HOW MUCH SHOULD OUR RESERVE CONTRIBUTIONS BE?

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There once was a man with one foot in a bucket of scalding hot water and one foot in a bucket of ice water. When asked how he felt, he said "On the average, I feel just fine!" With that illustration clearly warning you of the limitations of discussing averages, how much should your Reserve contributions be?

Typically (that is a dangerous word), most condominium associations should be setting aside 15% - 40% of their assessments towards Reserves. This ratio is lower for associations where each homeowner maintains their own home and the association only is responsible for some minimal common areas. Obviously every association has its own unique list of common area assets it is responsible to maintain. Some may have a longer list that force higher Reserve contributions (pool, elevator, tennis court, balconies, wood siding, etc.), some may have shorter lists of amenities or more cost-efficient exterior finishes.

In addition to these physical factors, there are three other important influences to your Reserve contributions.

- <u>Economic assumptions for interest and inflation.</u> Inflation has its effect on the entire replacement cost, while interest is only earned on the much smaller amount of Reserves actually on-deposit. This means interest earnings will never offset inflation, even in the rare case the two values are the same. Because of this, inflation has a very powerful influence on Reserve contributions. On average, every percent increase in interest requires a 13% increase in contribution size!

- <u>Your current "starting point".</u> Reserve Fund status is measured in terms of "Percent Funded", where 100% Funded means you have cash on hand equal to the deteriorated fraction of your Reserve components. If your association is new and you have very little deterioration, the value of that deterioration is small, and it doesn't take much Reserve cash to be 100% Funded. But if your Percent Funded is low (0-30%), as is the case with many older associations, it means the association has much more deterioration than Reserve cash. The association in this case needs to play “catch up” in order to avoid running out of money for Reserve projects. Because of the “catch up” effect, associations with a weak Percent Funded will have higher Reserve contributions than associations that find themselves in a strong position (70-130% Funded).

- <u>Your Objective.</u> The most common Reserve Funding Objectives are Full Funding, where the association’s objective is to become 100% Funded, and Baseline Funding, where the association’s objective is to simply not run out of money in light of projected Reserve expenses. Due to lack of “margin” for events that don’t occur exactly as planned, special assessments are much more common among Baseline Funding associations than Full Funding associations. Full Funding is a higher objective, so associations Fully Funding their Reserves have higher Reserve contributions than those with a Baseline Funding objective. In an interesting coincidence, the average difference in contribution size between the two is 13%.

Given this background, what is the bottom line for your association? In most metropolitan areas, "typical" condominium associations should be setting aside somewhere between $60 and $150 per unit, per month, towards Reserves. Associations with more common area elements to maintain and a weak Reserve Fund will need Reserve contributions at the higher end of the range. Appropriate Reserve contributions for associations with fewer common area amenities, who start with a strong Reserve Fund, will enjoy contributions at the lower end of the range.

So it all boils down to roughly $2 to $5 per unit per day. Not a big number. About the cost of a premium coffee drink. The cost of maintaining the major components of your condominium home are pretty cheap when you look at it this way!