ASSOCIATION RESERVES™
Planning For The Inevitable™

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Reserve Study Basics For 2019

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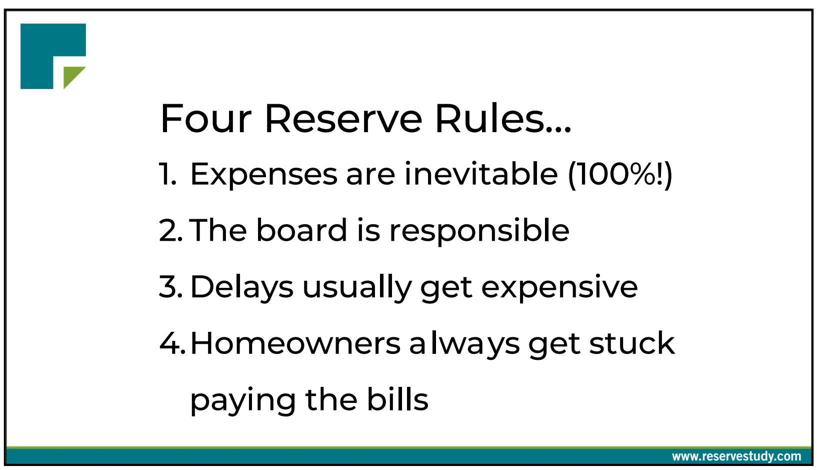
Miss the webinar? Watch it [here](). See all of our other available recorded webinars (on related or more advanced topics) [here]().

Don't ever believe it if someone tells you Reserves are complicated. It's simply a matter of setting aside cash to offset the ongoing deterioration of your common areas… paying the "bill" of ongoing deterioration. Then when something fails, you'll have the funds available and ready to be spent. In other words, if you take care of the present, the future takes care of itself.

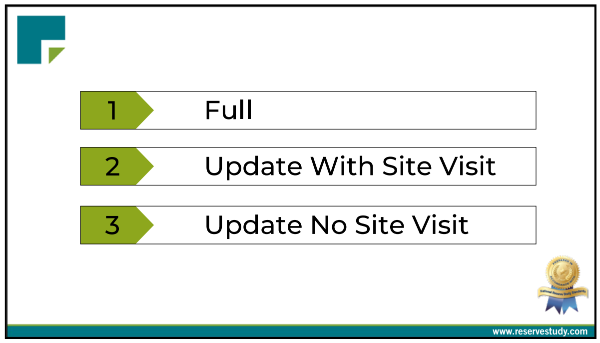
Reserve planning boils down to the simple "Four Reserve Rules":



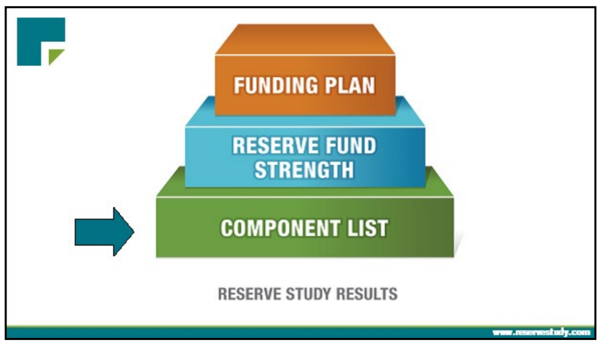
And why do you set aside Reserves? Because Reserve projects are so expensive they require years of financial preparation. Organizations simply don't have access to enough funds to perform most Reserve-size repair or replacement projects on a last minute basis. You need to plan ahead.

So what are some other basics?

There are three types of Reserve Studies, designed to provide you just the kind of cost-effective assistance/guidance that is needed. A "Full" when one hasn't ever been done, a "With-Site-Visit" update every few years, and a "No-Site-Visit" update in the in-between years.



Each of those Reserve Study types contain the same three kinds of information.

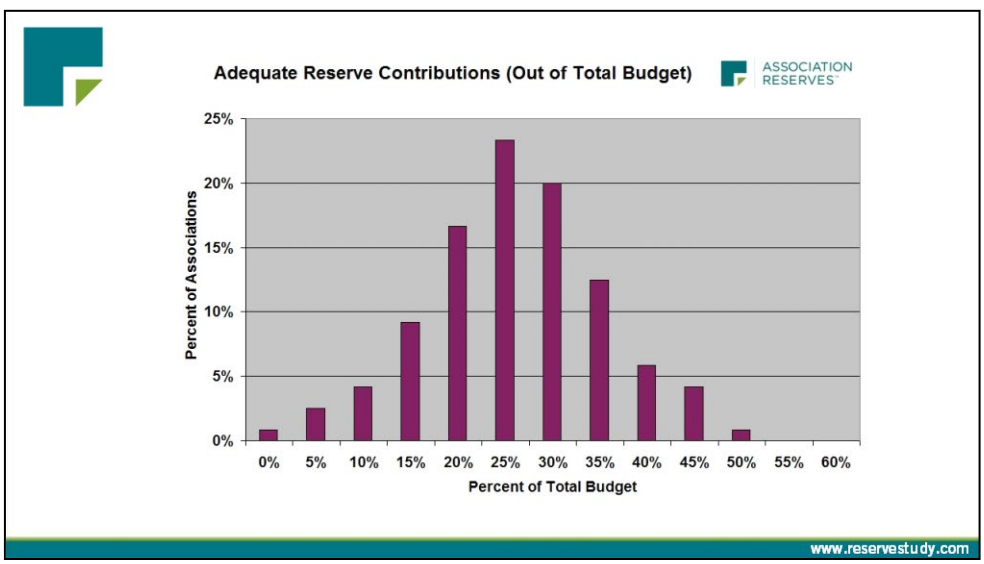


- Funding Plan tells you how much is needed to offset ongoing deterioration and provide for upcoming expenses, so projects can get done *on time*. See our Reserve Studies 103 webinar on Funding Plans here.
- Reserve Fund Strength tells you how well current funds have kept up with component deterioration, measured by Percent Funded. See our Reserve Studies 102 webinar on financial matters here.
- Component List identifies the specific projects to be funded through Reserves, revealing their scope and schedule. Those appropriate for Reserve Funding are defined by the National Reserve Study Standard four-part test shown to your right. See our Reserve Studies 101 webinar on Reserve Component selection here.

RESERVE COMPONENT "FOUR-PART TEST"

Your Percent Funded reveals the consequence of (not!) having enough Reserves on hand. Special assessments are commonly needed when Percent Funded is low, in the 0-30% range.

Aren't Reserve contributions, enough to allow you to perform Reserve projects in a timely manner, "too much" money for most associations? **No**! Adequate Reserve contributions are often a significant portion (15-40%) of your annual budget, as we show below. But for the typical condo owner, that is still <u>very inexpensive</u>: just a few dollars per day (about the same as a premium cup of coffee).



And remember – if your Percent Funded is low and your Reserve contributions aren't keeping up with ongoing deterioration, take heart. Most associations in your situation got into this jam over the course of many years (or decades). So take a few years to "right the ship": begin by increasing Reserve contributions this year $10/unit/month, and then do it again for the next two to five years. Soon you'll find your association with sufficient funds to keep the place looking sharp, increasing pride of ownership and property values!

So there's never a reason to worry… Association Reserves is here to guide your association through these inevitable expenses, towards a financially sustainable and improved future!

Need our professional assistance? Get a proposal for an updated Reserve Study by clicking here.

****Note: This course is approved for continuing education credit by:**

1. **The Community Association Managers International Certification Board (CAMICB) to fulfill one CE credit for the CMCA® certification**

2. **The State of Florida Department of Business and Professional Regulation for licensed Community Association Managers for one CE credit related to the CAM certification**

3. **The State of Colorado Division of Real Estate for licensed Community Association Managers for one CE credit related to the CAM certification.**

Webinar Questions Asked by 2019 Attendees

Q: Must you invest Reserves in CDs/TBills, or can you make conservative stocks and bond investments?

A: Check your Governing Documents, local statutes, and check with your legal counsel. In some jurisdictions, investments in anything other than conservative "no chance of loss of principal" investments are not allowed. Investments where no loss of principal is possible are good practice everywhere. Investing Reserves in stocks is ill-advised.

Q: You mentioned the typical fraction of budget going to Reserve contributions. What is typical for insurance (our highest cost)?

A: Sorry, not my area of expertise. I understand Reserves, insurance, management, and in some cases utilities are an association's largest budget line items, but I cannot quote figures on those items. But I believe that if insurance is your largest budget line item, it is likely you are underfunding Reserves.

Q: We started making up for underfunded Reserves this year and the contributions are substantial. We expect to be reducing our deficit for the next eight years. How can we communicate to potential buyers that this is a good plan, and our high assessments are not perceived as a negative?

A: Expenses are inevitable. Your association is preparing for them. Create a short summary for all your homeowners that can be shared with prospective buyers, making it clear that your current assessment structure is designed to provide for the needs of the association, maximizing home values, and minimizing the chance of special assessments (that other associations with lower assessments are inviting).

Q: Are there any laws to force associations to implement Reserve Studies in California?

A: Yes. There is a significant body of CA Civil Code addressing financial responsibilities of the board. Please consult with your legal professional or see a summary from a prominent CA law firm here. Bottom line: CA law requires a With-Site-Visit update at least every third year, annual Reserve Study updates in-between and annual disclosures (in a standardized format) of the Board's plan to address Reserve needs via a multi-yr Funding Plan.

Q: What rate of inflation do you recommend?

A: Because we are crafting a 30-yr plan, we need to use an inflation rate that is not sensitive to year-to-year fluctuations. So in looking backwards over the last 10-30 years we feel an inflation rate in the 2.5% - 3% range is a good value to use for planning purposes.

Q: What do you do if the current board has no interest in funding Reserves?

A: Two things: run for the board on a platform of fiscal responsibility (the expenses will happen, they cannot be avoided and homeowners property values are at risk if projects are not accomplished in a timely manner!), and set aside your own "Reserve fund", so when the inevitable special assessment happens, you are ready to pay that bill.

Q: How many years are covered in a Reserve Study?

A: National Reserve Study Standards require at least 20 years of income and expense be projected in a Reserve Study. Our firm, along with many others, show a 30-yr projection.

Q: Can you provide some insights regarding North Carolina Reserve Study requirements?

A: Please check with a local Community Association industry law firm. You can find one through the local NC chapter of the Community Associations Institute by clicking here. Or… you can contact the North Carolina office of Association Reserves here.

Q: We have no Reserve fund at all. One owner is absolutely against it, others think there is a value to having one. How do we get one created?

A: Open a Reserve account by board action, and start funding it. Your association doesn't have to run by unanimous agreement of all members. The board has a job to do, and that is run the association responsibly (whether all members like it or not!).

Q: Could you briefly explain how the business judgment (BJR) rule fits into Reserve Study decisions?

A: Certainly. We have a webinar that goes into more detail here, but basically the Business Judgment rule provides some degree of legal protection for board members who make decisions with these three characteristics:

- They are made in the board's area of authority and power

- They are made in the best interests of the association
- They are made after reasonable inquiry

Q: Can tree care and removal be funded through Reserves?

A: Yes, as tree care commonly meets the National Reserve Study Standard four-part test because it is a common area maintenance responsibility, life limited, with a predictable remaining useful life, and usually above a threshold cost of significance.

Q: Can professional fees such as engineering fees and consulting fees be paid from Reserves (in FL)?

A: Yes. Reserve projects meeting the four-part test are to be all-inclusive. This means permits and shipping and disposal should be part of a standard "repair or replacement" Reserve project. In addition, there are some professional fees that pass the four-part test as stand-alone Reserve projects (elevator load tests every few years is a prime example).

Q: If we have an updated Reserve Study, do you recommend that we have a site visit for the next study?

A: Remember the three levels of service, two of which are updates (With-Site-Visit and No-Site-Visit). With-Site-Visit updates are recommended "every few years" (three years is generally a good interval), with No-Site-Visit updates in the in-between years. This is a good combination of economy while providing the board with updated information through which they can run the association.

Q: Can you borrow from Reserves to pay for an unplanned expense that was not budgeted?

A: Yes, but let me be careful. If the project passes the four-part test, it is a Reserve project and borrowing is not the issue (even if it did not appear on the prior Reserve Study). It is simply an unplanned Reserve expense. Spending Reserves to pay an Operational expense or a capital improvement is inappropriate, as those Reserves are already designated towards Reserve projects. Borrowing for such projects generally can be done, but in many jurisdictions there is a multi-step process, with strict repayment requirements. Bottom line… if you spend Reserves for non-Reserve projects, commit to paying it back!

Q: Can we borrow from Reserves to avoid finance charges?

A: Yes. This is an example of an effective way to use Reserves while they are "just sitting there". We've seen boards borrow from Reserves to install energy efficient lighting, or a well, both to save significant funds for the association. They instituted strict repayment plans. Doing so eliminated the high cost of interest from borrowed funds, and kick-started the association's ability to save money on their electricity or water bills.

Q: Are we permitted by law to include inflation in our Reserve calculations?

A: You don't say which state, but I am not aware of a law in any of our 50 states preventing inflation from being used as a factor in developing a Funding Plan.

Q: A hurricane damaged a component scheduled for replacement in two years, and it was "made new" with insurance proceeds. How do we handle that in Reserves?

A: Update your Reserve Study, with a new (high) Remaining Useful Life for that component. Reserve funds that were set aside for that upcoming project, no longer needing to be accomplished in the next few years, will be redistributed to other components.

Q: Our budget projects special assessments in future years, and even with those special assessments our Percent Funded will still barely be positive. Does underfunding like this create a liability problem for the board?

A: Hard to tell. It may be that the board is temporarily underfunding Reserves for a greater good. I trust that they begin funding Reserves appropriately before the special assessments begin to occur. Board members willfully directing the association towards financial risk will likely not be defended by the association's D&O insurance.

Q: When you evaluate Reserves, do you use current replacement cost or future replacement cost?

A: Both, actually. The current cost is used in calculating the current Percent Funded. The future cost is used when calculating the multi-yr Funding Plan.

Q: Our association owns a large building that is being remodeled, last re-modeled 30+ yrs ago. Furniture for the remodeled building is not in the current Reserve Study. Even so, can that be paid from Reserves?

A: Yes, as long as the project meets the four-part test. It is an unfortunate omission, as such a project should clearly pass the four-part test and is a reasonable expectation that a new building be outfitted with a new HVAC, plumbing fixtures, and furniture. Of course, spending unbudgeted Reserve funds will cause the Reserve balance to drop and upcoming Reserve contributions to be slightly higher.

Q: I disagree with the % Funded model, believing it is more effective to look at cash flow and just make sure we have sufficient funds to pay for the expenses.

A: I hear you. Cash is king. But the statistics clearly show (and I showed a slide in the webinar) that associations that fund their Reserves with an eye on only being cash-positive, with insufficient "margin" for the inevitable projects that occur earlier or more expensive than anticipated, cause special assessments. Margin is necessary in our field of projecting the future. So looking at the association's Percent Funded, and caring about that figure being strong, has very positive effects (lack of special assessments and maximizing property values).

Q: You mentioned National Reserve Study Standards. Are there local standards – like Useful Life for Exterior Doors in an oceanfront location? Our doors are deteriorating faster than projected in our Reserve Study.

A: That is unfortunate about your doors. Reserves are a field of estimating. Revise/update your Reserve Study with a lower Useful Life for your doors. I cannot tell if it is a material defect, or an optimistic life estimate. Reserve Studies are sometimes called the "art and science" of estimating, and preparing for, an association's major repair and replacement projects. You've described how this is an art – with many nuances. There is no good local standard. That's why you need a credentialed Reserve Study provider and regular updates.

Q: Can components be a group of smaller items that individually wouldn't meet the four-part test? We have a clubhouse to refurnish, and we have 70+ backflow preventers, 12 sprinkler control boxes, etc.

A: Yes. It is common to "group" projects together when they occur with the same Useful Life and Remaining Useful Life. Clubhouse furniture is a prime example… no reason to list a chair separate from its table, or barstools separate from the coffee table. You'll replace them all at the same time… list them all together as one group. Same for other projects.

Q: Should plumbing lines and drains be included in a Reserve Study?

A: As long as they meet the four-part test. Unfortunately, sometimes remaining useful life and cost for plumbing projects are not known with enough reasonable certainty to be defined as a Reserve project. Check with your plumbing vendor – see if they are able to provide some insights in order to make a "reasonable estimate". But as long as the project is just a wild guess, it should not be listed as a Reserve component.

Q: Can we add a Reserve component for insurance shortfall?

A: No. Insurance deductibles do not meet the four-part test, because their timing (useful life and remaining useful life) are both unknown. Insurance losses, and the associated deductible that needs to be met, may require a special assessment if the Operating Fund does not have sufficient margin.

Q: Can you recommend language for homeowners when it is time to increase Reserve contributions?

A: Certainly. Start with the four-part test. Explain that expenses are inevitable (and largely predictable), the board is responsible to provide for those expenses, and it is better for the homeowners that the bill to offset ongoing deterioration be paid on an ongoing basis rather than a "surprise" special assessment (even though it really wasn't a surprise because you could see it coming years in advance!).

Q: Should Reserve philosophy be put into Homeowner documents for prospective buyers?

A: Absolutely. Make sure your owners are regularly reminded that their assessments are designed to provide for the needs of the association and prevent special assessments. It would be great for that same document be provided to prospective home buyers. I'd like to see philosophy about a home I was considering purchasing!

Q: What is the cost of "Reserve deterioration"? How is that different from something getting old and deteriorated?

A: The ongoing cost of Reserve deterioration is the Repair/Replacement cost divided by Useful Life. For instance, a $200,000 roof project with a Useful Life of 20 years is deteriorating at the rate of $10,000/yr. In general terms, setting about that amount aside will prepare the association for that eventual expense. That is different from saying "the roof is old and deteriorated, I hope we have enough Reserves to replace it next year!" That is a Reserve cash flow question that will be addressed in your Funding Plan.

Q: **How do you keep Reserve funds earmarked for future projects?**

A: In general, we don't recommend "earmarking" funds for separate and distinct Reserve projects. The association is best served with Reserve funds are available for use for whatever Reserve expenses occur. It would be silly to have to special assess for a $100,000 new roof, when there is only $50,000 in the "roof reserve", when there is $250,000 spread among all the other components. Re-allocating in such instances is regularly done. So stop trying to hold the individual funds "separate" and just consider Reserve funds "Reserves" (not roof $ or paint $ or carpet $...). See more here.

Webinar Questions Asked by prior year "Basics" Attendees

Q: Should an owner get their Reserves portion back after selling, and should a new owner pay more?

A: No. Reserve contributions offset the cost of ongoing deterioration. Contributions are not an owner's unspent "savings". Their contributions over the years pay for the deterioration that occurred *while they owned a home in the association*.

Q: If we haven't collected Reserves before, how do we start? Do we special assess everyone their Fully Funded Balance share, or do we add Reserve contributions to existing assessments?

A: Generally special assessments are a last choice method of funding Reserves, because they are so unfair. So special assess only if you need funds for an immediate project. Otherwise, begin collecting on an ongoing basis.

Q: Are Reserve contributions a different payment from the owners?

A: Generally no. Reserve contributions are usually just a portion (typically 15%-40%) of a homeowner's regularly budgeted total assessment. When the funds are collected, the board then transfers the Reserve portion to the Reserve Fund. Most associations don't collect assessments separately for the Operating fund and Reserve fund (although I've seen it done).

Q: How is that 15%-40% calculated… total assessment, or the non-Reserves portion?

A: The total portion. If you have $30k in total income each month, and budgeted Reserve contributions are $5k of that, your Reserve contributions are 16.7% of total budget (not $5K out of $25k non-reserves portion).

Q: Is the Reserve Fund literally a separate bank account?

A: A separate bank account for Reserves is best practice, for accounting and practical reasons (when the Reserves are not sitting in the checking account, they are less likely to be spent!). The Reserve fund may be as simple as an interest-earning savings account, or it may be a number of higher-interest-earning longer term laddered investment vehicles, or a combination of both.

Q: How many components are in a typical Component List?

A: Typically 25-45. There are a few very simple associations with very short Component Lists, and a few complicated/large associations (with golf courses, equestrian centers, etc.) with over 100 Components.

Q: During a site inspection, is it helpful to have a board member or manager come along to explain things?

A: Yes! If you have a building engineer, someone like that is also helpful. The insights provided (wear and tear, repair and replacement history, and their ring of keys) are very valuable!

Q: What if our association can't adopt a Full Funding model?

A: I don't believe "can't" is the right word. I think it is more accurate to say "won't". Deterioration is real, and it is expensive. A Full Funding model simply and sustainably offsets ongoing deterioration with Reserve contributions. It is fair and realistic. The alternative to making Full Funding contributions is making "Baseline Funding" contributions (where the Reserve fund drops in size & strength, just barely staying cash-positive). Because the Reserve expenses are unchanged, Baseline contributions offer slightly lower (approximately 13% less on average) Reserve contributions but at the price of a higher risk of special assessments).

Q: Aren't Fully Funded contributions too expensive for most associations?

A: No. In a side-by-side comparison, Fully Funded contributions average only 13% higher than Baseline Funding contributions. But note that Fully Funded contributions calculated by the *Straight Line method* tend to be much higher than any contribution calculated by the *Cash Flow* method because Straight Line contributions force a rapid approach to the 100% Funded level. We go into more detail in our Reserve Studies 103 webinar.

Q: If we vote to become Fully Funded, would that require a special assessment?

A: No. Fully Funded is a responsible multi-year objective, where the Reserve Fund size is equivalent to current Reserve deterioration at the association. You may wisely choose to get there smoothly, over the course of a number of years. Special assessments should be a "last resort" funding tool, not a way to strengthen your Reserves.

Q: What is the proper way to add components or adjust values for your components?

A: Make those changes in your next (annual) Reserve Study update. Give that information to your Reserve Study professional (a change in quantity, information about a project that cost more or less than expected, or something that is lasting longer or failed earlier than expected, something that was replaced with Operating funds, etc.). Keep your Reserve Study updated and accurate! It's the best way to keep your association "on target" financially.

Q: Are board members obligated to cooperate with their Reserve Study provider in providing information?

A: No, but it would be foolish to not cooperate. The Reserve Study is prepared for the benefit of the association. It is not a game... to see if your Reserve Study provider is a mind-reader, or how close Reserve Study provider's estimates came to your actual costs. Be candid and forthright, giving your Reserve Study provider the facts (of recent costs, component replacement history, vendor names, etc.) in order to maximize the accuracy and value of your Reserve Study.

Q: What do you recommend for associations that are underfunded?

A: Try what we call the $10 solution. Increase your homeowner assessments $10 this year, with all of it going towards increased Reserve contributions. Then do it again and again for as many years are necessary. Most associations will find themselves making appropriately sized Reserve contributions in just 3 – 5 years following this program.

Q: If we have a shortfall in Reserves, is it best to raise Reserve contributions all at once or a little bit at a time over a longer period of time?

A: Whenever possible, it is best to spread out Reserve contributions as smoothly as possible over as much time as possible. But if the funds are needed immediately, that means a special assessment will be necessary.

Q: We have a large deficit and only 18 units. What is the best way to fund our Reserves – assessment increase, Special Assessment, or Loan?

A: It takes time to collect funds through assessment increase. Typically associations in this situation need a combination of a Special Assessment (for immediate cash) and higher contributions (to prevent a future special Assessment). A loan is an expensive, uncertain alternative (many financially weak associations don't qualify for a loan).

Q: Instead of budgeted contributions, why not just special assess or take out a loan?

A: In addition to budgeted contributions being the most fair way to collect Reserve contributions (because each owner pays their share of deterioration, month by month, over the time they live at the association), budgeted contributions are the least expensive way to pay for Reserve projects. For a $250,000 roof, over 15 years homeowners would only need to contribute about $232k towards the project, with the rest made up by 1% compound interest from the bank. Special assessments are typically a last-minute option, when an association needs the money rapidly, but they take time to implement, there's no certainty the special assessment will pass, and the funds take a while to be collected. A loan is expensive. With current loan rates (7% and up-front fees), it will cost the homeowners about $320k over 7 years to pay for a $250k roof project. That's about $90k more than if they would have collected those same funds from the homeowners, over time via monthly contributions collected from the people using the component. Loans are generally an expensive way to pay for a project.

Q: Do you use current or future costs?

A: Per National Reserve Study Standards, Current Costs are identified and displayed in the Reserve Component List. Current Cost is used computing the current Percent Funded of the association, but inflated future costs are used when calculating the association's multi-year Reserve Funding Plan spread over future years.

Q: Shouldn't the physical analysis (site inspection) be conducted by an engineer?

A: The site inspection should be diligent and thorough. Experience in this field is more important than educational background. I'm a licensed Professional Engineer (PE), but the value of your Reserve Study Project Manager has more to do with training in the field of Reserve Studies than a particular college degree.

Q: How are replacement costs determined?

A: The typical methods are association history, relevant experience with other similar associations performing similar projects, interviews with knowledgeable association vendors, and usage of national estimating cost guidebooks.

Q: Can you update a Reserve Study by a different company?

A: Yes, if the Reserve Study was prepared according to National Reserve Study Standards (meaning required disclosures have been made for each component's

Title, description, quantity, Useful Life, Remaining Useful Life, and Current Replacement Cost). If for some reason you have no confidence in the estimates or measurements/quantities in your Reserve Study, then perhaps you should start over with another credibly prepared "Full" Reserve Study by a credentialed Reserve Study professional.

Q: Once you have a reliable Reserve Study, can a different Reserve Study provider "update" that report?

A: If the initial report was based on National Reserve Study Standards and contained all the elements and disclosures required by those Standards, yes.

Q: Assume a Reserve Fund line item had been scheduled for replacement at a projected cost of $10k. After replacement the final cost was $12k. For the next update, do you use the $12k estimate, or an even newer estimate of the cost?

A: Every time the Reserve Study is prepared/updated, "current" costs should be used. Always use the most recent value. If that $12k expense was this year or last, it is probably close enough to use. If it is more than a year old, get an updated value.

Q: Can you provide a "definition" of the results expected in a good budget, which includes Operating and Reserve? For example, one which covers expected costs for current owners going out X years, but one not to overfund for future owners.

A: A good budget provides for the short term and long term costs of the association. The daily/weekly/monthly expenses should be handled through the ongoing Operational budget. The ongoing cost of deterioration of our Reserve components should be paid through ongoing Reserve contributions. That way everyone pays their fair share along the way, and the needs of the association are met. See here for a national standard definition of "Adequate Reserves".

Q: What does it cost to hire a company to perform a Reserve Study from scratch? Scratch meaning the firm would start by doing the component list.

A: A "Full" Reserve Study is often in the range of 1% of the association's annual budget (although this percentage may not scale well for associations under 50 units or above 150 units). A Full Reserve Study is more expensive than a With-Site-Visit Update (since less measuring and development work is done in a With-Site-Visit), and a No-Site-Visit update is less expensive than either (due to no field work). Click here to get a custom proposal for your association.

Q: Do you have a list of the life of all the items in the association?

A: We do not maintain a pre-defined list. We maintain a list of Useful Life ranges for most standard components, but each Reserve Study is like a painting… a creative use of our knowledge of the property and the industry, and our skill in applying our experience and our existing "tool-set" of resources to the association's unique situation.

Q: Do you have and use a master component "punch list" with typical Useful Life expectancies and Replacement Costs?

A: We have company guidelines based on our experience, but each Reserve Study we prepare is a custom document, with the Component List based on the National Reserve Study Standard four-part test. Life cycle and Current Replacement Costs are based on the client's history with that component, the experience of other relevant properties, our background of experience with the asset, interviews with association vendors, the local environment (weather), maintenance, usage patterns, economies of scale, quality of materials, etc. We have some competitors who quickly move through an association with a "punch list" and as quickly pop out a cookie-cutter Reserve Study, but it doesn't approach our accuracy.

Q: We have brought up the subject of getting a Reserve Study thru the years, but we always get shot down by the same argument: "Don't want to put away that amount of my money. I'm too old." What should I do?

A: Choose your words carefully. Reserve contributions offset ongoing deterioration. They are not "for the future" for other people's benefit. Timely maintenance and minimized Reserve contributions (due to Reserve expenses that don't go over-budget from being delayed) maximize the owner experience. Real Estate agents notice and it is reflected in higher home values. Curb appeal is real and home values are higher when the Reserves are strong (see here), making adequate Reserve contributions one of a homeowner's best investments.

Q: Can the Reserve Study include recommended insurance coverage amount?

A: Insurable value and insurance coverage should not be expected to be within the expertise of the typical Reserve Study professional. That is a different skill set. Possible uninsured losses (fire, flood, hail, etc.) and the deductibles associated with those losses typically do not qualify as legitimate Reserve components, as they are not predictable.

Q: Can or should we Reserve for insurance premiums or insurance deductibles?

A: No. Insurance premiums are professional expenses throughout the year more appropriately handled through the Operating Budget. Insurance deductibles are inappropriate as Reserve components because their timing is not predictable (so this expense fails test #3 of the National Reserve Study Standard four-part test).

Q: We received a large check from our insurance company for roof storm damage. Do I deposit to Reserves or show it in the Reserve Study?

A: As stated in this webinar, repairs become legitimate Reserve projects when they extend the Remaining Useful Life of the asset. Most commonly, the answer is to deposit the check to Operating, spend the money on the repairs, and adjust the Reserve Study as needed with the new condition of the component and the addition of any excess funds to Reserves in the next Reserve Study update.

Q: We received a large check for a construction defect award. How do I treat this in Reserves?

A: See above. In general, deposit the funds in a settlement account and perform the necessary projects. If any funds are left over at the end, check with your attorney to find if there are restrictions on the use of those funds. If excess funds can be used for general Reserves, consider those additional funds and the reconstructed condition of the components in the next Reserve Study update.

Q: Have you conducted Reserve Studies in Ohio, or especially central Ohio (condominium) associations?

A: We have prepared Reserve Studies in all 50 states.

Q: Looking at your website, if you don't have an office close to our association, how do you perform the site inspection (who do you use), and what are the additional costs?

A: We select a trained/credentialed Project Manager from the most appropriate Association Reserves office, and travel to the site. No subcontractors or outside contractors are utilized. Any travel costs are built into our proposal.

Q: Are there laws that dictate what types of items on which you can spend Reserve funds?

A: Generally speaking, no. For instance, Florida requires Reserves be set aside for *at least* a short list of required Reserve projects, but those projects would already be included if they followed the National Reserve Study Standards four-part test. See our summary of state-by-state Reserve legislation here.

Q: Can we pay for a Reserve Study with Reserve Funds?

A: Typically the cost of a Reserve Study fails the National Reserve Study Standards four part test due to not being a common area maintenance responsibility – it is a professional service, more akin to accounting, tax, or legal services best handled from the ongoing Operational Maintenance budget.

Q: Can/should we reserve for retention ponds or an earthen dam and the lake?

A: If either meet the NRSS four-part test, yes. Consider the need for soil movement and stabilization. Consider the need for landscape control around the perimeter of the dam. Consider the need for spillway (or bridge) maintenance. Consider the need for dredging the lake bottom. There are many ways earthen dams and lake components can and should appear on your Reserve Study.

Q: Should our community budget for some funds to conduct the Reserve Study each year … either a With-Site-Visit Update or a No-Site-Visit Update?

A: Yes, that would be fiscally responsible. Reserve contributions are regularly one of the largest individual budget line items at a community association, so budgeting for an annual Reserve Study expenditure to guide Reserve contribution decisions is responsible.

Q: Should we Reserve for entire building replacement in addition to component (roof, siding) replacement projects?

A: No. Only specific components/projects that meet the NRSS 4-part test.

Q: Does a manager have any liability if the board keeps delaying Reserve projects?

A: In those cases it is best for a manager to make clear recommendations to perform timely repair and replacement projects, and get that recommendation recorded in meeting minutes. Commission a Reserve Study update so the board can see recommendations in black and white. Note that there is always some liability, but good recordkeeping can minimize a manager's liability!

Q: What are the consequences if our 20-yr old association has never had a Reserve Study?

A: Significant exposure to unsettling surprises and special assessments. Owners have likely not paid their fair share of the cost of deterioration at the association, home values are likely lagging, and the board has moderate to significant liability exposure.

Q: Is it best to do a large project a piece (phase) at a time?

A: It depends on cost and the association's Reserve Fund. In many cases, doing a large project yields discounts due to economies of scale, but it requires the association have significant funds to get it all done at once. If cash is tight, a large project can be phased, but phased projects often result in higher overall costs and longer periods of physical disruption at the association.

Q: Is it possible to use an ongoing allowance for a project instead of total replacement cost?

A: Yes. Some situations exist where total replacement is not expected, but partial replacements or repairs are expected (sidewalk repairs, plumbing repairs, fence repairs, etc.). These partial projects still meet the NRSS 4-part test.

Q: What do you think about a Do-It-Yourself Reserve Study?

A: Having a Reserve Study Professional on your team is valuable, but for simple associations or in the years in-between a With-Site-Visit update (instead of a No-Site-Visit update), an inexpensive Do-It-Yourself Kit may be good alternatives.

Q: For us Do-It-Yourselfers, do you have a sample Component List to use as a starting point?

A: No. We recommend hiring an independent Reserve Study professional to develop your first (Full) Reserve Study, finding all components that meet the National Reserve Study Standard four-part test. A sample list that we provide is likely not going to give you the guidance you need as board members to meet your responsibility to care and provide for the assets of the association.

Q: We are a 550 home Condo with replacement costs in excess of $25M. Are we a good candidate for an online tool?

A: No. No volunteer board member should have that large of a responsibility. The consequences are too significant. In your case, it is clearly cost-effective to hire a Reserve Study professional.

Q: We have a water company and a HOA. Do we need two Reserve Studies?

A: If you have two independent Reserve funds and two different budgets, you should have two different Reserve Studies. But of course they can be performed at the same time, just published into two separate reports.

Q: Why should we do a Reserve Study if it's not required in our state?

A: All your common areas are deteriorating and you need a plan to collect funds from the owners in a fair and responsible manner so the association will have enough cash for those predictable Reserve expenses. You prepare a Reserve Study update because that information is valuable to the association, not because it's required by State Law.

Q: What if the association is severely underfunded and the Board refuses to increase dues or Reserve contributions?

A: Expect deferred maintenance, Special Assessments, lower property values, or all of the above. Begin your own savings account to set aside some funds for the inevitable special assessment that will come. Consider selling and move to a home where you'll experience greater Real Estate escalation over time.

Q: What's wrong with being Underfunded?

A: Click here to view a nice, short video we prepared on that topic. Here is a short blog post you can read.

Q: How does an association become underfunded?

A: Generally it's a combination of years of contributions less than the ongoing cost of deterioration, years of expenditures in excess of what was budgeted, or a combination of both.

Q: What is deferred maintenance?

A: A project that is delayed, typically due to inadequate funds or indecision. The typical result is a higher project cost due to greater deterioration.

Q: Why are buyers not given the Reserve Study up-front in a purchase transaction?

A: A Reserve Study is a required seller disclosure in many states. It is always a good document to request in all the other states where it is not required.

Q: You indicated in the fourth test for a Reserve Component, that it is often above the range of .5% - 1% of the association's annual budget. Is that the same for an association with a tight budget?

A: All association budgets are tight. Dues need to be set so the association can responsibly and sustainably offset the ongoing cost of deterioration. Provide your association the funds it needs to be financially sustainable, with maximized home values.

Q: Do you have more content… more detailed information on preparing the Reserve Component list, calculating Reserve Fund Strength, or calculating an appropriate Reserve Funding Plan?

A: Yes. Please visit our Library for articles on the above subjects, or visit our Webinars page for recorded webinars on those topics. You can also download three eBooks: one on Component Lists, one on Reserve Fund Strength, one on Funding Plans.

Q: How do you establish Useful Life and Remaining Useful Life?

A: Our experience, observed condition, level of maintenance, environment, quality of material and workmanship, and age, to name a few considerations.

Q: What inflation factor do you recommend?

A: Because a Reserve Study is a document that projects trends for decades into the future, we recommend a stable inflation rate like 2.5% or 3%, representative of average trends in the past.

Q: How do you calculate the value of deterioration?

A: For each component, calculate the fractional age of the asset and multiply that by the current replacement cost. So for a $10,000 project that occurs every 10 years that is two years old (it is now 2/10ths "used up"), the value of deterioration is $2000.

Q: How is Percent Funded calculated?

A: It is a two-step process. Calculate the value of deterioration for each component (see above) and sum them all together to get a total value of current deterioration at the association. Then compare your Reserve Fund to the value of deterioration, and that is Percent Funded. If you have $60,000 in reserves and the total value of your deterioration is $100,000, your association is 60% Funded. See here for more.

Q: Is Percent Funded calculated with current or future costs?

A: Per National Reserve Study Standards, Current Cost, as it is a measure of the current financial status of the association.

Q: Please clarify – why calculate with current costs when the expenses are in the future?

A: The association's current Percent Funded, which calculates the current strength of the Reserve Fund, is calculated with current costs. The Funding Plan looks ahead into the future, considering interest earned in the process of developing a multi-year Funding Plan, so is developed using future costs. Percent Funded and Funding Plan are different calculations, for different purposes, using different values.

Q: Is the Reserve Study the current state of things at the association, or should it reflect the Board's plans/intentions?

A: The Reserve Study should reflect the current physical and financial state of affairs at the association, and the preparer's recommended multi-year Funding Plan. The board can document their plan separately.

Q: If we find out something new, should we update our Reserve Study mid-year?

A: No. A Reserve Study is an annual document. We recommend keeping a file of Reserve expenditures and suggested changes (adjustments, additions, or deletions) to use in the process of updating the Reserve Study for the next year.

Q: How often do you calculate Percent Funded?

A: Each year, as part of the Reserve Study update.

Q: What are the most common Reserve Funding mistakes?

A: The three most common Reserve Funding mistakes are:

1) Presuming that the recommendations from last year's Reserve Study, or one a few years prior, is still accurate.

2) Assuming that if you want to be 50% Funded, you make 50% of your Reserve contributions.

3) Thinking that Percent Funded reports Reserve contribution fraction of Fully Funded contributions, not a calculation of Reserve Fund size/strength.

Q: Can you discuss Straight Line vs Cash Flow funding methods?

A: Just two different mathematical strategies to pay for the same expenses. We address that in our Reserve Studies 103 webinar.

Q: Can you discuss best practice for investing Reserve Funds?

A: Best practice is to invest Reserves where there can be no loss of principal, and where they will be available when needed.

Q: If we are surplus funded (we are 183% Funded), can we refund Reserves to the owners?

A: You possibly could, but it is best to spread out that benefit by subsidizing Reserve contributions for many years, rather than giving current owners a windfall.

Q: Is it ok to be overfunded?

A: Some associations are overfunded. It is not desirable, as the association is designed to be not for profit, not to accumulate a net excess of funds. Overfunded associations should trim their Reserve contributions to gradually drop their Reserve Fund strength down to the 100% level.

Q: If the association is over funded (140% Funded), can we reduce dues $2 a month?

A: It's a bit more complicated than that, but if the association became overfunded because of Reserve contributions that were higher than their ongoing rate of deterioration, then dropping the Reserve contribution rate a little bit is a good first step. The right plan should be revealed in the association's next Reserve Study update.

Q: Why would an association ever be overfunded?

A: Sometimes they got there by an insurance award, by being very restrained on spending a construction defect award, or if the board or manager was "asleep at the wheel" while Reserves accumulated in excess of what was needed. Generally, there's no good reason to be overfunded.

Q: Where can we find the math or software for annual expense tables, incorporating interest and inflation, so we can manage our own Reserve Study?

A: Rather than explain the math (it's just compounded interest and inflation, as a Google search will reveal), it is much simpler for you to just use professional tools currently available. We take care of those calculations in your Reserve Study, and they are built into free online tools like www.QuickReserves.com.

Q: If a Board member doesn't want to raise the dues because most residents are on a fixed income, how can that be handled?

A: Board members have a legal responsibility to care for the assets of the association, not to care for the budgets of individual owners. If boards don't set the budget per their legal responsibility, they face legal exposure. If some people can't afford to live in your association, I'm sure they will choose to move to a more affordable home. You make your decisions as a board member, let them make their own decisions as a homeowner. We go into depth on this topic in our webinar "Tight Budgets, Tough Choices".

Q: If you're at 100% funded, you're ready to pay for the next, say 20 years, which is not realistic. Please comment.

A: That reveals a popular misconception about Percent Funded. Being 100% Funded means the Reserve funds on hand are presently equal to the current deteriorated value of the Reserve components, not the total replacement value of all the Reserve components. So being 100% Funded just means your Reserve Fund is currently "on pace", not that you're sitting on a big pile of money.

Q: The Fully Funded Balance measures an association's ability to replace all items at a specific point in time, but it doesn't take into consideration that expenses happen spread over time. Why would one want Reserves equivalent to the Fully Funded Balance?

A: See above. The Fully Funded Balance is the value of current deterioration, not the cost to replace all items at once.

Q: Do you calculate Percent Funded for each component or the association as a whole?

A: Percent Funded is a meaningful calculation only for the association as a whole. All the components go into that calculation.

Q: I think I heard you use the terms differently. Can you explain if "Fully Funded" is different from "Fully Funding"?

A: You have a good ear! Fully Funded is a state of being… when the association is at or very near the Fully Funded point (100% Funded). Fully Funding is an Objective of the association's Funding Plan… they can be 23% Funded now but they are "Fully

Funding" their Reserves, which means they intend to be 100% Funded in about 10-15 years.

Q: Are exclusive use common area included in the Reserve Component List?

A: Yes – if those assets meet the National Reserve Study Standards four-part test. Exclusive Use Common Area are still common area, just reserved for the private enjoyment of less than all unit owners.

Q: For street replacement, should reserves be set aside during the first years or only when the expense comes within 30 years?

A: Reserves should be collected throughout the entire life of the component, so all users of the component contribute to offset its ongoing deterioration. Don't be limited by a 20-year or 30-year threshold.

Q: Why would we want to have money in Reserves now for projects that will not need to happen for another 15-20 years, and why should we care about our Percent Funded (and your calculated Special Assessment risk) now when those big projects are far away?

A: It's all about fairness and responsibility. When everyone who is enjoying the use of those assets pays their fair share of the deterioration that occurred while they owned a home in the association, the future takes care of itself. If your large projects are many years away, now is the time to be making small ongoing contributions, so the unfortunate owners at the time of the expenditure don't have to pay more than their fair share.

Q: Why should we Reserve for a new roof? Living here in CO, our roofing company tells us that replacement will be covered by insurance when it gets destroyed by a hailstorm.

A: It is responsible to plan for ongoing deterioration. Hailstorms are never for certain, and roofing materials continue to get sturdier and sturdier. You don't want to get stuck with an old roof needing replacement, crossing your fingers that a hailstorm comes before you have to announce a special assessment because you irresponsibly never budgeted for a roof replacement.

Q: Is there a rule of thumb to determine if something should be funded from the Reserves or the Operating budget?

A: See our article here on that subject.

Q: Would you please explain 'borrowing' from your Reserve Fund for non-reserve expenses.

A: Sometimes a Reserve Fund looks large, and it is tempting to want to draw some cash from Reserves to pay for other (operating) expenses. Some associations temporarily “borrow” from the Reserve Fund to pay a large insurance premium, restoring the funds to Reserves over the next few months. Theoretically, no big deal. Just keep a good written record of the loan and the repayment plan, to prevent coming up short when it is time to pay for a Reserve project! But beware: some states have specific requirements to be met before Reserves can be used for non-Reserve expenses (loans), and some states require loans from Reserves be repaid within a specific number of months.

Q: If a new project is being implemented, where would the money come from to install the new project? I realize that the ongoing maintenance would be paid for from Reserves funds – assuming that the project is added to the Reserves component list. For example, our HOA is looking into installing a submeter system for the water. Currently, the water bills are paid out of the HOA operating budget. The HOA is looking into the submeters so that each member would be responsible for paying for their individual water use. So, where would the money come from for the installation of the submetering system?

A: Let's assume it is a new Reserve project (it currently exists and meets the four-part test defined in National Reserve Study Standards). Spend the $ from Reserves, and update the Reserve Study at the earliest opportunity (for the upcoming year). This update will incorporate the new component, and will likely report that higher contributions are needed to compensate for $ spent from Reserves, and as set-asides for the next occurrence of this project.

But in your example, new submetering equipment fails test #1, as it is not currently a common area maintenance project. So I would counsel that it is not a legitimate expenditure of Reserve funds. Once installed (with a special assessment or an official "loan" from the Reserve Fund repaid with anticipated water bill savings), it then "exists", and can be added to the Reserve Component List so funds are being set aside for the next occurrence of this project.

Q: Please explain. You said most associations only need to perform a Full Reserve Study once? Not every three years?

A: Correct. You’re likely confusing a Full Reserve Study with an Update With-Site-Visit. Once the Component List has been identified, and all components have been quantified, (80,000 Sq Ft of asphalt, 24,500 Sq Ft of roofing, etc.), you don't need to pay for another Full Reserve Study to re-establish the list and re-measure those components. From that point forward, what most associations need are Update Reserve Studies (either an Update With-Site-Visit which is good to do approximately every third year, or Update No-Site-Visit which is good in the in-between years).

Q: How often should you update your Reserve Study?

A: Because Reserve Studies are based on observations or information that is time-dependent (the condition of components, the cost of components, the Reserve Balance…), a Reserve Study is an annual document. It becomes outdated and inaccurate after one year. In addition, because Reserve contributions typically represent 15-40% of an association's total budget, that is a budget line item worth reconsidering (updating!) every year. Read more here. Finally, special assessments are measurably lower among associations updating their Reserve Study annually (see here).

Q: We are a small (14-unit), simple association. How often should we do a With-Site-Visit Reserve Study Update?

A: I would think every third year would keep your association generally pointed in the right direction. But please see this article on how associations significantly reduced their Special Assessment risk by updating their Reserve Study annually instead of only every third or fifth year.

Q: Why do you recommend an annual Reserve Study update if your major projects are many years away?

A: Because major Reserve projects take years of financial preparation. Conditions change, costs change, the association's financial resources change, and economic environmental factors change. You want to make progress towards your goal each year, not spending years drifting off-target.

Q: How can a Board update their Reserve Study themselves (to save some money)?

A: Most Reserve Study providers make Update With-Site-Visit and Update No-Site-Visit engagements available to their clients at very attractive prices. Remember, a board's job is to run the affairs of the association; their job is not primarily to avoid necessary expense. For simple update situations, boards can avail themselves to lower cost products like a Do-It-Yourself Reserve Study Kit (www.DIYReserveStudy.com).

Q: We are a small community of 13 homes and have a significant reserve balance that resulted from proceeds from a lawsuit. Can the association use some of these one-time proceeds for common area improvements?

A: Check with your attorney: Sometimes litigation proceeds are limited to very specific uses (road replacement, roof replacement, etc.) for which those funds were awarded (because any other use invalidates the award and will trigger the return of the funds). Check your Reserve Study (look at your Percent Funded): perhaps those funds only look like a lot of money, and they are needed for upcoming Reserve projects.

Q: **When an expenditure is made from reserve funds (in accordance with the plan) the Reserve Study's percent funded should remain virtually unchanged…correct?**

A: No. If the association is 50% Funded, it means the association only has 50% of the funds it should have at that particular point in time. So if the association performs a $100,000 roof project on time and on-budget, that will weaken the Reserve Fund further because the Reserve Fund (at 50% Funded) only had $50,000 of the $100,000 it needed.

Q: How do we add missing items to the list? And after they are added, how long before we can use money for them?

A: Reserve Studies are typically updated annually. In that process if you find a project meets the National Reserve Study Standards four-part test and isn't on your Reserve Component List, add it to your Reserve Study in the next update. Since the project meets the National Reserve Study Standard four-part test, it qualifies as a legitimate Reserve expense now. Obviously, it was an unanticipated expense, so expect your Reserve Fund to be weakened and expect your Reserve contributions to increase. Spend Reserve funds on Reserve projects. You don't have to wait until they can be utilized. See more on this common "detour" in this related presentation.

Q: How and when do we add major components (siding replacement, spalling repairs, decaying sewer lines, etc.) that are revealed as needs due to advanced building age?

A: As soon as reasonable estimates can be made, per the National Reserve Study Standards four-part test. See more on common "detours" like this in this presentation addressing how to navigate through a year of Reserve decisions at your association.

Q: Based on a home valued at $x,000 and x years old, is there a factor that should indicate the amount of $ in the reserve per house?

A: No. An appropriate Reserve Balance is defined by the size, scope, and timing of your Reserve projects, not by home value or association age.

Q: Once you receive the results of a Reserve Study, what is the best approach to dissect it, use it, and explain it to the Board?

A: Please see our webinar on exactly that topic!

Q: When you calculate Percent Funded and report strength or weakness, is that at the end of the 30 year period, or does it mean if you dip below 30% for say 2 years but you are over 70% for the other 28 years and you are at 90% after 30 years = you are still poor - or are you good/strong?

A: Percent Funded is calculated each year (hopefully now and for each of the next 20 or 30 years). Percent Funded is the comparison between your Reserve cash balance and the value of deterioration at the association. It is important to know your Percent Funded for your current year, because it tells you your risk of special assessment right now. It is also important to know how your Percent Funded is trending over the years (up or down, towards 100% Funded or not, based on your Reserve Funding Plan).

For instance - if your Percent Funded now is under 30%, you are approaching a 50% chance of a special assessment. So if your Funding Plan allows you to spend the next three years in the 0-30% Funded range, there is a high chance you'll need one special assessment in those three years. But if your Funding Plan directs your association towards stronger Reserves over the years, your special assessment risk will gradually reduce as you approach the strong (70-130% Funded) range. See more in this article.

Q: What are the pitfalls of only getting estimates for a few components (asphalt, perimeter wall, etc.) instead of commissioning a Reserve Study?

A: Who's to say that those are the only major components? How are you gathering the funds for all the other components that will need to be replaced? It sounds to me like a very weak effort at planning responsibly, which doesn't prepare the association for upcoming expenses and demonstrating that you know Reserve planning is a good idea but choosing to not do it well exposes the Board to liability.

Q: Where would one get estimates for a few components (asphalt, perimeter wall, etc.)?

A: National construction estimating guidebooks, Internet research, and current association vendors.

Q: In our 25-home association, our major common area asset is our roadway system. Do we need a Reserve Study?

A: I would recommend a Full Reserve Study, which will reveal the association's major components, its Reserve Fund strength, and recommended contributions. If indeed your Reserve component list ends up being a short list, it is a better candidate than others with a longer or more complicated Reserve component list for updating in-house.

Q: How do you convince a Board of an association with little in Reserves that they need a Reserve Study?

A: You can lead a horse to water but you can't make it drink. Remember the Four Reserve Rules:. 1) Everything deteriorates. 2) The Board is responsible to manage the affairs of the association. 3) Delays usually get expensive. 4) Homeowners always get stuck with the bill. The board is exposed to liability by not handling their job responsibility, exposing the association and its owners to unsettling surprises, special assessments, and diminished property values.

Q: How do you convince homeowners of Useful Life and Replacement Costs?

A: It depends on who generated those estimates. A credentialed Reserve Study professional (look for an "RS" or "PRA" behind their name) is a professional in this specialized field with years of experience under their belt. They see deterioration and replacement projects all the time. Their estimates by definition should be trustworthy. But if those estimates come from a homeowner volunteer, they've got an uphill battle to prove the credibility of their research.

Q: Why not do a Reserve Study yourself (in-house)?

A: See above. Will that Reserve Study carry enough authority to influence a change in the budget? How accurate is the Component List? How accurate are the estimates for Useful Life, Remaining Useful Life, and Replacement Cost? Of course you can do it yourself. But it may not be an effective exercise. And remember – the board's job is to provide for the needs of the association, not save $ wherever possible. Sometimes, good professional help costs money.

Q: What is a transitional Reserve Study?

A: A transitional Reserve Study is often a combination of a Transition Study and a Reserve Study. New associations need Reserve Studies – to ensure they are off "on the right foot" budget-wise, so they don't get 10 or 15 years down the road and find that the developer underestimated replacement costs or overestimated life expectancies in the initial budget (Public Offering Statement). A transition study is an effective tool, independently checking the physical elements of the association for completeness and that it was built and finished correctly. A transition study is a valuable tool for associations exiting developer control… allowing an independent expert in to inspect and document if there are any projects yet to be completed or needing to be redone.

Q: Should an association have a Reserve Study at the time of transition and when should the association begin funding Reserves?

A: It is good practice for the board to commission an independent Reserve Study by a credentialed provider shortly after taking control of the association. Like a transition study (see above), it will reveal the physical condition and funding status of the association, news the association should receive sooner than later. If there are physical problems with the association (construction defects), claims for Reserve underfunding may be added to the challenge against the developer. Ideally the developer should begin funding Reserves as soon as the homes are built, because that's when the common areas begin deteriorating. As soon as the homeowners take over, an independent Reserve Study will reveal if the association is "on track" with respect to Reserves, and if not, what contribution adjustments need to be made.

Q: How many years ahead should a Reserve Study look in order to plan responsibly?

A: See the NRSS four-part test again. There is no minimum or maximum Useful Life limit. So if you have a major project with a 40-year life (a seawall, or a major elevator or fire alarm system renovation), include it. It might be a bit of a fuzzy estimate now, but you can refine it as the years draw closer. That way everyone using and enjoying the asset is paying their small, fair share of deterioration, not placing the entire burden of replacement cost on the last 10 or 20-years of owners! By the way - National Reserve Study Standards require that a minimum of 20 years of income and expenses be presented in the Reserve Study.

Q: How do you determine the Component List? The one we got this year differed significantly in # of Components from the one we got last year from another company.

A: If the last Reserve Study was done by someone unfamiliar with National Reserve Study Standards, it may not be a credible list. It may be missing components and it may include projects more appropriately handled through the Operating budget. If the last Reserve Study was prepared by someone according to NRSS, they may have had a different philosophy with respect to detail, and while it may look very different in style, its substance may be very similar. For instance, one company may list one component "Rec Room – Refurbish", while another company may list the exact same assets individually… flooring, painting, chairs, tables, kitchen remodel, bathroom remodel, HVAC, etc.

Q: Our state requires "adequate Reserves", but doesn't define that. Can you think of a case example where that was tested and defined?

A: I can't think of a case example, but clearly "adequate" means "enough to perform its intended function". See this definition, developed in early 2018 by major Reserve Study providers from across the country.

Q: We have Reserve Study requirements in our State (CA), but nobody seems to be enforcing those requirements. Why not? Lack of enforcement makes it difficult for associations like ours with a rogue board.

A: Law enforcement is not my area of specialty. I trust law enforcement officials are working on more pressing problems. You can always run for the board, move, or sue the association: three things that are within your control.

Q: Are you familiar with an association being forced to pay for sewer drainage problems associated with shared utilities?

A: Periodically we come across an association with shared responsibilities (sharing their tennis court with an adjacent apartment or association, and I expect shared responsibility may likewise occur with utilities such as water or sewer systems. In those cases, the association should list the component in their Reserve Study, but with only their portion of the total expense (such as 50% of the tennis court resurface cost).

Q: In our association, we have a golf course managed by a third party company which charges for members and non-members to play the course. Do we need to Reserve for golf course assets?

A: It depends on how maintenance responsibilities are structured. If the golf course operator is required to maintain the course out of fees they collect, it is not association responsibility (it fails test #1 of the National Reserve Study Standard four-part test). If the golf course remains the maintenance responsibility of the association, golf course assets should appear as components in the Reserve Study.

Q: We have repair line items in our Operating budget. When do those become big enough to be considered a Reserve project?

A: When the repair changes the Remaining Useful Life in the Reserve Study. See more on common "detours" like this in this presentation addressing how to navigate through a year of Reserve decisions at your association.

Q: If our Percent Funded is 70% or more (strong), can we put in an automatic inflation-offsetting escalation factor to our contributions, kind of like cruise control, and have a more hands-off attitude towards our Reserves?

A: Good for your association to be one of the 30% with a strong Reserve Fund. But Reserves require diligence, not putting the subject on autopilot. Review your situation regularly, and make adjustments as appropriate. I'm sure you'll find your "cruise-control" settings need to be adjusted due to unanticipated changes to interest, inflation, Reserve Balance, or life expectancies.

Q: Why do you talk about painting as a Reserve component. Isn't that inappropriate due to IRS regulations?

A: No. Painting commonly meets the National Reserve Study Standards (NRSS) four-part test. Prepare your Reserve Study according to NRSS, prepare your taxes according to IRS standards. They are different documents, with different purposes, guided by different standards. See more here.

Q: Our auditor is giving us real push-back to take out IRS-defined non-capital projects (painting, asphalt sealing, tree trimming…) from our Reserve Study, threatening that our entire Reserve Fund could be considered "profit" and therefore taxable. What do we do?

A: A CPA can make the appropriate adjustments to your financial statements, separating Reserve contributions between capital and non-capital components. See article here. That, and perhaps a formal resolution suggested by your CPA, should be sufficient to protect your entire Reserve Fund from threat of taxation.

Q: Can tree care, plant material, or landscape projects be funded through Reserves?

A: Yes. Often landscaping projects meet the National Reserve Study Standards four-part test in that they are a common area maintenance responsibility, life limited (perhaps you need to replace old/mature vegetation every 10-20 years or so), you want to establish a regular schedule so the grounds stay attractive (meaning the Remaining Useful Life is well-established), and at many associations this type of project can be a significant expenditure.

Q: Should an irrigation system's life (30 to 50 years?) be included in reserves and reserves set aside for complete replacement?

A: Yes, see above. Major repairs or replacements to an irrigation system commonly meet the four-part test, and therefore are funded through Reserves.

Q: Are water and sewer lines typically Reserve components, or not?

A: Water and sewer lines, presuming they are common area maintenance responsibilities, should appear as soon as reasonable estimates can be made per the National Reserve Study Standards four-part test.

Q: When you talk about partial or phased repairs being effective, can you provide some math examples (fencing, siding, etc.)?

A: If you have miles of fencing that is in "random" condition, but is the type of fence that should be replaced every 25 years, you can successfully do 1/25th every year, 1/5th ever five years, etc. Just be careful… you don't want to be doing 1/10th every five years, or you won't get around the entire association for 50 years, an unsuccessfully long interval!

Q: How do we make our homeowners understand that deterioration is real, and that it needs to be funded?

A: We had one association with serious balcony problems where the homeowners voted down the special assessment for balcony repairs. But the board had a clever idea. The debris from the two balconies that had failed had been carted off to the landfill, but they piled the ugly dry-rotted structural beams from the third failed balcony right at the entrance to the association, where everyone saw it every day, with the sign "Are these holding up your balcony?" The board called for another special assessment vote, and it passed almost unanimously. Lesson: make it real to your members. Deterioration is real. Costs don't go away. See [this] article as an additional resource.

Q: Are commercial entities within the association required to contribute to the association?

A: It all boils down to what the Governing Documents require. Ground floor units in mixed-use associations (restaurants, dry cleaners, etc.) regularly are full-fledged members of the association, paying assessments just like residential owners. In large developments, some corner lots are not members of the association (gas stations, schools, or houses of worship), and therefore do not participate organizationally or financially in the association's operation.