

RESERVE FUND STRENGTH (% FUNDED)

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A Guide to Help Managers and Board
Members Understand and Develop Their
Reserve Fund Strength.

A publication of:



ASSOCIATION
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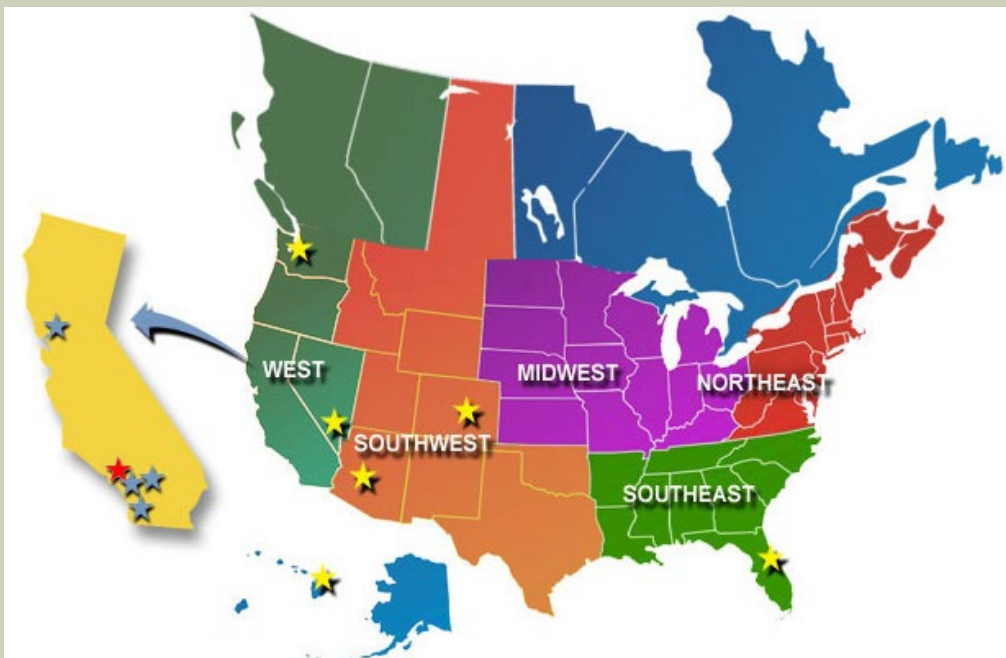
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Robert M. Nordlund, PE, RS is the Founder/CEO of Association Reserves, Inc. Established in 1986, Association Reserves is a professional Reserve Study company serving Association-governed communities of all shapes and sizes. Robert's organization performs approximately 3,000 Reserve Studies each year, with a staff of 19 Reserve Specialists in ten regional offices throughout the United States.



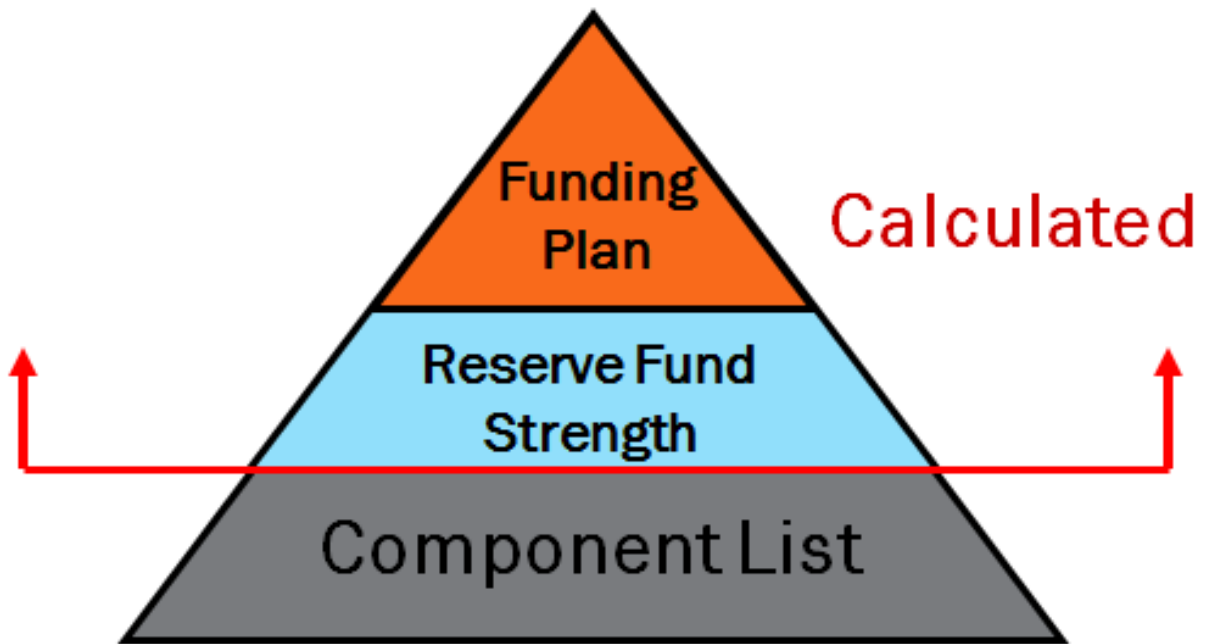
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This pyramid represents the relationship of the three key elements of a Reserve Study.



- The “**Component List**” serves as the foundation by spelling out the scope & schedule of all necessary repairs & replacements.



“**Reserve Fund Strength**” is a calculated ratio that compares the actual amount in Reserves to the current value of Reserve Component deterioration.

- The “**Funding Plan**” is a calculated plan of regular monthly assessments and/or special assessments necessary to perform the repairs & replacements in a timely manner.



SECTION 1:



HOW MUCH IS ENOUGH?

Instinctively, we all know that **large associations** with many common area amenities should have a high Reserve Fund balance.



Similarly, **small associations** with only a few common area amenities can get by on with a low Reserve Fund balance.



“But every association has different Reserve requirements depending on the scope and schedule of their Reserve projects.”



Let's try a simple exercise.

An acquaintance tells you he's the treasurer of his homeowner's association, and he's just been reviewing the current financial statements. His association has \$500,000 in their Reserve account, so he thinks they can probably cut next year's Reserve Funding Plan in half. After all, they've got half a million in the bank, right?

Dollar balances don't tell the whole story!

You know nothing but what he's told you. If the treasurer lived in a fairly new condo building with one pool and a tennis court, you'd probably figure they're in great shape. But what if he represents an aging 200-home community with crumbling roads, dilapidated amenities, and a 3,000 square foot clubhouse that needs a new roof and a paint job? How would that change your perception of things?



HOW MUCH IS ENOUGH?

It Depends!



It requires a comparison of the size of the Reserve Fund to some kind of benchmark.

National Reserve Study Standards (NRSS) define this benchmark as the “Fully Funded Balance”.



SECTION 2:



FULLY FUNDED BALANCE 101

FULLY FUNDED BALANCE (FFB)

Definition: A Financial representation of the “ageing” of the common area components



Ageing (also known as deterioration) is normal and inevitable!

The physical deterioration of a building starts the moment new construction is completed and starts afresh after each cycle of common area repairs & replacements.

Calculation:

$$\text{FFB} = \frac{(\text{Current Cost} \times \text{Effective Age})}{\text{Useful Life}}$$

This number is calculated for each component, then summed together for an association total.



The data that you will use to calculate your Fully Funded Balance is found in your Reserve Study's Component List.

Remember, the Component List details the Schedule (based on Useful Life (UL) & Remaining Useful Life (RUL)) and Scope (based on Current Cost) of every projected Reserve project.

Table 2: Reserve Component List Detail					Schedule	Scope
					9999-0LX	
# Component	Quantity	Schedule		Current Cost		
		Useful Life	Rem. Useful Life			
101 Comp Shingle Roofing - Replace	Approx 10,000 sq ft	20	15	\$100,000		
202 Iron Fence/Rail - Repaint	Approx 330 LF	4	1	\$1,485		
203 Stucco - Repaint	Approx 26,000 GSF	10	9	\$27,500		
204 Wood Surfaces - Repaint	Approx 11,000 GSF	5	4	\$19,850		
301 Gate Operator - Replace	(1) Overhead system	8	9	\$2,150		
302 Garage Doors - Replace	Approx (22) doors	24	13	\$10,450		
303 Intercom - Replace	(1) System	12	3	\$2,150		
401 Mailboxes - Replace	Approx (22) boxes	15	0	\$880		
402 Iron Bench - Replace	(1) 8 LF bench	20	9	\$600		
403 Iron Fence/Rail - Partial Replace	Approx 330 LF	10	3	\$1,420		

For the following Fully Funded Balance example, we will use the Comp Shingle Roofing data listed in red in the above Reserve Component List.



FULLY FUNDED BALANCE EXAMPLE:

- The roof of your Association was replaced 5 years ago
- Life expectancy of the roof is 20 years.
- Current cost to replace the roof is \$100,000

How much money should the Association have already saved to be “on pace” with the roof’s deterioration?

$$\text{FFB} = \frac{(\$100,000 \times 5 \text{ years})}{20 \text{ years}}$$

Answer: \$25,000

The roof has “aged” (or used up) 25% of its Useful life, so it makes sense that the Association *should* have 25% of the \$100,000 replacement cost on hand.



SECTION 3:

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% FUNDED: HOW TO CALCULATE IT & WHAT IT MEANS

**“Saving is a very fine thing, especially if your
parents have done it for you!”
- Winston Churchill**

.....

**Now that we know how to find and
understand Fully Funded Balance, we can
take the process a step further.**

**We are able to
calculate in real
terms exactly
how well the
Reserve Fund has
kept pace with
common
deterioration.**



***An Association’s Reserve Fund
“strength” can be measured using
% Funded!***



CALCULATIONS

- **% Funded**

$$\% \text{ Funded} = \frac{\text{Reserve Fund Balance (actual)}}{\text{Fully Funded Balance (computed)}}$$

Simply tally the amounts indicated on bank or investment account statements to get this number.

It is **IDEAL** to have **% Funded = 100**

This would mean your Reserve Fund Balance is equal to your Fully Funded Balance

Click here to learn more!



% FUNDED EXAMPLE:

Going back to our FFB example...

If the Association has \$25,000 actually sitting in the bank for the new roof after 5 years, and the roof's FFB is \$25,000:

$$\% \text{ Funded} = \frac{\$25,000}{\$25,000}$$

Answer: 100% Funded

Remember, % Funded measures how well the Reserve Fund has kept pace with deterioration, and 100% Funded means perfectly “on pace”!



Now let's say that instead of \$25,000, the Association only has **\$5,000** in their reserve account.

$$\% \text{ Funded} = \frac{\$5,000}{\$25,000}$$

The roof deterioration (i.e., FFB) remains the same at \$25,000 because the roof is still "5 years old".

Answer: 20% Funded

A "% Funded" of 20% means being substantially "off pace" compared to common area deterioration and in risk of needing a Special Assessment.



Now let's say that instead of \$25,000, the Association has **\$30,000** in their reserve account.

$$\% \text{ Funded} = \frac{\$30,000}{\$25,000}$$

Answer: 120% Funded



A “% Funded” of 120% means the Association is overfunded and can reevaluate the amount they are collecting for their Reserve account. Being overfunded means that you are on pace and in very little risk of a Special Assessment.



Reserve Studies 102: The Financial Analysis

Click the video to
learn more!



SECTION 4:



WHY % FUNDED MATTERS

Now that you understand what “% Funded” is and how it is calculated, you might be wondering why it is so important.

TWO REASONS

1. It is a meaningful, independent, and reliable measure
2. Reliable predictor of Special Assessments



1

Meaningful, Independent, Reliable Measure

Going back that Treasurer acquaintance...

He knows the amount of the Reserve Fund is \$500,000, but does he really know if the Reserve Fund has “kept pace” with the actual common area deterioration?



Can he assure the homeowners that the Association is in a position to perform timely repairs & replacements?

Is he prepared to have prospective buyers rely on his personal assessment of the situation to make an informed purchase decision?

Reserves “% Funded” is the only meaningful, independent, and reliable measure for him to use.





Reserve Fund < Deterioration
Underfunded



Reserve Fund = Deterioration
100% Funded



Reserve Fund > Deterioration
Overfunded

2

SPECIAL ASSESSMENTS:

**% Funded is a reliable predictor
of Special Assessment risk.**

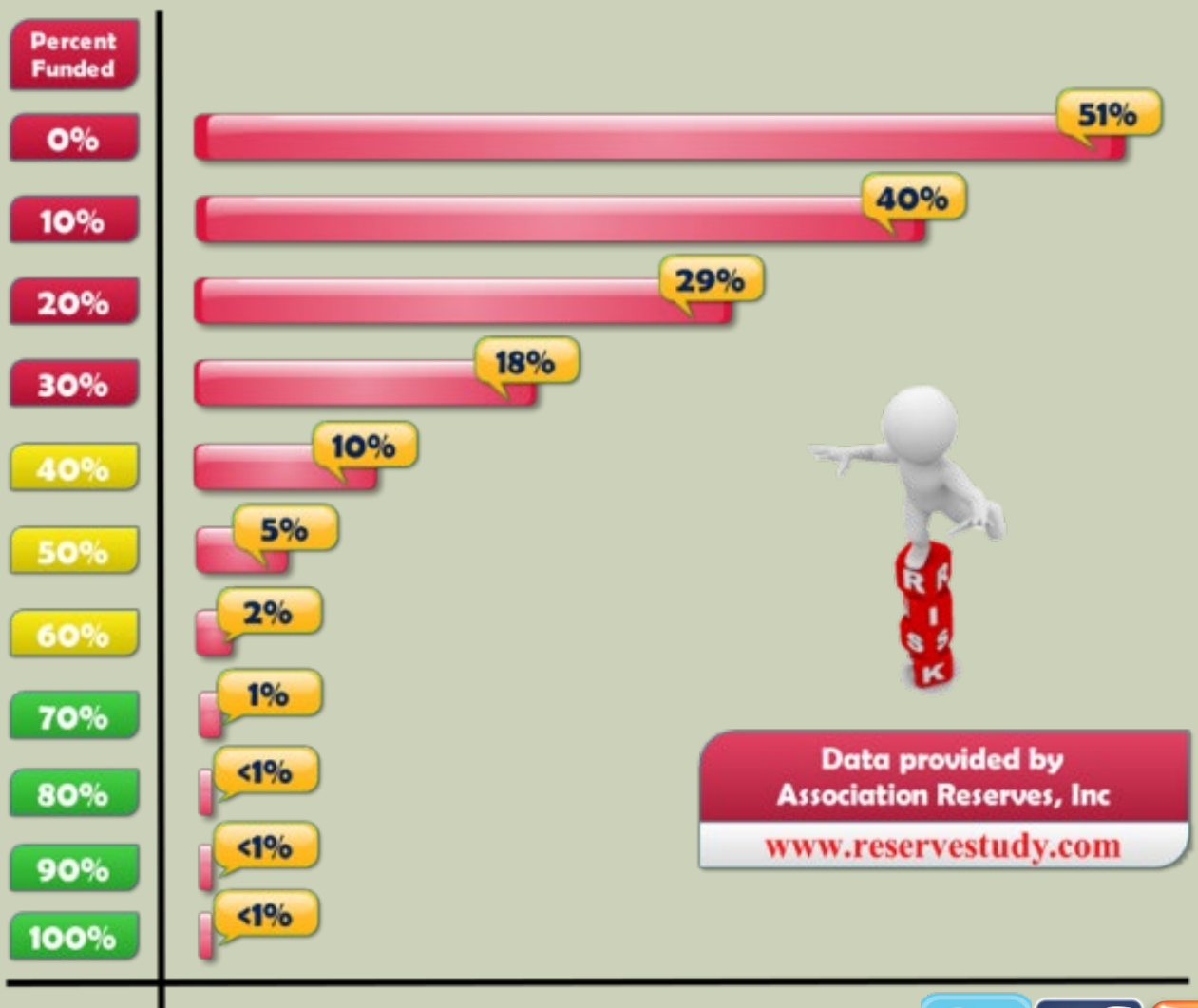


**Special Assessments are the typical unwanted
consequence when an Association is surprised
by significant expenses that are larger, or earlier,
than expected.**



“These simple computations help Boards gauge the relative “strength” of their Reserve Balance at a particular point in time.”

RISK of Special Assessment



As a general rule...

0 - 30% →

Reserve Fund is considered “weak”.
High risk of special assessments and deferred maintenance

40 - 60% →

Reserve Fund is considered “fair”.
Some risk of special assessments and deferred maintenance

70 - 100% →

Reserve Fund is considered “strong”.
Low risk of special assessments and deferred maintenance



“ Special Assessments are unsettling for the Association, both financially and politically. ”

Minor surprises should always be expected, such as a roof failing a year earlier than planned.

An Association with a strong Reserve Fund
(70 – 100% Funded)

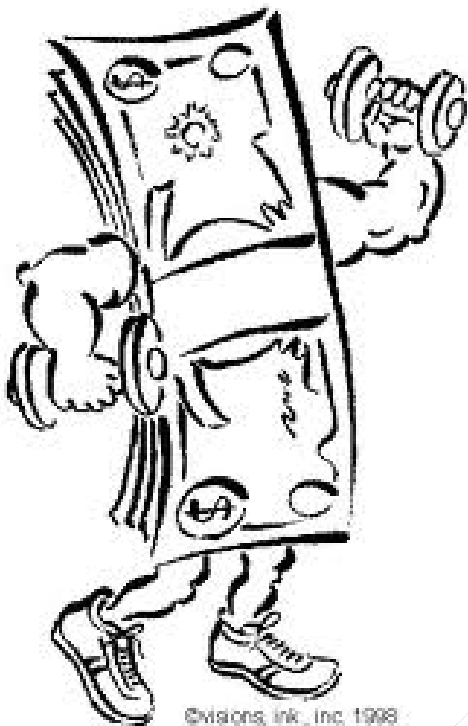
is better prepared to absorb such minor surprises without being forced into a Special Assessment.



Associations that have relatively little Reserves on-hand often find their Reserves inadequate, even if they planned their Reserve cash flow down to the penny.



Things don't happen exactly as you predict!



Designing for a relatively strong Reserve Fund provides a margin for protection when Reserve expenses are higher than expected or earlier than expected.



Request a Reserve Study Proposal Now!



Make sure your Reserve Study is up-to-date and your Association's Reserve Fund Strength is strong. Visit our [website](http://www.reservestudy.com) or call our office to request a proposal!



Stay Tuned.
Coming Soon!

All you need to know about

Funding Plans

