

WHAT IS FULL FUNDING AND BASELINE FUNDING?



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After the Component List has been created or updated, the current Reserve Fund Strength and a recommended Funding Plan are calculated. The Funding Plan typically takes the form of a recommended monthly Reserve contribution. This "action plan" is developed to take the Reserve Fund from its current condition to the Funding Objective. But the question remains, which Funding Objective, and why?

When we purchase insurance, we manage our risk exposure by changing the coverage or the deductible. In a similar manner you can manage your Reserves risk by choosing an aggressive (high risk of special assessment) or conservative (low risk of special assessment) Funding Objective. Boardmembers should evaluate their decisions in this area with respect to their obligations as corporate officers, similar to how decisions are made with respect to insurance deductibles or types of Reserve Fund investments.

Baseline Funding means establishing a Funding Objective of keeping the Reserve cash balance above zero. Unfortunately, due to having little or no "margin for error" this Funding Objective exposes associations to a high risk of special assessments (because things rarely happen exactly according to plan). Full Funding is a conservative alternative, where the objective in any year is to have a Reserve balance equal to the value of deterioration at the association. When the Reserve balance is equal to the calculated deterioration at the association, the association is described as "Fully Funded", or 100% Funded. Baseline and Full Funding are the two most common Funding Objectives. Threshold Funding, a third option, means keeping the Reserve Fund at or above a pre-determined dollar or Percent Funded amount (typically a "middle ground" objective).

Because Reserve income and expenses never occur exactly as planned, decide in advance your risk strategy (how distasteful you find special assessments). Your tolerance for special

assessments should dictate which Reserve Funding Objective you chose. Most associations select Full Funding or Baseline Funding objectives.

Both Full Funding and Baseline Funding objectives can be calculated with the cash flow (pooling) method. Full Funding contributions are typically only 10-15% higher than Baseline contributions, so the contributions are not markedly different between the two. The component (straight line) method, on the other hand, only leads to Full Funding, and its recommended contributions are unfortunately higher than Full Funding contributions calculated by the cash flow method. This is because the component method by nature unfairly “front loads” contributions so they are higher in the first few years of the Funding Plan. Full Funding contributions calculated by the component method are therefore markedly higher than Baseline contributions.