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THE CO-OP & CONDO RESOURCE

Everybody Hates Assessments

Handling the Unpleasant Inevitable

BY COOPERATORNEWS STAFF

Ahh, the pleasures of home ownership; a space to call your very own, to arrange and enjoy as you see fit, all while building equity. It's a key component of the American Dream—but when the faucet leaks in your condo or co-op unit, there's no more calling the landlord. You've got to fix it yourself. In shared interest communities, that's true of every component of the building, both inside and outside your unit. The upkeep, maintenance, and repair of everything from the roof to the boiler is a community expense, controlled by the board, the community's elected representatives. When repairs must be made, funding for those repairs can come from several sources: a lender, the community's reserve funds, or through assessment of the shareholders or owners. Depending on the scope and type of repair, there's a good chance the needed funds will come from assessments—which of course everyone hates.

A Word About Reserves

Before we get into assessments, let's understand reserves. It's tempting to think, "Well, we have reserve funds—why don't we just use them to make the repairs?" The simple truth is that in this case, one must think less like a homeowner, and more like an accountant to understand what reserves actually are, and why they're there.

For our purposes, there are essentially two types of reserves in a shared-interest community: operating reserves, and replacement reserves. A contribution to your building's operating reserves is built into your monthly maintenance or common charges to cover the cost of keeping your building or HOA running from day to day, and should be adjusted as needed to account for inflation. Replacement reserves, more commonly known simply as reserve accounts, are larger sums kept aside for emergencies. (It should be noted that in co-ops, there may be other reserves related to the building's underlying permanent mortgage—but those are beyond the scope of this article.)

Assess, Borrow, or Tap Reserves?

When the proverbial rainy day comes, and a co-op, condo, or HOA's roof has reached the end of its useful life and started to leak, the board basically has three choices for how to pay for the repair or replacement: They can assess the shareholders or owners, they can borrow the money, or they can dip into their reserves. Which may beg the question: Given how onerous and unpopular assessments are, wouldn't boards be better off using them as a last resort? Why not just automatically draw the

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funds from the reserves?

Simply put, because those reserves are there for a rainy day, even when it's already raining. "Shared-interest buildings have obligations to do work to keep their properties in good shape," says William McCracken, a partner with Moritt Hock & Hamroff, a law firm based in New York City. "They can pay for these expenditures out of their operating budget or reserves or they can borrow the funds. The other option is an assessment. It comes up when there is a need and they don't have a way to pay otherwise."

Borrowing is—at best—inconvenient and complicated for multifamily communities, as there isn't any fee position for the lender to place a lien against—though it is somewhat easier for a co-op, since the real estate is still 'whole.' Co-op's generally carry an underlying permanent mortgage on their property. When this mortgage comes up periodically for refinance, or when the corporation needs additional funds for repairs—to replace a roof or a boiler, or upgrade elevators, for example—the co-op corporation can refinance it and take out money to do the work. It's not so easy for condominiums. The only collateral available in their case is a lien against the monthly common charge collections, and terms for this type of financing are rarely favorable.

More Reasons to Assess

Assessments should be used for large projects, things like boilers, roofs, façade work—the big ticket items. Dan Wollman, CEO of Gumley Haft, a management firm located in New York City, points out that there's no 'too-big' when it comes to assessments. After all, if a project needs to be done, it must be done. "While the board should have the latitude to do what needs to be done," he says, "there should be fair and appropriate reporting to the owners and/or shareholders." Residents, as owners, want to protect their investment. They don't want information withheld from them. Truth is always the best policy.

Most associations and corporations just don't have adequate reserves to cover a major capital repair or replacement, Wollman continues. "They have to assess. Million-dollar projects can't be paid for from reserves—and even if they could, you'd have to replenish those reserves anyway. Therefore, assess. Or borrow, if you can. In the low interest rate environment we were in for many years, many buildings weren't interested in building up reserve funds anyway, since they couldn't earn much on the deposits. They could borrow at low interest, though. Now that thought process is changing."

Additionally, Wollman points out that "assessments should not be used for the daily operations of a building either—except for when costs rise quickly and precipitously. We have seen some co-ops and condos who institute, say, a fuel assessment. The view is that the assessment wasn't a permanent change to operating expenses, but there was a market-based change and everyone felt things would eventually calm down. Buildings budgeted for fuel at x-dollars, and it went up to y-dollars. They view it as a surcharge. We are now seeing this with dramatic increases in building insurance premiums, which have jumped this past year as well."

"The most common reason for an assessment is the need to do repairs," says Scott Wolf, CEO of Brigs, a management firm based in Boston. "Occasionally, an association might do an assessment to rebuild their reserve accounts after dipping into them. Instead of increasing monthly common charges, they may do a special charge to put money back in for future emergencies."

Minimums, Maximums, & Standards

When it comes to exactly how much money a community should hold in its reserve fund, "There are no minimums or maximums," says Wolf. "Your governing documents will say what 'adequate reserves' are required. Fannie Mae requires that 10 percent of operating expenses go into your operating reserves—but that's not nearly enough. The trend since the Surfside, Florida building collapse is to conduct reserve studies" to assess the condition and remaining useful life of major building systems and structures. This enables boards to budget accordingly and not be caught unaware when a major repair or replacement is needed. "More reserve studies are getting done," Wolf continues. "My biggest concern is that a board does a reserve study, gets a figure for how much they should have in their reserves based on the results of that study, and says 'there's no way we can do that.' You need to find a reasonable number the residents can live with."

According to Richard Brooks, a principal with the law firm of Marcus, Errico, Emmer and Brooks, based in greater Boston, "In reality there should be an adequate reserve fund. You know your roof's life span, for instance. Do a reserve study and budget for it. Make sure you have it. Every board has a fiduciary responsibility." And the consequences of not fulfilling that duty can be far more than just financial. "In dramatic hindsight," notes Brooks, "the refusal of the board at Surfside to fix their aging infrastructure proved deadly."

Keeping Track

In the aftermath of the Surfside tragedy, many states and localities have instituted regulations requiring all multifamily properties to complete reserve studies as part of mapping a financial path to keeping their properties healthy. One interesting development in this process is software created by Damian Esparza. His company, SmartProperty, Inc., is located in San Diego and services clients across the United States.

"What we do is called a living reserve study," says Esparza. "It brings the reserve study to life. A reserve study is a static document that provides little utility beyond setting contributions in the year it was performed. This information goes out of date quickly as costs go up. Projects get delayed, and boards

decide to defer. We ingest your current study into our software and give you tools to track your projects, adjust your costs, and move around your anticipated expenditures. It becomes a more organic living document, rather than a static report, because it can be manipulated."

What if a Resident Can't Pay?

Despite a board's best intention to fulfill its fiduciary responsibility and maintain the community's asset, and residents' commitment to be reliable and fully-vested members of their community, there may be times when one or more owners or shareholders are unable to pay their portion of a special assessment. How should the board handle this?

"The ability of shareholders or owners to pay should be part of the consideration boards make before assessing," says McCracken. "Consider over what period of time the assessment should be made, not leaving owners and shareholders in a difficult position. Once the assessment is made however, it's the obligation of the owner to pay it." If the resident fails to do that, McCracken continues, "It becomes the board's decision whether they need to pursue a nonpayment in a co-op or a lien in a condo."

While living in a multifamily building differs in many ways from living in a single-family home, the physical and financial realities are the same: if the roof is leaking, it has to be fixed. In a single-family home, that cost falls solely on the homeowner; in a co-op or condo, the cost is split among the people who live in the building. Everyone hates assessments—but with prudent planning, well-advised budgeting, and input from professionals, proactive boards can at least prepare residents for them, and make them as manageable as possible. ■

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