ASSOCIATION RESERVES™
Planning For The Inevitable™

Reserves: Selling Out, Settling, or Succeeding?

by Robert M. Nordlund, PE, RS   www.reservestudy.com   Nov 2016

Every association makes a choice, each year, about Reserve funding. Those decisions to "Sell Out", "Settle", or "Succeed" determine if your association will be prepared to perform your major repair and replacement projects in a timely manner (or not), and will have related financial effects that will affect the association for years. The only question is... which decision have you made?

Size: 70 units
Reserves: 49% Funded
Age: 15 yrs
Assmts: $245/mo
Res Contribs: $16.43/mo
Home value: $350k

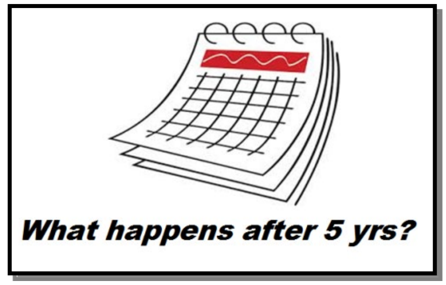
In this webinar we follow three associations, physically identical, and examine what happens over the years as they choose to Sell Out, Settle, or Succeed.

Confronted with looming expenses, each of these three associations, Coastline Villas, Produce Heights, and Riverbend get a Reserve Study, finding each at 49% Funded (mid-range) and recommending Reserve contributions of $71.43/mo for each unit (a $55/mo increase). Each association chooses a different course of action.

Coastline Villas, for a number of reasons, chooses to keep Reserve contributions unchanged at $16.43/unit/mo.

Produce Heights chooses to increase homeowner assessments by increasing Reserve contributions to $60/unit/mo, enough to theoretically keep their Reserves cash-positive.

Riverbend takes a courageous path, increasing homeowner assessments enough to handle the entire recommended Reserve contribution of $71.43/unit/mo.



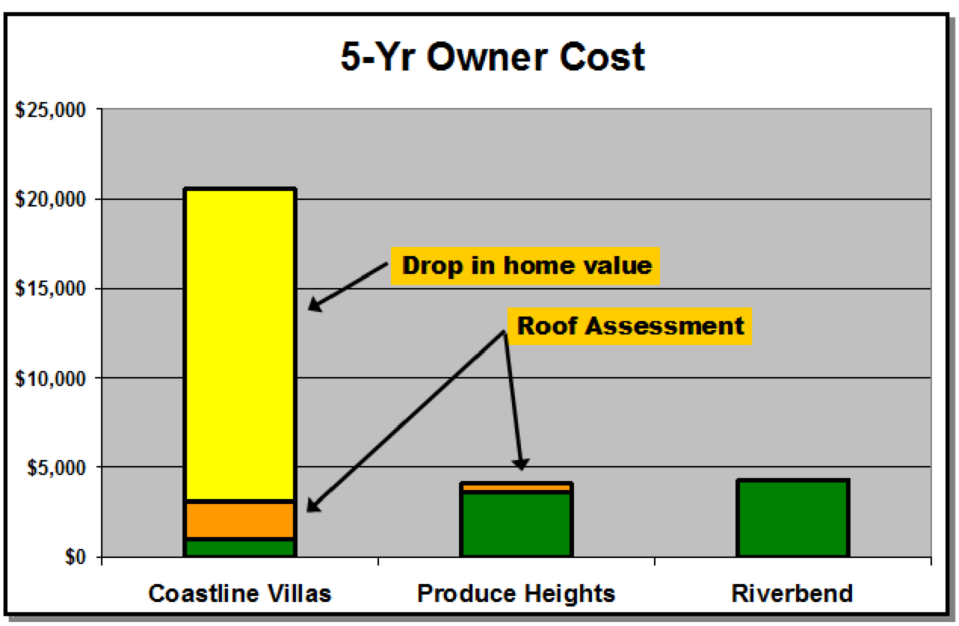
The question is…
What happens when that happens?

In the 5th year, the roof needs replacement (a year early). Without sufficient cash, Coastline Villas needs a special assessment of $2,070/unit (enough to cover the $1,500/unit roof cost plus related water damage). Produce Heights needs a $500/unit special assessment because their Reserves weren't quite enough to pay the entire roof replacement cost. Riverbend saw the failure coming, had interviewed contractors in advance, and got the roof done before it failed, on budget, using Reserve funds.

But still… so what?

Due to a competitive Real Estate market, prospective buyers see advantages at Riverbend and Produce Heights, so prices fall 5% at Coastline Villas.

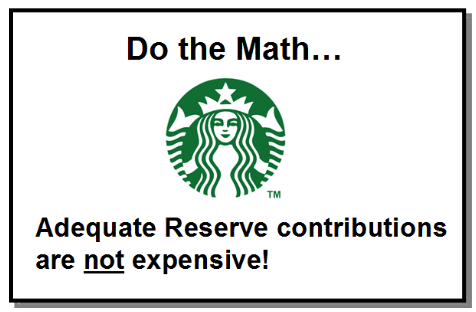
Coastline Villas saved $ on Reserve contributions (green), but gave most of it back in the special assessment (orange). But where they took the big hit was in home values, where that 5% cost them $17,500 each (because they were unprepared financially for a $1,500/unit roof project). Note: no Real Estate value change between Produce Heights and Riverbend, as buyers *and their Real Estate Agents* saw the roof project getting done at both associations without the delays, political disruption, and divisive special assessment that occurred at Coastline Villas.



Lessons learned?

1) Reserve deterioration is predictable and ongoing, and the cost of Reserve deterioration is as real as any other bill at the association. Ignore it at your peril!

2) The board's budget decisions affect home values, not just monthly assessments.



3) The cost of predictable Reserve deterioration is not high. Typical condominium Reserve contributions, nationwide, are very affordable: just a few dollars a day (similar to a premium coffee).

Special Notice! Associations often take decades to get into Reserve funding trouble. Most associations don't require the drastic budget changes Produce Heights and Riverbend made. Consider a "$10 solution": raising your Reserve contributions $10/unit/mo each year for three to five years until your Reserve contributions grow to offset ongoing deterioration.

More questions? Watch the complete webinar here. Find more information in our online Library, or contact Association Reserves at www.ReserveStudy.com or at

800/733-1365. Don’t expose your association to unsettling surprises because of poor Reserve Funding choices!

Webinar Questions Asked by Attendees

Q: How many years forward should a Reserve Study look? Our first one looked 20 yrs ahead, the next one (different provider) projected 40 yrs into the future.

A: National Reserve Study Standards require a minimum of 20 yrs of income and expense be shown. Some states require all major projects within 30 yrs be shown. So most Reserve Study providers have 20 or 30 yr future projections. Note: some firms include components expected to fail farther out than the "years shown" in financial projections, allowing funds to quietly build up for those components even though they don't show in the 20-yr or 30-yr display of income and expenses.

Q: Do construction specialists participate in the on-site Reserve Study inspection (to help evaluate roads, boat ramps, structures, etc), providing estimated life expectancies and replacement costs?

A: It depends on the Reserve Study provider. Most credentialed Reserve Study providers are by definition generalists, knowing much about many subjects/components. Most firms, ours included, know when to reach out for the assistance of a specialist with respect to obtaining life and cost estimates.

Q: Are companies performing Reserve Studies certified or accredited?

A: No. There are two types of national credentials in the Reserve Study industry, both similar to each other, and both awarded to individuals. Look for the Reserve Specialist (RS) credential, or the Professional Reserve Analyst (PRA), in your Project Manager (or their supervisor), as having either of these credentials assure the association that the individual has an appropriate educational or experience background, as a minimum level of applicable Reserve Study experience, and the individual adheres to consistent use of terminology.

Q: How is Reserve account health considered, and how does it affect the sales price of a home?

A: Good question and the answer is a number of ways. First, sufficient Reserves allow "curb appeal" projects to get done in a timely manner, maximizing home value. Savvy Real Estate agents are also aware of political/leadership issues at the association, specifically special assessments and other possible sources of turmoil. In addition, a strong Reserve fund is literally dollars "behind every door" in a savings account that each new homebuyer realizes is available to maintain their new home. What a tremendous advantage to buy a home with money already in savings to keep it well maintained!

Q: What is the responsibility of the Master Association with respect to Reserve planning for the sub-associations? We do annual, professional Reserve Study updates but our sub-associations don't!

A: Check with your legal counsel to confirm, but my understanding is that the Master Association Board is responsible for the Master Association only. The sub-association boards are responsible for their own associations. You can set a good example, and encourage similar responsible behavior, but I believe you have no power or responsibility. Let special assessments, deferred maintenance, and limited property values be limited to sub-associations who don't make adequate Reserve contributions. That is a pretty stiff consequence they suffer due to their fiscally irresponsible behavior.

Q: What actual trouble can a subdivision association (not a condo) get into? Our board laughs at fiscal responsibility, has cut Reserve contributions to 8% of total budget, and can't get a special assessment vote.

A: As above, check with your legal counsel who may point you to state laws on the matter. While the board's behavior may not be illegal, the financial consequences brought about by the competitive real estate market are strong. Those homes will sell for lower values. That is an unavoidable consequence that doesn't require a call to an attorney.

Q: In your examples, you spoke only of initial contribution rates recommended in the Reserve Studies those associations received. Were those part of a multi-yr plan?

A: Yes. The Reserve professional adhered to National Reserve Study Standards, creating a multi-yr funding plan for each that floated upwards annually with inflation, ensuring equitable Reserve contributions over the years for the owners. Coastline Villas made no change in the initial year or in following years. Produce Heights unfortunately made no further changes after their large initial year increase. Riverbend made those ongoing annual increases.

Q: You indicated the FHA was looking to see 10% (or did you say 20%?) Reserve contributions. 10% of what?

A: The FHA looks for a very simple figure, easy to spot and confirm. So they are looking for 10% of total assessment income going to Reserves. So if your budgeted homeowner assessment income is $10,000/mo, they need to see at least $1000/mo going towards Reserves. The “20% of total budget” figure is just for associations with a low Owner Occupied (in the 35% to 50% range), where the FHA will trade the higher risk due to lower Owner Occupancy with lower risk due to higher Reserve contributions. Read more here, here, and here.

Q: I just heard the FHA raised its Reserve Funding requirement to 20% of total budget. Is that true?

A: No. It’s standard requirement is 10% of assessment income. On Oct 26, 2016, the FHA found a way to allow associations with an Owner Occupancy under 50% to become approved. The tradeoff, as stated in the prior question, was higher Reserve contributions for those associations with an Owner Occupancy in the 35% - 50% range. Read more here.

Q: In the Reserve Study, what is the Fully Funded Reserve balance?

A: The Fully Funded Balance (FFB) is a calculation defined by National Reserve Study Standards. It reveals the deteriorated “value” of all your Reserve components, and is the figure to which your actual Reserve Balance will be compared to calculate your association’s Percent Funded. Read more here, or download our free eBook on the subject here.

Q: What was that tip you mentioned about language and Reserve contributions?

A: Always discuss Reserve contributions as offsetting ongoing deterioration, in “present tense” words. This makes Reserve contributions sound more like normal “paying a bill” than “funds set aside for the future”. It is easy for boardmembers and homeowners to dismiss funds set aside “for the future” as someone else’s problem. When you characterize Reserve contributions as offsetting ongoing (current) deterioration, it becomes much more real.