



FirstService
RESIDENTIAL



BUILDING TO LAST

a blueprint for success

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Capital improvements increase the value of your property.

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Whether you are a board member in a condo or co-op or a multifamily building owner, capital improvements are a fact of life. We know our clients may struggle with the complexities of these major upgrades, replacements and repairs, so we created this guide to help you better understand:

- » Capital Improvements
- » Their relationship to preventive maintenance
- » Reserve funds, special assessments and loans
- » The key elements of a successful capital improvement plan

What Defines a Capital Improvement?



If you find capital improvements confusing, you're not alone. One reason is that some boards and owners distinguish between "improvements" that require a vote — such as adding a gym — and "repairs and replacements" that do not — like replacing a roof.

The best way to know how capital improvements need to be defined and approved is to check with the building's governing documents, legal counsel and/or accountant. Here is a general definition that applies to many properties:

A capital improvement is a major replacement or repair that will increase a component's market value beyond its original or current state. In general, it is intended to lower future operational costs (such as maintenance or utility costs) or enhance residents' quality of life.

Capital improvements are meant to last more than a year and usually cost over \$10,000. However, they can also save your building money in the long run and increase property values.

Preventive maintenance: capital improvement's close cousin

In contrast to capital improvements, preventive maintenance jobs are less costly and are performed

more frequently. They are funded from your operational budget under the line item "Repairs and Maintenance (R&M)," and they are meant to restore your major components (or "assets") to their original condition or prevent them from deteriorating further.

Following a component's preventive maintenance schedule as recommended by the manufacturer or contractor increases its likelihood of reaching or exceeding its expected useful life — that is, the estimated amount of time it will serve its intended purpose. The more you can stretch a component's useful life, the longer you can go before it needs to be replaced or requires a major repair, which translates into more savings for your building.

However, there are caveats. "When you get toward the end of an asset's useful life, repairs sometimes can be more expensive than replacing the asset," explains Tal Eyal, president of FirstService Project Management. "If the cost of maintenance is close to or more than the replacement cost, it's time to replace the asset. The item might even be tax deductible or you may get a tax incentive." It may also be worthwhile to replace an asset rather than repairing it if the replacement comes with a manufacturer's warranty, has a longer life expectancy or is more energy efficient, all of which could save the building money.

Some maintenance jobs can turn into capital improvement projects unexpectedly. For example, roof damage could appear to require a simple repair, but further inspection might reveal that the entire roof needs to be replaced.

A close-up photograph of a black calculator and two gold credit cards. The calculator is on the left, showing the numbers 8, 9, and 0. The credit cards are on the right, showing embossed numbers. The background is a warm, golden-yellow color.

Will That Be Cash or Credit?

Once you're ready to start a project, you need to determine how the building will pay for it. You have several options:

Your reserve fund

The first source you should tap into is your reserve fund. Hopefully, you've been following your reserve study's recommendations and putting the appropriate amount of money aside. Choosing the right type of account for your reserve fund is important, too. Since your board has a fiduciary duty to your unit owners or shareholders, it's imperative that you protect the money they are entrusting you with. However, that doesn't mean putting it in a checking account that yields no interest. "We've helped many buildings significantly increase their return on investment just by moving their reserve money to higher-yielding — but safe — accounts, like CDs," says Ahrensdorf.

What if you don't have enough in your reserves to cover the cost? Unfortunately, many buildings don't adequately fund their reserves. Boards are often reluctant to increase assessment fees in response to rising costs because of the reaction owners or shareholders are likely to have. Since funding day-to-day operations is a more immediate need, they attempt to reduce expenses by decreasing the amount they set aside to fund future projects.

Besides leaving you with an inadequate amount of money for needed repairs and upgrades, underfunding your reserves can have other serious consequences.

For one thing, it can negatively affect property values. In addition, it can dissuade prospective buyers from moving into your building.

Even if your board has been diligent in funding your reserves, you might come up short if, for example, an unforeseen event not covered by insurance causes significant damage that must be addressed immediately. Or your board may realize that adding desirable amenities is the only way to compete with other properties being built in your area. Whatever the reasons for your shortfall, you do have other funding options, which you can use individually or in combination.

Special assessments

You probably already know one of the primary downsides of a special assessment: It can cause discord within the building, especially if you are also increasing fees to cover shortfalls in your operating budget. The upside, however, is that once the work is completed, there's no debt left to repay.

Residents are usually more willing to pay a special assessment if they will benefit directly from the work or if they understand the reason it's needed. Offsetting the financial burden by allowing residents to pay it in installments can also make a special assessment more acceptable. Keep in mind, however, that since you won't have the entire balance of the special assessment right away, you may have to either delay work until you do or align installments with the contractor's periodic payments.

Loans

Loans have become increasingly common for funding capital improvements in recent years, a trend that has been mirrored at FirstService Financial. “In 2012, only two boards asked us to help them secure a loan,” notes Ahrens Dorf. “In 2020, that number rose to 102 as the financial landscape became more stable.”

One of the advantages of taking out a loan is that you have the money immediately. A loan can also help you fill a gap in your reserve fund or in the amount you’re able to collect up front when owners or shareholders pay a special assessment in installments. You can even take out a loan for the full amount of the project and then use a special assessment to pay it back.

Increased assessment fees

Raising the amount owners or shareholders pay for their regular assessment fees so you have more money in the budget to allocate to your reserve fund is another way to cover the cost of a capital improvement project. This option may be the least popular among owners or shareholders, but it can provide your building with additional money for an upcoming project and to grow your reserve fund for future projects.

Insurance

Although insurance can’t pay for a planned capital improvement, inadequate coverage can result in unanticipated capital expenses. Make sure you are properly covering assets that may be susceptible to damage from weather or other mishaps.





Planning for Success

Capital improvements not only affect your building's health and reputation but also owners' or shareholders' wallets. That's why you need to prioritize projects appropriately. It's also crucial to create a plan prior to starting each capital improvement project, to have a professional managing the project and to communicate with residents about the project's status as work progresses.

Communicating with residents

Lack of transparency is a common complaint residents have about their boards or the building owner. Residents will often respond with anger when communication is inadequate, especially regarding costly capital improvement project. Even if a project is essential, clearly explaining the reasons may be all it takes to gain residents' acceptance. Additionally, sending out surveys to get resident feedback about what projects are important to them demonstrates that the board values their opinions.

It's best to keep residents informed about major capital improvement plans by discussing them in meetings along with popular communication channels including emails, the building's website, newsletters, flyers and mass communication tools. Getting buy-in from residents helps projects proceed more smoothly.

Regular, relevant and timely communications are also important during capital improvement projects so that residents are aware of work that's in progress, how it might impact them and when it's likely to be completed. This helps manage expectations and helps residents see that there's an end in sight.

Prioritizing projects

For the most part, your components' remaining useful life determines the timing of your capital improvement projects. For instance, a component that is coming to the end of its expected useful life next year will probably need to be replaced before one that is expected to last another five years. But what if several components are reaching the end of their useful life simultaneously or there are several additional projects you want to do?

Of course, you need to prioritize structural work over those projects that are simply aesthetic or nice to have. Beyond that, however, prioritization depends on the asset. Let's say you're looking at projects for the exterior of a building. "These projects would be categorized into three classes," according to Eyal. "The first group would be those projects that have to be done, like replacing the facade. You have no choice because it presents an imminent danger," he explains. "The second group would consist of those projects that make sense to do, such as an outside leak. And in the third group you would have your wish-list items."

Defining a project's scope and timeframe

When you're ready to start planning a specific capital improvement project, consider the advantages and disadvantages of various approaches. With FirstService Residential as your management company, you have the opportunity to visit other properties the company manages where similar work has been performed. This could reveal that there's a lower-cost way to do the project, or you may realize that investing a little more money provides an option with significantly greater benefits.

Decide when to start the project by working backward from when you want it completed. Be sure to take weather, seasons, holidays and times when occupancy might be high or low into consideration. Remember to build in time for delays caused by any of these factors, too.

Hiring a project manager

By providing construction management services from concept to completion, project managers can significantly reduce the burden on your board, the owners and the property manager. Their expertise enables them not only to oversee capital improvements, but also to optimize the value of your projects (value engineer). Their job is to advocate on behalf of your board or building ownership to decrease total project time and cost, in part by leveraging their existing resources and relationships to purchase goods and services at a lower price. They are also responsible for keeping the project running smoothly and ensuring that work meets quality standards and code.

Project managers are usually engineers or other construction professionals with years of experience. It's important to not make the mistake of expecting your property manager to act as the project manager since property managers do not have

the same expertise. A property manager's role is to keep operations running, not to oversee capital improvement projects, and they can't do their regular job properly if they are also expected to manage those projects, too.

Soliciting bids

Both your project manager and your property manager can help identify reliable vendors and contractors. A good property manager will also be able to minimize the complexities of soliciting bids by taking on the job of interviewing and negotiating costs with engineers and contractors.

At FirstService Residential, we rely on Vendor Information Verification Experts (VIVE), a third-party service provider, to streamline the vendor screening process. VIVE independently ensures all service providers working at our properties are continually screened for valid trade licenses, adequate and current insurance, business background screening, and acceptance of our code of conduct.

We also recommend that boards and owners check with their building attorney regarding any potential liability you may face during the project and determine whether you need to obtain any additional insurance during the work.

To ensure that all vendors and contractors have necessary licenses, certifications and insurance coverage and that they offer warranties for their components and the work they perform.



How Well Do You Handle *Capital Improvements?*

Use the following checklist to find out where your association stands.



FirstService
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YES

NO



Our reserves are more than 70% funded.



We have the money we need for our next capital improvement project.



Our reserve fund is kept separate from our operating fund and is earning interest.



We follow the recommended preventive maintenance schedule on all our components.



We solicit owner and shareholder feedback to find out which capital improvement projects are most important to them.



We keep owners and shareholders informed about the status of ongoing capital improvement projects.



We openly discuss upcoming capital improvement projects — including funding issues — at board meetings, and provide information through our other communication channels.



Our capital improvement projects are overseen by an experienced project manager.



We work with a property management company that helps us solicit bids and determine how we should fund our capital improvement projects.



Capital Improvements: A Blueprint for Success

Capital improvements can be complex, but understanding them better will help you make better decisions. Keep this guide as a reference so that your board can hit the ground running when you're ready to start your next project.

Want more advice on planning your capital improvement projects? [Contact FirstService Residential today!](#)



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About FirstService Residential

As North America's largest manager of residential properties, FirstService Residential oversees more than 7,000 properties and 1.5 million residential units across 21 U.S. states and three provinces in Canada.

In New York City, FirstService Residential's management portfolio comprises more than 500 rental, condominium, and cooperative properties with an aggregate value of more than \$20 billion. This includes more than 70,000 residential units that are home to over 250,000 people in properties ranging from luxury towers and new developments to pre-war landmark buildings and apartment complexes.

With an unmatched combination of deep industry experience, local market expertise and personalized attention, FirstService Residential delivers proven solutions and exceptional service that add value, enhance lifestyles and make a difference, every day, for every resident and community it manages. FirstService Residential is a subsidiary of FirstService Corporation, a North American leader in the property services sector. For more information, visit www.fsresidential.com.

