ASSOCIATION RESERVES
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STORY OF THE MONTH

WHY "STANDARDS" MATTER

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The 1998 National Reserve Study Standards have been in place for over 14 years. These standards give all of us in the Reserve Study industry clear definitions of terms that we use (and calculations that we make) on a regular basis. One of those important terms and calculations is "% Funded", also known as the measure of Reserve Fund strength.

National Reserve Study Standards define "% Funded" very specifically as:

"The ratio, at a particular point of time of the *actual (or projected actual)* Reserve Balance to the *Fully Funded Balance, expressed as a percentage."**

* *Fully Funded Balance* is also clearly defined in National Reserve Study Standards

By comparing "dollars on hand" to "dollars needed, % Funded provides an easy way to measure Reserve Fund strength on a relative basis. Like all "ratios", the result of the calculation has meaning, regardless of the amounts involved. For example, most housing lenders like to see a Loan to Value (LTV) ratio of 80%. The LTV ratio has meaning regardless of whether a buyer is financing a $1,000,000 single family dwelling or a $100,000 condominium.

When it comes to the calculation of "% Funded", National Reserve Study Standards leave no room for confusion. "% Funded" can only be calculated one way and it provides everyone with a clear idea of the Reserve Fund strength of any Association at a specific point in time.

So, you can imagine my surprise (and frustration!) when a California Assessment & Reserve Funding Disclosure Form recently crossed my desk with two different measures of "% Funded". The form had been sent to me by a concerned homeowner and had been prepared by an otherwise reputable Management Company for an extremely large (over 5000 home) master community.

According to the Disclosure Form, the first "% Funded" calculation of **13%** was associated with a Funding Plan based on the "Straight Line" computation method. The second "% Funded" calculation of **100%** was associated with a different Funding Plan derived from the "Cash Flow" computation method.

Simply put, the company that prepared the Disclosure Form has revealed themselves to be mathematically illiterate. % Funded measures Reserve Fund Strength at one point in time. It can only be one number. Second, the % Funded calculation is independent of future Reserve contributions, or the manner in which those contributions were computed.

So the $64,000 question is this:

Is the Association **13% funded** or **100% funded**?

Unfortunately for anyone who makes a decision based on this state-mandated disclosure document, the Management Company discounted the weaker 13% funded calculation as being irrelevant and represented the Association as being fully (i.e., 100%) funded.

National Reserve Study Standards exist for a reason. One of the main reasons is to provide Boardmembers and Managers the information they need to make informed decisions. The standards also prevent misinformation and surprise among homeowners or interested outside parties (lenders and buyers). National Reserve Study Standards offer Reserve Specialists like us consistent terminology and definitions, so we can make repeatable calculations, craft appropriate Funding Plans, and provide reliable disclosures for our clients.

Anyone who tries to save time or money by preparing their own Reserve Studies needs to involve someone with the mathematical horsepower to get the calculations right! Made up terms, definitions, calculations, and justifications that are inconsistent with National Reserve Study Standards will wind up doing the Association a major disservice with a flawed Reserve Study that does more harm than good. If your Reserve Study or your State Disclosure Forms are unclear, confusing, surprisingly optimistic, or duplicitous, beware. The documents were probably not prepared in accordance with National Reserve Study Standards!