

FUNDING RESERVE ACCOUNTS RESPONSIBLY PROTECTS YOUR COMMUNITY

Condominium associations frequently ask what annual contribution should, or must, be made to the reserve fund. In typical lawyer fashion the answer is “it depends”. It depends upon the age of your community, the history of funding reserves, the timeline for addressing capital projects, and the willingness to commit to fiscally prudent long-term budgeting. The shocking collapse of Surfside Condominiums in Miami this summer, the increasingly aging communities built in the 60’s, 70’s, and 80’s, and the ever-present pressure from owners to maintain the lowest possible monthly common charges cause Board members to face the daunting task of determining the level of funding to achieve reasonable reserves. Many factors affect the decision and will determine whether the level of funding is fiscally prudent kicks the can down the road to become an unreasonable burden on future owners.

Neither Connecticut nor federal law mandates the level of reserve funding. Each Association annually, however, “...shall provide to all unit owners a summary of the proposed budget, including a statement of the amount of any reserves, and **a statement of the basis on which such reserves are calculated and funded.**” See Conn. Gen. Stat. Section 47-261e(a)(1). The obligation to disclose the basis for the annual contribution to reserves forces the Board to defend its decision at each annual meeting or risk the budget being rejected by the unit owners.

Fannie Mae/Freddie Mac and FHA, federal agencies providing and guaranteeing mortgages for the purchase or refinance of units, require a yearly contribution of 10% of the annual budget, or the amount determined by a capital reserve study, which usually is greater than 10% unless the Association has maintained a very stringent reserve contribution policy for many years. Failure to contribute at least 10% prevents owners/purchasers from obtaining Fannie Mae/Freddie Mac or FHA financing as well as being blacklisted by banks, which follow those guidelines in their underwriting policies.

A capital reserve study is a long-term capital budget planning tool to analyze the Association’s annual contribution to reserves for the replacement or major refurbishment of common elements such as roofs, doors, windows, roads, exteriors of buildings, painting, etc. Benefits of a capital reserve study include turning projects into predictable expenses rather than a financial surprise, reliance upon expert opinion rather than lay people, and demonstrating fiscal responsibility to potential buyers. Depending upon the size of your community expect the \$3,500 - \$5,000 investment to be well-worth the expert advice needed for the Board, and owners, to budget prudently for the long-term health of the association’s common elements.

Most condominium owners sell their unit within eight years and, therefore, resist funding reserves since they will not be living in the community when the major capital project is needed. Landlords are focused on cash flow and profit rather than the long-term value of the community. Board members more concerned about being re-elected than the financial realities that are unavoidable in the long-term all contribute to underfunding reserves. David Haber, a Florida attorney in a New York Times Op Ed on July 29, 2021, commenting upon condominiums failing to fund adequate reserves stated: “(a)ll of this speaks to an unfortunate reality: For far too long, condominium owners have, in essence, eaten at the table and then left the restaurant, moving on and leaving subsequent owners to pay the bill for delayed maintenance that should have been paid for long ago when the tab was run.”

Underfunded reserves negatively affect the community in one, or more, of the following ways:

- A. Reduces the resale value of units. Purchasers will negotiate lower prices or seek a community with reserves adequately funded.
- B. Prohibits owners and purchasers from obtaining mortgages including Fannie Mae/Freddie Mac and FHA.

- C. Unexpected special assessments, which cause undue financial hardship especially on owners with fixed incomes.
- D. Increases the cost of the project since prices only increase.
- E. Increases the annual maintenance and repair costs for the upkeep of deteriorated capital items.
- F. Inability to pay an unexpected major expense such as an unexpected insurance deductible, boiler breakdown in the winter, etc.

Obtain, and rely upon, a capital reserve study to educate everyone and defend the level of funding to your reserve account. The short-term benefit to current owners by underfunding reserve contributions will only increase the pain suffered by the future owners as well as some of the current owners. Responsible Board members, acting in good faith for the benefit of the entire community by funding adequate reserves, are fulfilling their fiduciary responsibilities and protecting everyone's current and future value of many owner's most significant investment.

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