



# HOW MUCH SHOULD AN HOA HAVE IN RESERVE?



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Choosing to live in a condominium complex or gated townhouse community certainly has many perks as to the maintenance of the property. As part of such a community, homeowners enjoy care-free living while the homeowners association or HOA is tasked with ensuring that all of the common areas of the property are well-maintained and cared for.

This includes having all the landscaping cared for on a weekly basis, the pool (if there is one) cleaned and maintained, and all other physical aspects of the property kept in good working condition. Basically, anything that isn't connected with the individual unit in which you live is the responsibility of the HOA to repair and replace in a timely manner.

That's why you pay your HOA fees on a regular basis. A portion of these resources are allocated to the Operating budget, which covers the routine management, upkeep and maintenance of the shared areas of the property. From the pool, to the utilities, to the yard work, your association fees are being used to make sure these parts of the community are tended to on a regular basis and everything is in good working order.



If the Board of Directors is acting responsibly, a portion of these fees are also allocated towards the Reserve budget. This covers repair and replacement costs that will come about over time.

Let's say the driveway needs to be sealed or the exterior of the buildings need to be repainted, your HOA fees will be used for those things, in addition to the various routine costs of managing the property.

But if your HOA doesn't have enough cash in reserve to cover the expenses of a major repair or replacement, you could be subject to a Special Assessment in which all of the homeowners of the units contained on the property will be expected to come up with their proportionate share of the project cost. Depending on the work that needs to be performed, you could be on the hook for thousands of dollars when you least expect.

Does this mean your Board of Directors is being derelict in their duties? If the special assessment is for a predictable (Reserve) project that failed in plain sight right on schedule, it certainly appears that way!

In some states, an HOA is not bound by law to conduct a Reserve Study. In others, the Board must disclose relevant reserve information to all pertinent parties involved in any real estate transactions within the HOA. Regardless, a Board is responsible to meet the financial needs of the association & comply with all applicable laws.

## RESERVE FUND ADEQUACY

Let's consider those HOAs that do conduct regular Reserve Studies and work towards maintaining "adequate reserves". A long time HOA trade organization called the Community Associations Institute (CAI) worked closely with a number of Reserve Study professionals to develop the following definition of reserve adequacy: "Adequate Replacement Reserves" is defined as a Replacement Reserve Fund and stable and equitable multi-yr Funding Plan that together provide for the timely execution of the association's major repair and replacement expenses as defined by National Reserve Study Standards, without reliance on additional supplemental funding.



You'll notice that the definition contains two parts: having enough cash -and- not relying on outside funding sources like loans or Special Assessments.

A current Reserve Study is the only way to determine reserves adequacy. That's because a Reserve Study contains a funding plan designed as much as possible to avoid the need for outside funding sources. Absent a Reserve Study, it's just a guess!

The Reserve Study examines the basics of the HOA, things like age and condition of the building, as well as all of the features and common area amenities that the HOA is responsible to maintain.

The study is a forecast of sorts, estimating when certain components of the property would be due for a repair or a replacement and the expenses associated with having this work performed at that time. While the Reserve Study is certainly a projection, it is based on projects that are both inevitable and predictable! The study provides Boards with numbers to work with in attempting to fund reserves at the same pace of the property's deterioration and ahead of repair or replacement costs.

It's possible that your HOA is currently underfunded and the Board will be forced to rely on a Special Assessment at the time of an expensive repair or replacement of something around the property.

## RESOURCES ON RESERVE

But let's assume for the sake of argument that your homeowners association is taking all of the necessary steps to ensure that the property's reserves are well funded and prepared for both inevitable and predictable future repair and replacement expenses. How much should the HOA have on hand to address these costs?

Although every property is unique, most reserve experts will suggest that the reserves be funded at 70% or higher of the property's calculated deterioration. A reserve fund at that level will, in most cases, mean a low risk of Special Assessment, and satisfy the definition of reserve adequacy as long as responsibly sized contributions continue to be made. However, HOAs with weaker reserve funds (i.e., less than 30% funded) can also satisfy adequacy requirements. Despite being underfunded, they can achieve reserve adequacy by adopting an aggressive funding plan that avoids reliance on outside funding sources.



## HOME VALUES

Whether or not the homeowners association takes action to ensure the money is available to complete repairs and replacements in a timely manner is a decision the Board will need to make. It is important for the owners of the various units of the property to have confidence that the Board is fulfilling their responsibility in this regard. Studies have shown that homes in condominium associations with strongly funded reserves sell for 12% more than comparable homes in underfunded associations.