ASSOCIATION RESERVES™

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BLOG

AVOIDING FUTURE SPECIAL ASSESSMENTS

by Drew Sleezer
Project Manager
Association Reserves

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www.reservestudy.com

Life is full of risks. You may be stuck with your current circumstances, but you have surprising power to influence many future risks. As a manager or board member, you are responsible for the care of common area assets enjoyed by many homeowners. Understanding your association's current risks and knowing what action you can take to minimize future risks is an important part of your responsibility.

As a part of every Reserve Study, we calculate the association's Percent Funded, a measure of the association's Reserve cash-on-hand compared to common area deterioration. It's no surprise that special assessments are much more common among associations with relatively little cash compared to the value of common area deterioration (having a low Percent Funded). Data from over 40,000 Reserve Studies prepared over the last 30 years has allowed us to prove the clear relationship between Percent Funded and Special Assessment risk.

We know that associations in the 0-30 Percent Funded range should expect special assessments almost 50% of the time (once every other year, on average), because the association has no cash margin for events that don't go according to plan. Take a look at the Baseline (designed to keep the Reserves cash-positive) Reserve funding plan shown below for the association's next 30 years. The association is currently 54% Funded, in the 30-70% range where special assessments occur about 12% of the time (about once every eight years). Let's say the board is comfortable with that level of risk, but no more. So why would we counsel them that Baseline Funding isn't a good decision for their association? They are projected to have "enough" cash, aren't they?

The reason is that special assessment risk is additive. It is like flipping a coin, where half the time you get "heads". So after two flips, it is likely you'll get one "heads". After 10 flips, it is likely you'll get five "heads". You can see in this association's Baseline Funding plan that over the course of 30 years they are projected to be in the (red) 0-30% range nine years. This means the association will likely have four or five special assessments during the years their Reserves are in the red 0-30% range. That's too often for this Board! So they're going to have to increase their contributions a bit, to prevent their Reserve Balance falling into the high-risk 0-30% range.

It's all a matter of funding Reserves appropriate to your risk tolerance. Don't let today's "acceptable risk" drift to tomorrow's "unacceptable risk"! The future is [uncertain](), but that is different from unpredictable. The budget decisions you make today will affect your association's special assessment risk in future years.