RESERVE PLANNING: PRACTICAL APPLICATION (PART 5 OF 6)

by Jim Talaga, RS
President
Association Reserves – WA LLC

December 2014

www.reservestudy.com

In our October newsletter we looked at the question of which funding plan methodology to use: "Straight Line" or "Cash Flow". This month we look at how to use the state required reserves disclosure as a tool for advancement of your association.

Many associations are poorly funded in the state of Washington. That's a fact. Perhaps this is the reason why many choose not to include these disclosures within the budget mailing package to all owners as required by WA law for many during the budget process (we estimate only 1/3 are providing them – and we do it for you, for free). They often bring bad news. If that's the case within your community association, or one you know, they are missing an opportunity.

Reserves disclosures highlight several important pieces of information, essentially boiling down to: **the funding path recommended by the reserve study provider**, and **the funding path set by the board of directors through the proposed budgeted reserve contributions within the upcoming budget cycle.**

In the sample / actual below, the association is proposing $7,421 per month ($63.97 per unit) be budgeted to reserves. The reserve study provider is recommending $17,177 ($148.08 per unit). Big difference! **Read on to see the ramifications of the board's decision.**

a)

Budgeted Amounts:	Total	Average Per unit*	
Reserve Contributions:	$7,421.00	$63.97	
Operating Budget:	$25,717.00	$221.70	
Total:	$33,138.00	$285.67	per: Month

Recommended amount:	Total	Average Per unit*	
Reserve Contributions:	$17,177.00	$148.08	per: Month
Funding Plan Objective:	Full Funding		

The second page of the reserves disclosure shows a 30-year cash flow summary recommended by the RS provider, illustrating how the association can meet their projected expenses and gradually build reserve fund strength over time (see 10 year snippet below):

Year	Starting Reserve Balance	Fully Funded Balance	Percent Funded	Rating	Annual Reserve Contribs.	Loans or Special Assmts	Interest Income	Projected Reserve Expenses
2013	$17,686	$1,419,938	1.2%	Weak	$206,124	$83,334	$74	$28,700
2014	$278,518	$1,561,917	17.8%	Weak	$212,308	$0	$166	$105,678
2015	$385,314	$1,632,736	23.6%	Weak	$218,677	$0	$246	$6,578
2016	$597,659	$1,811,737	33.0%	Fair	$225,237	$0	$355	$0
2017	$823,251	$2,006,987	41.0%	Fair	$231,994	$0	$460	$38,999
2018	$1,016,707	$2,172,153	46.8%	Fair	$238,954	$0	$545	$92,974
2019	$1,163,232	$2,291,033	50.8%	Fair	$246,123	$0	$385	$1,033,333
2020	$376,407	$1,449,394	26.0%	Weak	$253,507	$0	$252	$0
2021	$630,165	$1,651,457	38.2%	Fair	$261,112	$0	$380	$0
2022	$891,657	$1,864,340	47.8%	Fair	$268,945	$0	$502	$45,210

The third page of the reserves disclosure shows another 30-year cash flow summary based upon the board's proposed budgeted reserve contributions. (see 10 year snippet below).

Year	Starting Reserve Balance	Fully Funded Balance	Percent Funded	Rating	Annual Reserve Contribs.	Loans or Special Assmts	Interest Income	Projected Reserve Expenses
2013	$17,686	$1,419,938	1.2%	Weak	$89,052	$83,334	$45	$28,700
2014	$161,417	$1,561,917	10.3%	Weak	$91,724	$0	$77	$105,678
2015	$147,540	$1,632,736	9.0%	Weak	$94,475	$0	$96	$6,578
2016	$235,533	$1,811,737	13.0%	Weak	$97,310	$0	$142	$0
2017	$332,985	$2,006,987	16.6%	Weak	$100,229	$0	$182	$38,999
2018	$394,396	$2,172,153	18.2%	Weak	$103,236	$0	$200	$92,974
2019	$404,858	$2,291,033	17.7%	Weak	$106,333	$0	$0	$1,033,333
2020	-$522,142	$1,449,394	0.0%	Weak	$109,523	$0	$0	$0
2021	-$412,619	$1,651,457	0.0%	Weak	$112,808	$0	$0	$0
2022	-$299,811	$1,864,340	0.0%	Weak	$116,193	$0	$0	$45,210

Recently, a tenured attorney (developer client base) told me "reserve studies don't really tell you much". **What does the above information tell you?** It tells me the current plan is to run the association out of money in seven years. It tells me not to consider purchasing here without heavy negotiation of the sales price. It tells me the current assessments are inadequate. It tells me this is a high-risk community. It tells me lots of things…

Now how can this type of information actually help you? You can't gloss over it – the disclosure highlights the truth, and sometimes the truth hurts. When you begin with the truth, you're that much closer to the solution. Reserve expenses are inevitable – don't hide from them - plan for them. **Provide this disclosure to all owners. Hey, it's required!**

As I stated earlier in the practical application series, begin with a 5-year plan (expenses far right column). Communicate the upcoming expenses to the community and together find the best value for the community for these projects, being proactive instead of reactive. Yes you may face some anger and varying opinions, but you will also discover helpful suggestions and potential new volunteers who ask good questions as a result of the disclosure. One of your truthful answers may be “Yes, clearly the board of directors has not done a good enough job preparing the community for these expenses. But we are here now with a desire to do something about it”. Volunteers are the lifeblood of your community, and reserves disclosures will not only help you prepare for projects, they may also uncover your next valued board or committee member.