

## Deferred Maintenance

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### The Ramifications of Waiting

Deferred maintenance as it relates to existing site and building components is the practice of postponing maintenance activities including repairs on real property and infrastructure in order to save costs, meet budget funding levels, or realign available budget monies. The failure to perform needed repairs could lead to asset deterioration and ultimately, asset impairment. Generally, a policy of continued deferred maintenance may result in higher costs, asset failure, and in some cases, health and safety implications. This paper explores some of the challenges building owners and property managers face as properties endure the sometimes volatile economic cycles, as well as the life cycles of properties and their respective building components.

The old adage of “haven’t we learned our lesson” keeps replaying in my memory. Reflecting on previous cycles allows projections for the next cycle and the expression of “hindsight is 20/20” should remind us that past lessons learned should not be repeated. That is why it is so imperative that we remember the sordid stories of iconic buildings left devastated in the last cycle as operations suffered from economic downturns. The most successful property transactions and investments are those where you were aware of the risks and had a clear understanding of the property repairs or replacements involved over the anticipated hold term. However, things change with time and maintaining the exit strategy developed at acquisition is critical to profitability. Commercial real estate markets are experiencing such rapid change in the current marketplace and with intense competition, compressed market cycles, and the expanding global marketplace industry, it is time for participants to reassess their operational strategies as they relate to investment potential. Consequently, real estate professionals have never been more in need of reliable staff with the expertise to understand complicated transactions, complex building systems and the inherent consequences of decisions to defer

maintenance during a given year, or during an economic recession - and the ultimate outcome which those decisions will have in the increased cost of operation 5 to 10 years from now. Knowing how to project those needs will be the key to buying profitable assets in the future.



### Capital Does Matter

Naturally, as buildings age, components start to wear. Some asset managers appear to approach building ownership as if the buildings have an infinite life, and continue to repair, renovate, and replace portions and components of a building until systems are obsolete or completely inefficient. This restricts the use and even the ability to sell the asset or reuse it for other purposes. In addition, older buildings often do not fulfill the needs of the tenants based on technological advancements or programmatic and social changes. Due to these changes, buildings constructed in the 1960's and 1970's may not have met the needs for tenants in the 1980's and 1990's, but they made them work. With even greater technological innovation in the 21st century, these buildings will continue to be obsolete and ultimately

require major renovation in order to attract tenants. Similarly, buildings designed and constructed as a single tenant corporate facility may need to address economic changes that necessitate the conversion to multi-tenant office space. This creates unique challenges for Building Owners as they manage real estate and negotiations with potential occupants. As leases expire, tenants ultimately seek newer facilities or request concessions to stay in their current space. Whether we are anticipating costs for maintaining tenant leases or maintaining building systems - capital matters. In a fee-based asset management arrangement, or even with an internal property management company operating as a separate profit center, Building Owners may need to re-assess ways to hold managers accountable for the condition of the buildings and how they are maintained. In addition, some form of budget or account for operating maintenance may be needed to demonstrate the past practices to potential purchasers at the time of the sale. This will allow the Owner to demonstrate to potential buyers that operational decisions were not made solely to save costs associated with maintenance in the short term which could sacrifice the long-term performance of the building systems or shorten system life, requiring premature replacement. Now is the time to put these maintenance procedures and records in place, to afford the best return on investment in the next transaction cycle.



*Worn and patched roof flashing; rusting at roof screen*

## **Timing is Critical**

Specific examples include: roofing systems start to leak; heating and cooling systems become inefficient; and machinery parts wear out. This deterioration is cyclical and compounds the deficiencies. Therefore, with adequate and timely preventative maintenance and component replacement, management can control and

plan to address many of these conditions proactively. However, when management does not prevent these conditions or take care of them on a timely basis, the result is deferred maintenance issues. Deferred maintenance results when planned maintenance, repairs, replacement, and renewal projects are delayed due to a lack of resources or perceived low priority. Deferral of the activity results in a progressive deterioration of the facility condition or performance. The costs of the deterioration including capital costs, operating costs, and productivity losses are expected to increase if the activity continues to be deferred. While typically not an issue with spaces in public view, we find that well-functioning facilities, or at least the perception of such, is a key part of a successful business operation. The low priority items typically are the back-of-house areas. Most managers find funding of maintenance items is the easiest to cut from an operating budget. The common question asked is "Can you make it another year?" and the answer is generally yes. However, you cannot continue to say yes and make temporary fixes by applying "Band-Aid" fixes. Deferral of most maintenance activities does not produce immediate failure or observable deterioration. However, the repetitive deferral of maintenance activities can significantly impact the expected useful life of buildings and its components. There are many projections as to the financial impact of not performing operational and continuous maintenance. Some experts estimate this cost to be two or three times the cost of the original maintenance task. If the task goes on for so long that the asset "breaks", the repair/replacement cost can get as high as 15 times the cost of the original task. This cost impact takes into consideration not only the physical work to fix the asset, but the loss of productivity and efficiency costs. In any case, it is clear that the longer an item goes unrepaired, the higher the cost.



*Severely distressed concrete pavement*

We have found many deficiencies in most organizations' approach to maintenance and its funding that have contributed to the current situation. First and foremost, there is no accountability for the condition of buildings and how managers maintain them. Forward-thinking organizations recognize that their maximum operational efficiencies will be achieved by focusing their internal efforts on their core strengths and by strategically partnering with those specialists that add value to their investment objectives. It is specifically these partnerships that help distinguish industry leaders from mere participants. Managing the facility with a proactive maintenance program that includes documentation to present to potential buyers will not only serve as a checklist for evaluating management's performance, but will also serve to demonstrate proactive maintenance. We recommend that Owners consider implementing the following practices:

- Revising the operating, maintenance, and capital outlay budget process, especially for facility maintenance, renewal, and renovation;
- Establishing a standard condition level for each facility and requiring management to develop a program to achieve this level;
- Establishing a reserve fund for each building for continuous maintenance;
- Requiring management to provide information that demonstrates they have properly performed operating and continuous maintenance; and
- Establishing a Capital Preservation and Renewal Reserve Fund to accumulate long-term funding for capital renewal activities by relating the funding to financing instruments used to fund capital improvements and renovations.
- Requiring management to demonstrate that they have only used the funds for the purposes intended and not used for funding on other programs or activities.

## A Facility Asset Management System

We also recommend the use of a Facility Asset Management System to allow for the accumulation, analysis, and prioritization of the data needed to assess maintenance costs and management performance of maintenance. This system, in addition, should provide the information necessary to plan for each phase in the life cycle of a building. CODA has performed thousands

of property condition reports (also known as Property Condition Surveys, Physical Assessment Reports, Physical Needs Assessments, or Engineering Reports). These Property Condition Reports provide reliable and detailed information on the building's operating systems, overall design and construction, and architectural features. The purpose of the property condition report as part of a Facility Asset Management System is to identify and communicate conspicuous defects or deferred maintenance of a subject property's materials and systems, components, or equipment as observed during a field observer's walk-through survey. Our staff evaluates the condition of the property to identify specific issues for maintenance reserve budget estimates for replacement or repair actions. We rely on a comprehensive checklist, visual observations, review of available drawings, and interviews with operations and maintenance personnel. The review of available construction drawings and related documentation is performed by experienced architects/engineers who look at operations and maintenance procedures with the appropriate property management personnel, and assess property status relative to occupancy levels, safety systems, building codes, zoning, utilities, flood plain, and other pertinent issues. Our reports present information you need to know in clear and concise language. The property description is comprehensive and supported by photographs and diagrams, and the executive summary section presents the findings in a high-level user-friendly manner. Supporting data and cost estimates are well organized and easily referenced.



*Rusting and deterioration of piping critical to the building's operation*