

NAVIGATING THE NEW CONDO LAW

A HANDBOOK FOR ASSOCIATION MANAGERS AND BOARD MEMBERS

- ▶ Structural Integrity Reserve Studies (S.I.R.S.)
- ▶ Reserve Studies
- ▶ Milestone Reports
- ▶ Insurance Appraisals



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Dear Community Manager and Board Member,

This handbook shall provide the reader with a reference for insurance appraisals and reserve studies. Due to the passing of SB-4D and the SB-154 glitch bill, this handbook contains an extended chapter for reserve studies, structural integrity reserve studies, the difference between the two, and of course the milestone reports.

Besides the condo declaration and the association's budget, reserve studies and insurance appraisals are two of the most important documents for the association.

Reserve studies are essential in assisting the board with budget considerations and financial planning in general. A good reserve analyst will identify all the components in a community which the association will have to replace in the future. Reserve studies should be prepared for a 30-year period and updated on an annual basis. Structural Integrity Reserve Studies (SIRS) are required by law every ten years for all buildings with 3 or more stories. (1-, 2-, and 3-unit condos are exempt)

The insurance appraisal plays a vital role in the insurance process. Without it, the association has no solid basis to insure buildings at the correct amount. Therefore, the Florida legislature has implemented language in Florida Statutes (F.S. 718.111) to provide for an insurance appraisal every three years. A well-written report will assist the insurance agent not only with the valuation but also with essential information about the property from flood maps to building sketches.

If you have questions about any of the work products contained in this book, please do not hesitate to contact us for assistance.

Patricia Staebler, SRA, RS
State-Certified General Appraiser RZ2890
CAI Reserve Specialist RS350





CHAPTER 1: **General Introduction to Reserve Studies**

When a major repair or replacement is required in a community, an association has a couple of options available to address the expenditure:

The first and most favorable method is assessing an adequate level of reserves as part of the regular membership assessments and thereby distributing the cost of the replacements uniformly over the entire membership. An association is a community and as such comprised of past, present, and future members. It is good stewardship to distribute the cost for replacement evenly among all these members. Any decision by the Board of Directors to adopt a calculation method or funding plan which would disproportionately burden future members to make up for past reserve deficits, would be a breach of its fiduciary responsibility to those future members. Unlike individuals determining their own course of action, the board is responsible to the community as a whole.

If the association is setting aside reserves through regular assessed membership dues, it will have the full term of the life of the component (e.g., roof), to accumulate the necessary funds. Additionally, those contributions would have been evenly distributed over the entire membership and would have earned interest as part of that contribution.

Many associations opted for years, if not decades, to waive reserves partially or totally. The new condo law now requires associations to fund the necessary components for building envelope and other components supporting the structure. But until associations catch up with the necessary funding reaching levels which will support their reserve requirements, many associations will face lack of funds and will have to opt for other methods, such as acquiring a loan from a lending institution to affect the required repairs. In many cases, banks will lend to an association using “future homeowner assessments” as collateral for the loan. With this method, the current board is pledging the future assets of an association. They are also incurring the additional expense of interest fees along with the original principal amount.

Because many associations will not even have sufficient funds to finance their SIRS requirements, it can be expected that many associations will waive the components which do not have to be part of the SIRS. This option will create an environment of declining property values due to a growing list of deferred maintenance items and the association’s financial inability to keep pace with the normal aging process of the common area components. This, in turn, can have a seriously negative impact

on sellers in the association by making it difficult, or even impossible, for potential buyers to obtain financing from lenders. The new Fannie Mae and Freddie Mac regulations require lending institutions to request copies of the association's most recent reserve study, SIRS, milestone report, and reserve budget, prior to granting loans, either for the association itself, a prospective purchaser, or for an individual within such an association.

If an association is not working with a lender, the community will face special assessment to cover the necessary expenditure. When a special assessment is passed, the association has the authority and responsibility to collect the assessments, even by means of foreclosure, if necessary. With the new law in place, special assessments will become a "normality" in association's financial management. Approximately 60%-80% of associations that we have provided services for are underfunded and about 15%-20% are severely underfunded. The outcome of milestone reports will force many associations to invest millions of dollars to remediate their building envelope.

• What do we reserve for?

All major expenses that occur must be budgeted for in advance to ensure the availability of the necessary funds at the end of the useful life of a given component. Reserve expenses are reasonably predictable both in terms of frequency and cost. Regular expenses on a monthly or annual basis, such as payroll, landscape services, pool maintenance, etc. are not part of the reserves but belong into the operating/maintenance account.

Examples of reserve expenses include but are not limited to:

- ▶ Roof
- ▶ Exterior paint/waterproofing
 - Façade
 - Balcony surfaces
 - Walkway surfaces
- ▶ Structural Reserves
- ▶ Plumbing
- ▶ Electrical
- ▶ HVAC system
- ▶ Fire Safety
- ▶ Building machinery (mostly in high-rises)
- ▶ Elevators
- ▶ Access control
- ▶ Lighting
- ▶ Furniture, fixture and equipment (FF&E)
- ▶ Interior Finishes
- ▶ Pool resurfacing
- ▶ Pool equipment and heaters
- ▶ Fences and walls
- ▶ Asphalt mill/repave or coating
- ▶ Resurfacing of sport areas
- ▶ Landscape, irrigation and landscape lighting



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- ▶ Resurfacing of sport areas
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Florida Statute 718.112 describes those as follows:

“In addition to annual operating expenses, the budget must include reserve accounts for capital expenditures and deferred maintenance. These accounts must include, but are not limited to roof replacement, building painting, and pavement resurfacing, regardless of the amount of deferred maintenance expense or replacement cost, and any other item that has a deferred maintenance expense or replacement cost that exceeds \$10,000. The amount to be reserved must be computed using a formula based upon estimated remaining useful life and estimated replacement cost or deferred maintenance expense of each reserve item. The association may adjust replacement reserve assessments annually to consider any changes in cost estimates or extension of the useful life of a reserve item caused by deferred maintenance.”

Many managers and board members ask, if the “\$10,000-threshold” described in Florida Statutes is the only criteria used to decide if a component should be included in the reserves or the operating account.

It depends, usually on both the quantity and the cost of the item, when compared to the size of the association. If the association has just one HVAC unit with a replacement cost under \$10,000, the HVAC unit could be budgeted for in the operating budget; however, if an association has multiple units (e.g. a high-rise with HVAC units for each elevator lobby), the total amount for all HVAC units will be considered under reserves. It also depends on the size of an association. For example, a large community can pay for a \$7,000 pool heater unit without a problem, whereas a small community might not.

These considerations will have to be discussed and worked on and the decision will be made between the reserve analyst, the board and management.

• How to properly calculate a reserve component to meet state requirements:

An example for fully funded is an HVAC unit with a useful life of 10 years and the expected cost of \$10,000. Assuming the HVAC unit is five years old, the association would need \$5,000 at the end of year 5, to have the HVAC unit “fully funded”.

Age of the component divided by the useful life times the current replacement cost:

$$(5/10) * \$10,000 = \$5,000$$

• Funding Calculations:

Current Funding:

This model is based on the current reserve balance (reserve funds in the bank account) and the current contribution to the reserves for the current fiscal year. It is a good instrument to show the association the current status of the reserves and how the financial situation would develop over the next 30 years if the association continued funding at the current level.

Pooled Funding, also called Threshold or Cash Funding:

This model is also based on the current reserve balance; however, here we calculate the amount the association needs to contribute to the reserve account to pay all future obligations contained in the reserve study. The pooling method is a convincing solution for associations who are in financial distress and would have to pay much higher amounts when using the straight-line method. Also, for Structural Integrity Reserve Studies (SIRS), pooling becomes more important, but we will address this later.

The monetary difference between the assessments for pooling and straight-line funding convinces a lot of associations to make the decision to vote for changing the accounting method. When using the pooled accounting, all funds are in one single account and can be cross utilized, which is not allowed in the component funding method, unless voted for by the community. The goal for the pooling method is to not let the funds drop below zero or another predetermined threshold.

Component Funding Model, also called Straight-line Funding:

This model is also based on the current amount of saved funds for the reserves and computes every component as fully funded, as outlined in the formula before. Calculating “fully funded” for every single component results in the component funding model or straight-line funding model. Associations who use the straight-line accounting method must use this financing model. The straight-line funding model tends to overfund an association in the long run with funds going over the 100% mark. This accounting method does not allow for cross-utilization, unless voted for by the community.

Fully funded versus funding fully:

Many associations claim their reserves are fully funded, which in most cases is untrue. Not a single association in our work portfolio over the past 20 years has been fully funded. Therefore, it is important to understand the differences between “being fully funded” and “funding the reserves fully”.

Fully Funded Reserves:

Please recall the example with the AC unit: A \$10,000 item with 10 years of life, requiring \$5,000 at the end of year 5, \$6,000 at the end of year 6, etc. If this calculation is performed for every component an association is responsible for, the sum of all these calculations (the time equivalent amount for each component) needs to be in the bank at the end of any given fiscal year. If the association would have the required amount in the bank, they can claim to be fully funded.

Funding Reserves Fully:

If associations claim they are “fully funded”, they most often mean they did not waive the calculated reserve requirements in either the pooled or component funding method. Let’s look at an example:

Contribution during the current fiscal year:	\$150,000
Contribution needed for pooled funding:	\$250,000
Contribution needed for component funding:	\$450,000

If the association is pooling the reserve funds, and they vote to contribute \$250,000 in the upcoming fiscal year, they are funding their reserve requirements 100% - but that does not mean an association is fully funded. **Know the difference, so you can educate your community accordingly.**



• Update Frequency

Estimating the remaining useful life of a component can be tricky and with our Florida weather replacement can occur sooner than expected. Furthermore, construction cost constantly changes. Therefore, it is wise to update the reserve study for a community every year, particularly when an association is pooling their funds.

Further reasons are:

- ▶ Did the association add or replace any significant common element in the last year?
- ▶ Did the association deviate from the scheduled replacements?
- ▶ Did the association contribute to or withdraw reserve funds other than as scheduled?
- ▶ Have there been any technological advances or improved product development that might result in a component change?
- ▶ Did any law changes occur, for example sprinkler retrofitting, elevator environmental upgrades, bi-directional amplifier, which would require an unexpected expense?
- ▶ Have any components reached the end of their useful lives earlier than projected?

In general, once an association makes the investment to pay for a reserve study, this investment should be protected by updating the study on an annual basis rather than getting a new reserve study every couple of years.

Working with local consultants ensures consistency and readiness by the consultant to assist with updates of the reserve studies.

CHAPTER 2: Reserve Study Glossary



► Budget Year

The budgetary year for which the report is prepared. For associations with fiscal years ending December 31st, the monthly contribution figures indicated are for the 12-month period beginning 1/1/20xx and ending 12/31/20xx.

► Inflation

This figure is used to approximate the future cost to repair or replace each component in the report. The current cost for each component is compounded on an annual basis by the number of remaining years to replacement, and the total is used in calculating the monthly reserve contribution that will be necessary to accumulate the required funds in time for replacement. The correct way to apply inflation is the compounding method. An inflation balloon payment (to make up the difference from current to future cost) is not permitted by Department of Business and Professional Regulation rules.

► Annual Assessment Increase

This represents the percentage rate at which the association will increase its assessment to reserves at the end of each year. For example, to accumulate \$10,000 in 10 years, you could set aside \$1,000 per year. As an alternative, you could set aside \$795 the first year and increase that amount by 5% each year until the year of replacement. In either case you arrive at the same amount. The idea is that you start setting aside a lower amount and increase that number each year in accordance with the planned percentage. Ideally, this figure should be equal to the rate of inflation.

► Investment Yield Before Taxes

The average interest rate anticipated by the association based upon its current investment practices.

► Taxes on Interest Yield

The estimated percentage of interest income that will be set aside to pay income taxes on the interest earned (differs from state to state).

► Projected Reserve Balance

The anticipated reserve balance on the first day of the fiscal year for which this report has been prepared. This is based upon information provided and not audited.

► **Percent Fully Funded**

The ratio, at the beginning of the fiscal year, of the actual (or projected) reserve balance to the calculated fully funded balance, expressed as a percentage.

► **Annual Assessment**

The assessment required by the association each year. Because many associations have different size condominium units, the calculation for each association will differ. Some calculate by unit, some by SF, and therefore, it makes sense to calculate the overall annual assessment and leave the allocation by unit or SF to the management or board.

► **Interest Contribution (After Taxes)**

The interest that should be earned on the reserves, net of taxes, based upon their beginning reserve balance and monthly contributions for one year. This figure is averaged for budgeting purposes.

► **Percentage of Replacement or Repairs**

In some cases, an asset may not be replaced in its entirety, or the cost may be shared with a second party. Examples are budgeting for a percentage of replacement of streets over a period of time or sharing the expense to replace a common wall with a neighboring party.

► **Placed-In-Service Date**

The month and year that the asset was placed-in-service. This may be the construction date or the date of the last servicing or replacement. If the placed-in service date is not known, the date can be estimated by the analyst based on observation and condition. For example, if a component is estimated to be 15 years old and we write the year 2023, the components placed-in-service date would be 2008.

► **Estimated Useful Life**

The estimated useful life of an asset is based upon industry standards, manufacturer specifications, visual inspection, location, usage, association standards and prior history. All these factors are taken into consideration when tailoring the estimated useful life to a particular asset. For example, the carpeting in a hallway or elevator (a heavy traffic area) will not have the same life as the identical carpeting in a rarely used meeting room.

► **Adjustment to Useful Life**

Once the useful life is determined, it may be adjusted, up or down, by this separate figure for the current cycle of replacement. This will allow for a current period adjustment without affecting

the estimated replacement cycles for future replacements. A good example is the first painting/ waterproofing for a building. Usually, the developer applied paint will not last a full 10-year paint cycle. Therefore, the paint cycle would be set to 10 years, but for the first paint application after turnover the reserve analyst would adjust the useful life by 2 – 4 years.

► **Estimated Remaining Life**

This calculation is completed internally based upon the report’s fiscal year date and the date the asset was placed-in-service.

► **Replacement Year**

The year the asset is scheduled to be replaced. The appropriate funds will be available by the first day of the fiscal year for which replacement is anticipated.

► **Annual Fixed Reserves**

An optional figure, which, if used, will override the normal process of allocating reserves to each asset. This method requires “bending” the reserve study to the budget, whereas the budget should be superseded by the study. Very few associations use this method.

► **One-Time Replacement**

Notation whether the asset is to be replaced only once, e.g., addition of a component such as adding a perimeter wall.

► **Current Replacement Cost**

The estimated replacement cost effective at the beginning of the fiscal year for which the report is being prepared.

► **Future Replacement Cost**

The estimated cost to repair or replace the asset at the end of its estimated useful life based upon the current replacement cost and inflation.

► **Component Inventory**

The task of selecting and qualifying reserve components. This task can be accomplished through on-site inspection, review of association design and organizational documents, a review of established association precedents, and discussion with appropriate association representative(s).



CHAPTER 3: **Fannie Mae and Freddie Mac** **NEW LENDER REQUIREMENTS**

In July, Fannie Mae and Freddie Mac released updates to “project eligibility standards” for condominiums and housing cooperatives. A project refers to a condominium, housing cooperative, or any multi-family common interest ownership association with more than five attached units.



70% of conventional mortgages will be sold in the secondary mortgage market to Fannie Mae and Freddie Mac, to free up money in the primary mortgage market. Associations will see lender questionnaires and requests from lenders for additional documentation including:

- ▶ Insurance policies
- ▶ Budgets
- ▶ Financial Reports
- ▶ Reserve Studies, SIRS, and Funding Schedules
- ▶ Documentation regarding special assessments, if applicable
- ▶ Documentation about litigation or ADR, if applicable
- ▶ Building Inspection Reports (Milestone), if available

A project will likely be deemed ineligible if:

1. The project needs critical repairs.
2. There is a current evacuation order due to unsafe conditions.
3. There are unfunded repairs totaling more than \$10,000 per unit.
4. The property insurance coverage is not full replacement value and doesn't include all the coverage as required.

(Note: cash value replacement is unacceptable)

An association's budget must include the following:

Fannie Mae

- ▶ Adequate funding for insurance deductibles
- ▶ At least 10% of the budget must be for reserves
- ▶ No more than 15% of income generated from rental or leasing of commercial parking facilities

Freddie Mac

- ▶ Adequate funding for insurance deductibles
- ▶ Less than 10% to be set aside for reserves, provided that the association has a reserve study that supports the lesser amount and the association is following the reserve study
- ▶ No more than 15% of owners are more than 60 days delinquent in paying their assessments
- ▶ If commercial space is more than 35% of the total building and below-grade square footage is used as commercial or non-residential space, the project is ineligible

Fannie Mae and Freddie Mac agreed to reciprocity for these requirements, meaning what the one knows, the other will know. These banking regulations became effective in September 2023

For more detailed information go to:
<https://advocacy.caionline.org/fannie-mae-and-freddie-mac-new-lender-requirements-go-into-effect-in-september/>

CHAPTER 4: Anatomy of a Structural Integrity Reserve Study based on the New Condo Law

Non-Waivable SIRS Components

After the collapse of the Champlain Tower in Surfside, Florida, the legislature passed SB-4D and the glitch bill SB-154 to avoid future catastrophes. Florida is dealing with many aging buildings and many of them lack adequate upkeep due to insufficient reserve funds. The law applies to all buildings with 3+ stories. (1-, 2-, and 3-unit condos are exempt)



Associations can no longer waive reserves for certain items recognized in the law and will be forced to have a SIRS every ten years. As the law currently reads, every association must have a SIRS in place by the end of 2024 in preparation for the fiscal year 2025.

Like any other reserve study, a SIRS consists of a visual observation of all components and the financial analysis over a 30-year period. The visual observation must be performed by an engineer, architect, or a designated reserve specialist (RS).

The components required by law are as follows:

- a) Roof
- b) Structure, including load bearing walls and other primary structural members
- c) Fireproofing and fire protection
- d) Plumbing
- e) Electrical systems
- f) Waterproofing and exterior painting
- g) Windows and exterior doors **(Unless unit owner responsibility)**
- h) Any other item that has a deferred maintenance expense or replacement cost that exceeds \$10,000 and the failure to replace or maintain such item negatively affects the items listed above (e.g. HVAC systems in certain cases)

The components can be pooled, but they cannot be waived. Going back to the example on page 9, if your reserve analyst calculates an annual assessment of \$250,000, the association cannot legally waive that required reserve contribution by law.

• Waivable Components

All other components are considered “waivable”. Waivable components can include for example:

- ▶ Elevator
- ▶ Railings
- ▶ Interior finishes
- ▶ Pool and sport areas
- ▶ Site improvements
- ▶ Etc.

Many underfunded associations will attempt to attribute their entire funds to the SIRS components, leaving the waivable components unfunded. As explained before, this will result in loss of community appeal and an increasingly difficult buy/sell situation.

The SIRS components and the waivable components can be pooled. However, SIRS components may not be mixed with waivable components; therefore, the reserve analyst will have to develop a reserve study with two chapters:

- ▶ A separate pooled study for the SIRS components
- ▶ A separate pooled study for the waivable components

The following spreadsheet shows our proprietary finance modeling and the comparison between ONE reserve study for all components (in this case an association would have to use straight-line [component] funding) versus two separate studies (one SIRS Non-Waivable and one WAIVABLE components). In most cases the outcome of the financial comparison shows, the association would benefit from separating the reserve budgets as follows:

Comparison Chart - All Components together vs. SIRS and Waivable separated

Type of Report	Total Assets	Allocation of Assets	Beginning Balance	Contributions		
				Current	Pooling	Component
ALL Components in one Study	\$4,000,000	100%	\$500,000	\$92,000	\$240,000	\$350,000
SIRS Non-Waivable Components	\$2,212,000	55%	\$280,000	\$51,000	\$136,000	\$190,000
Waivable Components	\$1,788,000	45%	\$224,000	\$410,000	\$112,000	\$165,000
SIRS and Waivable Together	\$4,000,000	100%	\$504,000	\$461,000	\$248,000	\$355,000

Note:

The allocation of assets is calculated based on the separation of assets into SIRS and Waivable Components.

Percentages are then applied to Beginning Balance and Current Contribution (55% used for SIRS, 45% used for Waivable)

If all funds are kept in one reserve schedule, the association will have to collect for component funding:

\$350,000

If funds are kept in two separate reserve schedules the association will have to collect for two pooled assessments:

\$248,000

This is an example from one of our work files and the color coding is as follows:

- ▶ Green All components (SIRS and Waivable) in one study
- ▶ Red All SIRS components
- ▶ Blue All Waivable components
- ▶ Yellow SIRS and Waivable components together

If the association wants to keep all their components in one study, the reserves have to be held in component funding and may not be cross utilized (not even with a majority vote). This would require an annual contribution of \$350,000.

If the SIRS components (red) and the waivable components (blue) are in two separate report sections, the association may pool the funds. Adding the two pooling amounts together, the annual contribution would be \$248,000 – significant savings when compared to the all-in-one component funded report.

In this spreadsheet we use finance modeling by using the amount of total assets (SIRS and Waivable together) and comparing them to the assets of the two separate studies. This allows us to separate the beginning balance and current contribution appropriately by applying the percentage ratios.

How to distribute the beginning balance is an important decision. Once funds have been applied to the SIRS, they cannot be used for any other component as defined by the law.

To be completely transparent, we recommend that associations not only develop two separate reserve schedules (based on the SIRS/RS studies), but also hold their funds in two separate bank accounts, one for SIRS, and one for waivable components.

• **Associations need a SIRS every ten years, what happens in years 2 – 9?**

Our clients asked us that very question, hoping they can go back to “old habits” in the years between the law mandated SIRS requirements.

But in reality, once the law becomes mandatory (1/1/2025), reserve studies in between the 10-year cycle will have to be prepared in exactly the same way and waiving the reserves is not permitted.

• **Is a reserve study every ten years sufficient?**

The legislator’s decision to require a SIRS only every ten years is not helpful, because this regulation will give associations the impression that a reserve study every ten years might be sufficient. Reserve Specialists recommend a reserve study update for smaller associations every 2-3 years, and for larger associations, such as high-rises or multi-building associations, every year.

Take away:

The transition from an all-in-one reserve study to a two-chapter SIRS/RS study can be accomplished by choosing an experienced reserve specialist, who can help the association to make an educated decision on how to distribute their current funds to the SIRS and Waivable components.

CHAPTER 5: How to handle Associations with Mixed Building Types



Many associations in our market area are comprised of a mixture of building types. Many of these associations stretch from Gulf to Bay with for example, a high-rise on the beach, mid-rises between high-rise and street, and 1-story villas on the other side of the road towards the bay.

Does a unit owner in a villa really want to pay for the SIRS components of the high-rise?

Does a unit owner in a mid-rise want to pay for the SIRS components of the high-rise?

We don't think so.

The only way to be fair to all owners within these mixed associations, is to provide standalone reserve studies for the different building types. Based on the example above, the following standalone studies would be necessary:

- ▶ One SIRS and one reserve study (with the waivable components) for the high-rise
- ▶ One SIRS and one reserve study (with the waivable components) for the mid-rises
- ▶ One reserve study for the villas
- ▶ One reserve study for the common elements

The reserve analyst will have to educate the association to develop a reserve budget based on the standalone reserve studies. Four studies, four budgets, and four bank accounts. This is the **ONLY** way to handle mixed building type associations in a fair manner to all unit owners.

If a reserve provider prepares only one reserve study for the entire community, they disregard the law, unless the association uses strictly straight-line funding. If pooling is used, reserve studies, schedules, and bank accounts need to be separated.

SB-154 states:

“At a minimum, a structural integrity reserve study must identify each item of the condominium property being visually inspected, state the estimated remaining useful life and the estimated replacement cost or deferred maintenance expense of each item of the condominium property being visually inspected, and provide a reserve funding schedule with a recommended annual reserve amount that achieves the estimated replacement cost or deferred maintenance expense of each item of condominium property being visually inspected by the end of the estimated remaining useful life of the item. The structural integrity reserve study may recommend that reserves do not need to be maintained for any item for which an estimate of useful life and an estimate of replacement cost cannot be determined, or the study may recommend a deferred maintenance expense amount for such item. The structural integrity reserve study may recommend that reserves for replacement costs do not need to be maintained for any item with an estimated remaining useful life of greater than 25 years, but the study may recommend a deferred maintenance expense amount for such item.”

This paragraph does not apply to buildings less than three stories in height; single-family, two-family, or three-family dwellings with three or fewer habitable stories above ground; any portion or component of a building that has not been submitted to the condominium form of ownership; or any portion or component of a building that is maintained by a party other than the association.”

CHAPTER 6: Milestone Report

Florida Senate Bill SB-4D and SB154 do not only regulate SIRS, but also the milestone report. Every condominium or co-op building with 3 or more stories will require a milestone inspection, when the building reaches its 30th year. Local building departments may require an earlier inspection under certain circumstances, such as environmental impact due to a close location to the coast. After the initial inspection the subject building will need a milestone inspection every ten years.

The scope of work for a milestone report is as follows:

Work performed includes a visual (non-destructive) examination of habitable and uninhabitable areas of the building, including the major structural components of the building, and to provide a qualitative assessment of the structural condition of the building. The visual examination is based on consecutive access to approximately 25% of the units. The specific units to be visually examined will be determined during the meeting and interview.

The following bullet points cover the most frequently asked questions from our clients:

- ▶ The milestone inspection can be performed by a professional engineer (P.E.) or architect, licensed in Florida, who can engage a team of professionals under their supervision.
- ▶ Single-family, duplex, and 3-plex buildings with three or fewer habitable stories above ground are exempt from the milestone report requirement.
- ▶ Milestone reports consist of two phases; if the building passes phase 1, a phase 2 inspection is not necessary.
- ▶ The phase 1 report must be completed 180 days after the local authority requests the milestone report by written notice. If a phase 2 inspection becomes necessary, the inspection may involve destructive testing.
- ▶ If a phase 2 inspection is required, within 180 days after submitting a phase 1 inspection report the architect or engineer performing the phase two inspection must submit a phase two progress report to the local enforcement agency with a timeline for completion of the phase two inspection.

- ▶ An association that is required to complete a milestone inspection in accordance with s. 553.899 on or before December 31, 2026, may complete the structural integrity reserve study simultaneously with the milestone inspection. In no event may the structural integrity reserve study be completed after December 31, 2026.
- ▶ If the officers or directors of an association willfully and knowingly fail to complete a structural integrity reserve study pursuant to this paragraph, such failure is a breach of an officer's and director's fiduciary relationship to the unit owners under s. 718.111(1).
- ▶ A milestone inspection does not consider compliance with the Florida Building Code (FBC) – if that would be the case every building constructed before the last FBC update (2023), would fail the milestone inspection. The milestone inspection concentrates on the primary structural members of a building and whether there is substantial structural deterioration. Primary structural members of a building are designed to carry the vertical and lateral loads of a structure.
- ▶ The phase 1 milestone inspection report will be sent to the local authority, whether passed or not.
- ▶ With a passing grade, the next report will be due in 10 years. Without passing phase 1, phase 2 will be initiated.
- ▶ Within 45 days after receiving a phase one or phase two milestone inspection report from the architect or engineer who performed the inspection, the association must distribute a copy of the inspector-prepared summary of the inspection report to each unit owner, regardless of the findings or recommendations in the report.
- ▶ For the SIRS report, it will be beneficial to know the outcome of the milestone report, either phase 1 or 2. The reserve analyst should address any recommendations and/or requirements from the milestone report in the reserve planning.

For more information on milestone reports, please feel free to contact our engineering partners or order their services through our web portal: <https://staeblerappraisal.com/get-in-touch/>

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CHAPTER 7: Insurance Appraisals

Florida State Law:

Florida Statute 718.111 reads as follows:

Adequate property insurance, regardless of any requirement in the declaration of condominium for coverage by the association for full insurable value, replacement cost, or similar coverage, must be based on the replacement cost of the property to be insured as determined by an independent insurance appraisal or update of a prior appraisal. The replacement cost must be determined at least once every 36 months.”



Although state law requires the appraisal only every three years, insurance carriers might require more frequent updates. Please make sure, the appraiser who prepares the update, actually visits the property for an update inspection and provides a new set of photos. Insurance carriers might not accept reports with photos older than three years.

• Minimum Contents of an Appraisal:

▶ Letter of transmittal

- Addresses the property owner with statement of date of inspection and summary of values

▶ Certification

- Certifies the report and the work of the appraiser to the subject property

▶ Signature, rank and license of the appraiser

- Certifies the appraisal was prepared by a licensed commercial appraiser, whose license is current

▶ General and limiting conditions

- Explains conditions and limitations, e.g., if the appraiser had to make assumptions due to a lack of construction plans

► **Scope of Work (USPAP requirement)**

- Describes the steps the appraiser has to take to arrive at the value requested by the client (insurable value)

► **Description of subject property**

- A short narrative which should give an overview of the property such as number of buildings and related site improvements like pool, carports, sport facilities, etc.

► **Flood map and CCCL map**

- The flood map is a must as it will determine if the appraisal needs more than one value (Flood and Wind/Casualty Values)
- The CCCL map is needed if the property is located seaward of the coastal construction control line

► **Photos of exterior and interior**

► **Photos of site improvements**

► **Owner of record**

- Makes sure the report is in fact written for the subject property

► **Identification of client and users**

- Ties the report to the client and explains who else may use the report

► **Date of appraisal and date of report**

- Shows the carrier the validity and timeliness of the report

► **Purpose and function of the appraisal**

- Describes how the report is used and for what purpose it was prepared (Insurable value to be used to determine proper insurance coverage by the insurance carrier)

► **Improvement Description**

- Essential to determine the ISO classification and important for the insurance carrier to understand the construction features of the subject property



► **ISO Classification (see later section for details)**

- Six ISO classifications determine the construction quality and the insurance risk of a property
 - ISO 1 Wood Frame
 - ISO 2 Joisted Masonry
 - ISO 3 Combustible
 - ISO 4 Masonry Non-Combustible
 - ISO 5 Modified Fire Resistive
 - ISO 6 Fire Resistive



► **Definitions**

- Explanation of insurable value and construction definitions

► **Excerpts from the construction plans or the condo plat book**

- Provides insight in the construction features, which is important for the insurance professional as well as the appraiser

► **Valuation pages from Core Logic**

- A necessity to show the carrier how the proper insurable value was calculated

► **Site Improvement valuation (line-item, no lump sums)**

- Site improvements like pool, pool fence, pool deck, garages, carports, etc. should not be added together in a lump sum, to allow the client as well as the insurance professional to choose which items should be insured

► **Summary of values**

- Summary of values should be presented by buildings with building numbers and/or physical addresses

► **Appraiser's qualifications and copy of license**

- Proof for the client and other users that the appraiser is appropriately qualified to prepare the appraisal

• Definition for Insurance Appraisals:

Flood Value:

This value is only needed when the property is located in a flood zone, which requires flood insurance (usually A, AE, V and VE zones). The flood valuation contains the entire building from the foundation to the rooftop. However, for an appraiser it is wise to calculate the flood value even if it is not needed because it represents the entire building. This is the value, which can be compared to local construction cost, to the cost of comparable properties in the market area and when discussing cost with contractors and developers.

Wind/Casualty Value:

This value is more or less a derivative of the flood value excluding the interior finishes and the foundation with minor parts of plumbing and electric. The wind/casualty value cannot be compared to local construction cost as it is difficult to understand for individuals not familiar with condominium law.

Value “As-Is”:

For the purpose of the insurance policy, the building has to be valued as follows: “The replacement or repair of the structure with like-kind materials based on preexisting conditions”.

Value “Up to Code”:

This value includes the current building code, e.g. impact resistant openings, building elevation, updated codes for all subtrades, etc. The difference between the “as-built” and the “up-to-code” value is the basis for the Ordinance of Law Endorsement.

New Construction versus Replacement Cost:

Because replacement, reconstruction, and repair is always more expensive than new construction it is vital for an appraiser to use the correct valuation software, like Core Logic. The difference between the two values can easily reach 15-20%. If an appraiser uses the wrong value it can lead to coinsurance penalties in a case of loss.

• The Three D's:

The following items should never be included in an insurance appraisal:

Depreciation:

A building is insured at replacement value (RCV) and not at the depreciated value (ACV). The difference between RCV and ACV is important for an adjuster and the insurance carrier; however, an appraiser should not compute the depreciated value, as it is not the scope of work for an insurance appraisal.

Demolition:

Usually an insurance policy will automatically include a certain percentage of the dwelling coverage to provide for demolition. This is an adjuster and insurance carrier consideration and has no place in an insurance appraisal.

Debris Removal:

The same as before is true for debris removal.

• ISO Classifications

The Insurance Services Office (ISO) is a leading source of information for risk management in the insurance industry. Insurance carriers depend on ISO when it comes to determine the construction quality of a building and Citizens does not even accept an insurance appraisal without an ISO classification.

There are six ISO classifications:

▶ **ISO 1 Wood Frame**

Buildings with exterior walls, floors and roof constructed of combustible construction.

▶ **ISO 2 Joisted Masonry**

Buildings with exterior walls of masonry, but with combustible roofs and floors.

▶ **ISO 3 Noncombustible**

Buildings with exterior walls, floors and roofs of noncombustible or slow burning material; structural steel, walls and roofs are noncombustible, slow burning fiberglass insulation (for example, a warehouse).

▶ **ISO 4 Masonry Noncombustible**

Buildings with exterior walls of masonry, not less than four inches thick, or buildings with exterior walls of fire-resistive construction with a rating of not less than one hour and noncombustible or slow-burning roofs, regardless of the type of insulation on the roof surface (for example a full masonry building with concrete floors, concrete roof and built-up or membrane roof cover).

▶ **ISO 5 Modified Fire Resistive**

Buildings with exterior walls, floors and roofs of masonry materials not less than four inches thick or fire-resistance rating less than two hours but not less than one hour. This classification also includes structural steel protection techniques.

▶ **ISO 6 Fire Resistive**

Exterior walls of solid masonry, including reinforced concrete not less than four inches thick, hollow masonry not less than twelve inches thick; exterior non-bearing walls and wall panels may be slow burning, combustible or with no fire-resistance rating. Floors and roof are cast-in-place and at least four inch thick; the building also contains cast-in-place reinforced beams and columns. All structural steel needs to be protected with proper steel protection techniques. Both, pre- and post-tensioned concrete units have steel cables installed in the concrete to provide tensile strength.

● **Who may prepare an Appraisal Report?**

In Florida we have three different appraiser ranks, all regulated by the Department of Business and Professional Regulation (DBPR) and the Florida Real Estate Appraisal Board (FREAB) which functions as a division of the DBPR.

State-Registered Trainee Appraisers:

▶ The education requirements include 100 classroom hours of Board-approved courses covering the topics required by FREAB in subjects related to real estate appraisal. After registering with the DBPR

the Trainee Appraiser may only work under the supervision of a State-Certified Appraiser (either residential or general). Trainees are not allowed to sign an appraisal report without the accompanying signature of their supervisors.

State-Certified Residential Appraisers:

- ▶ Residential Appraisers can only appraise residential properties up to four units.
- ▶ The education requirements include successful completion of 200 classroom hours of board-approved courses covering the topics required by FREAB in subjects related to real estate appraisal.
- ▶ Provide proof of satisfactory completion of a 2-year associates degree or higher
- ▶ 1,500 hours of real property appraisal experience obtained over a 12-month period
- ▶ Pass the Residential National Exam and Florida Supplemental Exam.

State-Certified General Appraisers:

- ▶ General or commercial appraiser may appraise both, residential and commercial properties.
- ▶ The education requirements include successful completion of 300 classroom hours of board-approved courses covering the topics required by FREAB in subjects related to real estate appraisal.
- ▶ Provide proof of satisfactory completion of a 4-year bachelors degree or higher
- ▶ 3,000 hours of real property appraisal experience obtained over an 18-month period in real property appraisal. At least 50% (1,500 hours) of the claimed experience must be in commercial appraisal work.
- ▶ Pass the General National Exam and the Florida Supplemental Exam.

For your next appraisal report, make sure the person you hire is properly licensed; and remember, buildings with more than four units can only be appraised by a State-Certified General Appraiser.

If you are not sure whether the person you want to hire is licensed, go to the DBPR website and make a license search.

<https://www.myfloridalicense.com>



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