**"This reserve study should be reviewed carefully. It may not include all common and limited common element components that will require major maintenance, repair, or replacement in future years, and may not include regular contributions to a reserve account for the cost of such maintenance, repair, or replacement. The failure to include a component in a reserve study, or to provide contributions to a reserve account for a component, may, under some circumstances, require you to pay on demand as a special assessment your share of common expenses for the cost of major maintenance, repair, or replacement of a reserve component."**

The full Washington Condominium Act may be reviewed on the Washington State Legislature's website at <http://apps.leg.wa.gov/rcw/default.aspx?cite=64.34> and parts 64.34.380 to 64.34.392 for the Reserve Study Amendment's portions. In April 2011, the Act was amended to change the required content within the Reserve Studies, add reporting of the Reserve Study results as part of the budget summary to owners, and extend the Reserve Study requirement to homeowners' associations with significant assets. For questions regarding the Act, we recommend contacting an attorney familiar with condominiums' legal requirements.

**LIMITATIONS AND ASSUMPTIONS OF A RESERVE STUDY:**

This Reserve Study is not a report on the condition of the buildings maintained by the Association, or a detailed report of repairs necessary to the building. It is also not an investigation into or comment on the quality of construction of the reserve components, or whether the construction complies with the building code or the requirements of the Washington Condominium Act.

The observations made by Reserve Consultants Ltd. are limited to a visual inspection of a sample of the reserve components. Unless informed otherwise, our assumption is that the components are constructed in substantial compliance with the building code and to industry standards, and that it will receive ordinary and reasonable maintenance and repair by the Association. These assumptions include that most reserve components will achieve their normal useful lives for similar components in the Pacific Northwest, and that they will be replaced when necessary to prevent damage to other reserve components.

This Reserve Study assumes that the Association will be maintained to keep a good level of appearance, with a special emphasis on retaining the original appearance of the Association to the greatest possible extent. The analysis also assumes that the Association will replace materials as they are required with good quality materials,

installed by qualified, licensed, contractors. We further assume that the Association will experience the full typical useful life for the new materials installed.

The long term nature of this study requires that certain assumptions and predictions be made about future events. Since there can be no guarantee that these future events will occur as assumed, this analysis must be viewed in light of the circumstances under which it was conducted. Reasonable effort has been made to ensure that the conclusions of this report are based on reliable information and sound reasoning.

This report should be updated annually with actual repair costs, reserve balances, etc. Every three years it should be updated with a site inspection and professional review. Regular updating will allow changes based on actual occurrences and adjustments for the cost of repairs to be incorporated into the annual reserve contributions. This will allow any savings or additional costs to be properly allocated among unit owners.

#### **OUR APPROACH TO A RESERVE STUDY:**

Reserve Consultants Ltd. employs a “Reasonable Approach” when evaluating reserve components in order to draft a study that is of greatest value to our clients. This means we attempt to predict, based on the costs involved and the client’s objectives, what a reasonable person will decide to have done when maintenance, repairs, or replacement become necessary. For example, a reasonable person will not replace a fence when it only needs to be repainted. The benefit of this is that reserve contributions are minimized to allow for what it most likely to occur. Our studies are not based on a worst case scenario, but rather on what we expect is most likely to occur. Our approach assumes minor problems will be corrected as they occur, before they become major problems.

Many sources were used in drafting this report. These include:

- Site visits and inspection of facilities;
- Conference with association representatives;
- Review of architectural plans of the buildings, if made available;
- Review of the declaration for the Association, or a list of components the Association is responsible for;
- Generally accepted construction, maintenance, and repair guidelines.

The costs estimated for this Reserve Study are based on several sources:

- Costs experienced by Daybreak ;
- Costs experienced by other associations in the area;
- RS Means Building Construction Cost Data 2013.

Several factors may influence the actual costs that the Association will experience. The quality of replacement materials of items can significantly impact cost, as well as the



timing between replacements. The use of Architects or independent construction managers to specify and oversee work may also cause additional expenses. Condominium associations typically experience higher costs than other comparable multifamily projects, in part due to the difficulty contractors have obtaining insurance to work on condominium buildings.

When making estimates on the future inflation and interest rates, we use a staggered approach given the current economic environment. For 2013 and 2014, we use an inflation rate of 3%, and an interest rate of 1%. For the remaining years of the study, we use a 4% inflation rate and a 3% interest rate.

#### **RESERVE STUDY BENEFITS TO UNIT OWNERS:**

The benefits of a consistent annual reserve contribution as determined by a Reserve Study are many:

- **Provides disclosure to buyers and owners.** No matter how the Association chooses to fund its reserves, the Reserve Study will provide owners and prospective purchasers with information about future expenses for repair and replacement of the common elements so that they can make an informed decision about buying and owning a unit. It will help eliminate the surprise of large unexpected repairs costs, which may be passed on to owners.
- **Is fair.** Each owner contributes only for the useful life consumed during their term of ownership. When used from the start of an association, current owners are not assessed for what previous owners did not pay.
- **Protects the owner's investment.** By ensuring that funds always exist to keep a community maintained and functional, each owner's investment in their unit is protected.
- **Increases salability & lending attractiveness.** Savvy purchasers and lenders are closely examining association finances before making commitments. A good Reserve Study and adequate reserves illustrate an association's financial health and endurance. Lenders often require that associations have adequate reserve contributions, or they will not offer loans for units within the association.
- **Reduces special assessments.** By utilizing a reserve study to aid in medium and long range planning, the need for special assessments is greatly reduced. This assists personal financial planning and reduces uncertainty and fear of ownership.
- **Complies with the Washington Condominium Act.** The Washington Condominium Act requires that all condominiums' have a reserve study prepared by an independent professional qualified in drafting a reserve study. Reserve Consultants Ltd. has been performing reserve studies in the Greater Puget Sound area since 1992, and employs qualified independent Reserve Study Professionals.

## **ASSOCIATION OVERVIEW**

Daybreak at Issaquah Ridge is a 90-unit residential community located in Issaquah, Washington. The community consists of 7 wood framed buildings that are three stories. The buildings have vinyl siding and asphalt composition shingle roofs. Construction of the buildings was completed in 2000.

The Association has asphalt roads and parking areas lined by concrete curbs and sidewalks. There are a combination of both carports and garages located on the street behind the buildings. The units feature exterior decks and unit entry balconies.

There are several items that individual unit owners are responsible to maintain and pay for, including, but not limited to, damage by tenants or their pets. Refer to individual component descriptions for additional components that are the individual unit owners' responsibility.

The costs for these items are not included in the reserve account contribution recommendations. Individual owners should remember that they have the responsibility to pay for repairs to these elements and added items. The Association should establish policies and processes regarding the maintenance on these "owner responsibility" items.

## REVIEW OF GENERAL CONDITIONS

The overall appearance of the building is very good. The asphalt paving was repaired and seal coated in 2011. The exterior vinyl siding is in good condition. The paint on the trim is weathering as expected. Repaired and recoated in 2013, the exterior decks and unit entry balconies appear to be in great condition. There were no issues reported with the asphalt shingle roofs. Replacing the windows is the responsibility of the unit owner. The windows are original to the building. No issues were reported with the plumbing or drainage. The grounds and landscaping appear to be regularly maintained. Minor and major repairs have been conducted on a regular basis.

### **MAJOR EXPENSES OVER THE NEXT 30 YEARS:**

<b>COMPONENT – REPAIR TO BE MADE:</b>	<b>NEXT IN YEAR:</b>	<b>ESTIMATED COST:</b>
7.4.1 - Roof, Replace	17 (2030)	\$349,636
6.1.2 - Decks, Repair	18 (2031)	\$304,638
6.1.2 - Decks, Re-Coat	6 (2019)	\$143,470
6.2.2 - Siding, Repair	10 (2023)	\$44,495
7.4.1 - Roof, Repair	7 (2020)	\$35,151
16.6.1 - Exterior Lighting	7 (2020)	\$29,089

### **COMPONENTS EXCLUDED FROM THE RESERVE STUDY:**

The following components qualify for inclusion within the Reserve Study, but have been excluded for the following reasons:

**2.9.1 Landscaping** – Maintained through operating budget.

**5.4.1 Rails, Aluminum** – Expected to last longer than the 30-year reserve timeline.

**8.2.1 Doors** – Expected to last longer than the 30-year reserve timeline.

**8.5.1 Windows** - Unit Owner Responsibility.

**10.1.1 Carports** - Expected to last longer than the 30-year reserve timeline.

**15.4.2 Storm Water System** - Maintained through operating budget.

**16.3.1 Electrical** - Expected to last longer than the 30-year reserve timeline.

## FINANCIAL ANALYSIS & RESERVE CONTRIBUTION RECOMMENDATIONS

For budgeting purposes, we recommend that Daybreak set the contribution rate at \$74,400 for reserves beginning in 2014. This amount should increase annually with inflation. This amount is determined using the Cash Flow method with a Threshold Funding plan, to provide adequate reserves each time an expense is anticipated, with a minimum level of reserves (the threshold) equal to one year's reserve contribution at all times during the study period, so that no special assessments will be required. These figures are based on a reserve balance on 3-31-2013 of \$197,617, plus a planned remaining 2013 reserve contribution of \$56,321. Figures were provided by an association representative. Daybreak should determine the best reserve funding level for their association based on their maintenance needs and risk aversion.

<b>Recommended 2014 Contribution:</b>	\$74,400
Recommended Contribution per Month:	\$6,200
Average Contribution per Unit per Year:	\$827
Average Contribution per Unit Per Month:	\$69
Average Contribution per Unit per Year as a Percentage of Average Unit Value:	0.52%

The contribution as a percentage of average unit value is calculated to provide a way for owners, and prospective owners, to compare the reserve requirements of one association with that of another association or of single-family home ownership. Typically, condominium associations in the Puget Sound area need to set aside from ½% to 1% of their average unit value, homeowners' associations need to put aside 1/3% to ½% and single family homeowners should put aside 1% to 2% each year.

**See the Tables & Graphs section for additional information on contribution rates, expected expenses, and projected inflated values.**

### FUNDING PLANS

As noted above, an annual contribution of \$74,400 is a Threshold Funding plan to provide funding as expenses are incurred over time, while maintaining a minimum reserve balance of one year's contribution. Absent specific instructions from clients, or unusual circumstances, this is our recommended funding plan.

An alternative strategy Daybreak could employ is Baseline Funding. This provides for necessary expenditures without maintaining a minimum reserve balance. To pursue such a strategy, the recommended Baseline Funding contribution rate would be \$69,900.

Daybreak could also consider contributions to obtain and maintain the level of reserves to be Fully Funded, so that the Percent Fully Funded is 100% by Year 30. The recommended Full Funding contribution rate would be \$79,100.

We recommend that Daybreak adopt a policy regarding their reserve funding which would address the level of funding that the Association would strive to maintain, as well as methods of investing reserve funds to best match risk with return and investment length with expected expenses.

### **FULLY FUNDED BALANCE CALCULATIONS**

The Fully Funded Balance for Daybreak is \$395,213. The actual current funding is \$197,617. The Association is approximately 50% funded. This means that based on a straight line savings for each reserve component, the Association saved 50% of the accumulated depreciation of the reserve components.

Generally, associations that are:

- 60% or more Funded are considered reasonably well funded;
- 25% to 60% are considered adequately funded;
- 25% or less Funded are considered at high risk for special assessment.

At 50%, Daybreak is considered adequately funded.

See the Fully Funded Balance Calculation table for more detail, and the graph for a visual representation of the current level of funding.

## **DISCLOSURES**

1 – RESERVE CONSULTANTS LTD. ALSO PROVIDES CONSTRUCTION INSPECTION SERVICES FOR CONDOMINIUMS, AND DOES DESIGN AND CONSTRUCTION OVERSIGHT FOR MAJOR REPAIR PROJECTS, INCLUDING ROOFING, DECKS AND BUILDING ENVELOPE REPLACEMENT.

2 – KEN HARER, A PRINCIPAL OF RESERVE CONSULTANTS LTD. IS ALSO THE MANAGING PARTNER OF CONDOMINIUM LAW GROUP, PLLC, A LAW FIRM THAT PROVIDES LEGAL SERVICES TO CONDOMINIUMS AND OTHER COMMUNITY ASSOCIATIONS.

3 – NO SHAREHOLDER OR EMPLOYEE OF RESERVE CONSULTANTS LTD. HAS ANY INTEREST IN, OR OBLIGATION TO, ANY CONSTRUCTION COMPANY, MANAGEMENT COMPANY, OR DEVELOPMENT ENTITY THAT CREATES CONDOMINIUMS.

4 – RESERVE CONSULTANTS LTD. HAS BEEN A MEMBER OF COMMUNITY ASSOCIATION INSTITUTE SINCE ABOUT 1993, AND HAS PERFORMED WORK FOR MANY ASSOCIATION MANAGERS.

5 – THIS REPORT AND ANALYSIS IS BASED UPON OBSERVATIONS OF THE VISIBLE AND APPARENT CONDITION OF THE BUILDING AND ITS MAJOR COMPONENTS ON THE DATE OF THE INSPECTION. ALTHOUGH CARE HAS BEEN TAKEN IN THE PERFORMANCE OF THIS INSPECTION, RESERVE CONSULTANTS LTD. (AND/OR ITS REPRESENTATIVES) MAKE NO REPRESENTATIONS REGARDING LATENT OR CONCEALED DEFECTS WHICH MAY EXIST AND NO WARRANTY OR GUARANTEE IS EXPRESSED OR IMPLIED. THIS REPORT IS MADE ONLY IN THE BEST EXERCISE OF OUR ABILITY AND JUDGMENT. CONCLUSIONS IN THIS REPORT ARE BASED ON ESTIMATES OF THE AGE AND NORMAL WORKING LIFE OF VARIOUS ITEMS OF EQUIPMENT AND APPLIANCES. PREDICTIONS OF LIFE EXPECTANCY AND THE BALANCE OF USEFUL LIFE ARE NECESSARILY BASED ON INDUSTRY AND/OR STATISTICAL COMPARISONS. IT IS ESSENTIAL TO UNDERSTAND THAT ACTUAL CONDITIONS CAN ALTER THE USEFUL LIFE OF ANY ITEM. THE PREVIOUS USE OR MISUSE, IRREGULARITY OF SERVICING, FAULTY MANUFACTURE, UNFAVORABLE CONDITIONS, ACTS OF GOD, AND UNFORESEEN CIRCUMSTANCES MAKE IT IMPOSSIBLE TO STATE PRECISELY WHEN EACH ITEM WOULD REQUIRE REPLACEMENT. THE CLIENT HEREIN SHOULD BE AWARE THAT CERTAIN COMPONENTS WITHIN THE ABOVE REFERENCED PROPERTY MAY FUNCTION CONSISTENT WITH THEIR PURPOSE AT THE TIME OF INSPECTION, BUT DUE TO THEIR NATURE, ARE SUBJECT TO DETERIORATION WITHOUT NOTICE.

6 – UNLESS OTHERWISE NOTED, ALL RESERVE COMPONENTS ARE ASSUMED TO MEET THE BUILDING CODE REQUIREMENTS IN FORCE AT THE TIME OF CONSTRUCTION. INFORMATION PROVIDED BY THE CLIENT IS ASSUMED TO BE ACCURATE AND RELIABLE.

7 – CONCLUSIONS REACHED IN THIS REPORT ASSUME RESPONSIBLE OWNERSHIP AND COMPETENT MANAGEMENT OF THE PROPERTY. INFORMATION PROVIDED BY OTHERS IS BELIEVED TO BE RELIABLE, BUT WE ASSUME NO RESPONSIBILITY FOR ACCURACY THEREOF.

**APPENDICES:**



*Reserve  
Consultants*  
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**EVALUATORS' CREDENTIALS**

**JOHN LEONARD**      ASSOCIATE, RESERVE CONSULTANTS LTD.  
BS UNIVERSITY OF MASSACHUSETTS AT AMHERST

John Leonard holds a certificate in Project Management from Boston University and has training in building inspection and ICC building codes. Since August of 2003, John has worked on a variety of projects, large and small. As an Associate of Reserve Consultants, John has been working with condominium associations in management of substantial capital improvement and repair projects, including exterior envelope repair and plumbing replacement since 2003. He has an extensive background in project management. Prior to joining Reserve Consultants, John had five years' experience as a project manager in the high tech sector. In 2011, he became a recognized "Reserve Specialist" by the Community Association Institute.

**IAN GARAVAGLIA**      ASSOCIATE, RESERVE CONSULTANTS LTD.  
BS UNIVERSITY OF WASHINGTON

Ian Garavaglia graduated from the University of Washington with a degree in Sociology. Since graduation Ian has spent the past 10 years working as a general contractor with Williams Scotsman on various projects across the county. He has helped to manage various trades throughout the construction process on multimillion dollar projects such as the Marysville High School campus and the Ruby Pipeline operational facilities.





### **FULLY FUNDED BALANCE RELATIONSHIP TO THE CONTRIBUTION RATE**

The contribution rate is the steady level of annual reserve contributions to keep the reserve account balance above zero and pay for all anticipated repairs as they occur for 30 years into the future. It is the amount sufficient to pay for repairs as they occur, and does not have any mathematical connection to the Fully Funded Balance or the Percent Fully Funded.

The Fully Funded Balance relates to how much the building has deteriorated compared to the cost of making it like new again. For example, if a roof will last 10 years and cost \$100,000 to replace, then when it is 2 years old it is 20% used up, and the Fully Funded Balance for its future replacement will be \$20,000. When it is 8 years old, it will be 80% deteriorated, and its fully funded balance would be \$80,000.

However, if no savings were kept since the roof was installed for its replacement, and it is already 5 years old, then it would need a contribution rate of \$20,000 for the next 5 years to pay for the roof when it reaches 10 years old. At Year 6, 20% of the repair cost would be saved, but the Fully Funded Balance would be \$60,000, and it would only be 33% fully funded. Year 7 would have \$40,000, and move to 57% funded (since the Fully Funded Balance went to \$70,000). The roof would only be fully funded the year of the last contribution and pay for the new roof.



### SAMPLE FULLY FUNDED BALANCE CALCULATIONS AND CONTRIBUTION RATE

Here is a sample of how the Fully Funded Balance is calculated for a simple association with 6 reserve components. For ease of calculation, one component reaches the end of its useful life each year, each has a useful life of 6 years, and each costs \$100,000 to replace.

#### Fully Funded Balance Calculations

#### SAMPLE ASSOCIATION

COMPONENT DESCRIPTION	USEFUL LIFE	EFFECT. AGE	REMAIN USEFUL LIFE	CURRENT REPLACE COST	FULLY FUNDED BALANCE
Plumbing	6	6	0	\$ 100,000	\$ 100,000
Parking lot	6	5	1	\$ 100,000	\$ 83,333
Roof	6	4	2	\$ 100,000	\$ 66,667
Paint	6	3	3	\$ 100,000	\$ 50,000
Decks	6	2	4	\$ 100,000	\$ 33,333
Siding	6	1	5	\$ 100,000	\$ 16,667
<b>TOTAL FULLY FUNDED BALANCE</b>					<b>\$ 350,000</b>

**IF ACTUAL RESERVE BALANCE = \$ 50,000**

**THEN PERCENT FULLY FUNDED = 14%**

Every year, this association needs \$100,000 as a reserve Contribution Rate to fund its repairs to avoid special assessments. **This is true regardless of how much money it has in reserves to start.** If the association starts with a reserve of \$50,000, it is 14% funded. If it starts with a reserve balance of \$300,000, it is 86% funded. Either way, the contribution rate should be \$100,000, because that is the average repair expense each year. The only exception to this is the odd case of an overfunded association (more than 100%) where the contribution rate may be less for a few years until savings reaches a risk level that the association finds acceptable.

#### Why is the Percent Fully Funded Important?

If the association experiences those unplanned expenses, a high reserve balance will cover unexpected expenses. **An association with a well-funded reserve account has less risk of special assessments to pay for unexpected expenses.** A poorly



funded association would have a higher risk of a special assessment. With an unexpected \$100,000 expense, the 14% funded association shown above runs out of money and needs a special assessment to cover the cost. The 86% funded association drops to 57% funded, but does not require a special assessment. The Contribution Rate remains unchanged for both.

An association that is Fully Funded may have large cash reserves, and will still be making the same contributions unless it allows itself to become less Fully Funded. Since the association has to contribute \$100,000 every year whether it is 14% funded or 100% funded, it can choose whether or not it wants to keep that extra \$300,000 in the association's reserve account, or in the hands of its members.

We typically recommend that the association select a minimum reserve account balance, or Threshold it wants to maintain, and select a contribution rate to maintain that minimum rather than try to build their account to 100% fully funded. We further recommend associations consider a threshold balance equal to one year's reserve contribution. However, each association must judge their unique risk tolerance. Sometimes, the contribution rate necessary to cover repairs in the near term will build to Fully Funded in the later portions of the 30 year time frame.

Other observations based on our simple 6 component association: If the association starts at 14%, to build the fund to a Fully Funded condition in 30 years requires they increase their annual contribution to \$110,000. If they want to build to a fully funded condition in 13 years, they need to contribute \$125,000 a year. That extra \$25,000 a year is not necessary to pay for any repairs over the period of the study.



## **GLOSSARY OF TERMS**

If a term is defined by law, it is so noted and placed within quotes. Some terms, like “significant assets” have different definitions from the Condominium Act or Homeowners’ Association Act; the relevant one is provided here.

**“Baseline Funding Plan”** – It means establishing a reserve funding goal of maintaining a reserve account balance above zero dollars throughout the thirty-year study period described under RCW 64.34.380. RCW 64.34.020 (41)

**Component Number** - A number assigned to each reserve component that allows grouping of like components. Based roughly on Construction Industry Standards.

**Common Elements** – Those portions of the building which are owned collectively by all owners in a community, and for which the association is responsible.

**"Contribution Rate"** means, in a Reserve Study as described in RCW 64.34.380, the amount contributed to the reserve account so that the association will have cash reserves to pay major maintenance, repair, or replacement costs without the need of a special assessment. RCW 64.34.020 (10) and RCW 64.38.010 (6)

**Constant Dollars** - Pretends that inflation does not exist. Shows all costs and contributions in today’s dollars, no matter how far in the future they occur.

**”Effective Age”** Means the difference between the estimated useful life and the remaining useful life. RCW 64.34.020 (19) and RCW 64.38.010 (7)

**Experience** - A term used in component sheets to describe how a component Useful Life might be determined. This term indicates that the inspector is using his past knowledge of similar situations to predict a ‘useful life’.

**“Full Funding Plan”** – It means setting a reserve funding goal of achieving one hundred percent fully funded reserves by the end of the thirty-year study period described under RCW 64.34.380, in which the reserve account balance equals the sum of the deteriorated portion of all reserve components. RCW 64.34.020 (42)

**"Fully Funded Balance"** Means the current value of the deteriorated portion, not the total replacement value, of all the reserve components. The Fully Funded Balance for each reserve component is calculated by multiplying the current replacement cost of that reserve component by its effective age, then dividing the result by that reserve component's useful life. The sum total of all reserve components' Fully Funded Balances is the association's fully funded balance. RCW 64.34.020 (22) and RCW 64.38.010 (9)

**Inflated Dollars** - As opposed to constant dollars, inflated dollars recognize that costs in the future will probably be higher than today because each dollar will buy fewer goods and services. A rate of inflation must be assumed and applied to all future costs. Also referred to as future cost.

**Inflation Multiplier** - 100% plus the assumed rate of inflation. Thus, for an assumed yearly inflation rate of 5%, the "multiplier" would be 105% or 1.05 if expressed as a decimal number rather than as a percentage. Each successive year the previous year's "multiplier" is multiplied by this number to arrive at the next year's "multiplier."

**Interest Rate Multiplier** - The assumed rate of interest earned on the average annual reserve bank account balance. Thus, 4% interest would be 0.04 expressed as a decimal number. A rate of interest earned must be assumed for all future years. Typically this is lower than the rate of inflation.

**Limited Common Element** – Those common elements which are assigned exclusively to one or some Units. Unit owners may be responsible for the cost to repair and maintain limited common elements, so those costs will not appear in a Reserve Study.

**Means** - A term used in component sheets to describe how a component 'typical life' might be determined. This term refers to a book published by RS Means. The book lists various maintenance terms, problem solutions, and 'typical lives'.

**Next Repair** – The next time the "Repair Cycle" starts with work on a component.

**Percent Fully Funded** – The percent of the Fully Funded Balance which the current community Reserve Account actually has in it.

**RCW** – the **R**evised **C**ode of **W**ashington. RCW 64.34 is the Washington Condominium Act; the statute that governs condominiums. RCW 64.38 is the Washington Homeowners' Association Act; the statute that governs Homeowners' Associations.

**"Remaining Useful Life"** Means the estimated time, in years, before a component will require major maintenance, repair, or replacement to perform its intended function. RCW 64.34.020 (31) and RCW 64.38.010 (14)

**Repair Cycle** – The frequency of repair to maintain a component to reach or extend its Useful Life

**"Replacement Cost"** Means the current cost of replacing, repairing, or restoring a reserve component to its original functional condition. RCW 64.34.020 (32) and RCW 64.38.010 (15)

**Reserve Account** - Money set aside for future repair and replacement projects. For condominiums, the RCW requires a separate Reserve Account be maintained to hold reserves to fund repair or replacement of Reserve Components.

**"Reserve Component"** Means a common element whose cost of maintenance, repair, or replacement is infrequent, significant, and impractical to include in an annual budget. RCW 64.34.020 (34) and RCW 64.38.010 (16)

**Reserve Contribution** - The amount of money saved to fund replacement costs for maintenance and repairs of Common Elements. See "Contribution Rate". Current contributions and recommended contributions may be different.

**Reserve Specialist** – A designation for those professionals who have met the standards established by Community Associations Institute ([www.caionline.org](http://www.caionline.org)) for Reserve Study providers.

**"Reserve Study Professional"** Means an independent person suitably qualified by knowledge, skill, experience, training, or education to prepare a reserve study in accordance with RCW 64.34.380 and 64.34.382. RCW 64.34.020 (35) and RCW 64.38.010 (17)

**RSG** - A term used in component sheets to describe how a component 'typical life' might be determined. This term stands for 'Reserve Study Guide' which is a publication that lists some 'typical lives' for various components.

**"Significant assets"** – It means that the current total cost of major maintenance, repair, and replacement of the reserve components is fifty percent or more of the gross budget of the association, excluding reserve account funds. RCW 64.34.020 (43)

An example to calculate whether an association has significant assets is the following:

If the association has a sign (\$1,000), 3 park benches (\$1,500), and a fence along a property line (\$10,000), then their total cost for reserve component replacement would be \$12,500. The association would have significant assets if the operating budget was less than \$25,000 per year ( $\$12,500/\$25,000=50\%$ ).

**Special Assessment** - A levy against all unit owners that is necessary when a needed repair/replacement/upgrade cannot be funded from reserves.

**Threshold Funding Plan** – Our typical recommendation is a reserve Contribution Rate that is constant, increasing with inflation, to provide funds for all anticipated Reserve Expenses for the life of the study, but leaving a minimum level of Reserves (the "threshold") at all times. Our default minimum threshold is one year's contribution. It is also possible to have a "Threshold Funding Plan" that sets a minimum "Percent Fully Funded" below which an association would not fall during the study period or a specific money amount in constant or inflated dollars

**Typ.** - Abbreviation for 'typical'; used on photographs and in text to refer to a problem that is shown or described once, but applies to many locations.

**Typical Life** - An average expected life for an average reserve component. As in any statistical average, there is a range of years over which each individual item might fall. This is the same as "Useful life"

**"Useful Life"** Means the estimated time, between years, that major maintenance, repair, or replacement is estimated to occur. RCW 64.34.020 (40) and RCW 64.38.010 (20)

**Year End Balance or Reserve Balance** - What is projected to be left in the reserve account after the expected yearly expenses and contributions are added to the prior year's carryover balance. Assumes that the reserve contributions expenses occur as predicted.

**Yearly Expenses** - The total labor and material costs associated with all of the repairs/maintenance that are budgeted in that particular year.

**30-Year Spreadsheet** - A summary listing each reserve component and its yearly cost to maintain/repair over the next 30 years. It also lists the annual reserve balance, reserve contributions, reserve expenses and bank interest earned on any reserve balance.

## **GRAPHS & TABLES**

The following pages include the graphs and tables which illustrate our findings and were used to determine the optimum annual reserve contribution rate to the reserve account. It is important to realize that some of these items have large unknowns for both time and price. The estimates are based upon experience, industry averages and apparent component condition.

There are two categories of graphs and tables: Fully Funded Balance related and Reserve Projections related. The Fully Funded Balance material details how Daybreak's Fully Funded Balance was reached, along with its Percent Fully Funded and how we project they will change over time. The Reserve Projections material details the anticipated repairs and expected financial data over the next 30 years, both in constant dollars at today's value, and using our inflation forecasts.

The included Fully Funded Balance graphs and tables are:

1. Table – Fully Funded Balance Calculations
2. Graph – Percent Fully Funded
3. Graph – Inflated Percent Funded at Year End Over 30 Years at Recommended Contribution Rate
4. Graph – Inflated Fully Funded Balance vs. Projected Reserve Balance over 30 Years at Recommended Contribution Rate

The included Reserve Projection graphs and tables are:

1. Graph – Daybreak Reserve Projections: 2013 Constant Dollars
2. Table – Reserve Study Projections: 30-Year Spreadsheet with Constant Dollars
3. Graph – Daybreak Reserve Projections: Inflated Dollars
4. Table – Reserve Study Projections: 30-Year Spreadsheet Allowing for Inflation



**RESERVE COMPONENT INVENTORY FORMS**



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