

Reserves to the Rescue?

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www.ReserveStudy.com
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Miss the webinar? Watch it [here](#)


In “normal” times, boards are counseled to not plunder their Reserves to offset Operating budget shortfalls. But these are not “normal” times. With unemployment spiking and delinquencies rising, paying “essential” bills may be difficult. So this webinar addresses how boards may be able to manage their Reserves in a way that benefits the association’s short-term cash needs, while not undermining the financial future of the association. But this must be done carefully, and the process by which it is done is crucial.

What to do first?

Gather your facts, review and tighten your Operating Budget, maximize your assessment collections, and begin coordinating with your legal counsel to make sure you are following your Governing Documents and State Law. Only after you’ve done those four steps should you consider Reserves as a Rescue opportunity.



What to Do?




- ✓ • Assemble information (bank balance, delinquencies...)
- ✓ • Review/Adjust Operating Budget
- ✓ • Maximize collections (and communications)
- ✓ • Work with legal counsel (Governing Docs & State Law)
- Consider Reserves as a Rescue Opportunity


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What is a safe process?

Flowing from the Business Judgment Rule is a three-step process that will help protect a board should their actions or decisions be challenged. That process should be well documented, and should show the following about the board's behavior:



Business Judgment Rule




- Act in Good Faith
- In best interests of Association
- With due diligence (ask questions)

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The key is that the board has good documentation regarding their decision process, beginning with a description of the predicament that is being solved.

What is the first way Reserves can help the association, by Conserving Cash?

Stop spending! Begin by prioritizing your projected Reserve expenses. Not all Reserve projects are equally significant. Review your Reserve Study (it helps if it is for the current year!), and identify projects planned for 2020. Understand your Reserve projects fall into one of five categories:



Prioritizing Reserve Expenses

-  Inconsequential
-  Re-Evaluate
-  Obsolescence
-  Protection
-  Catastrophic

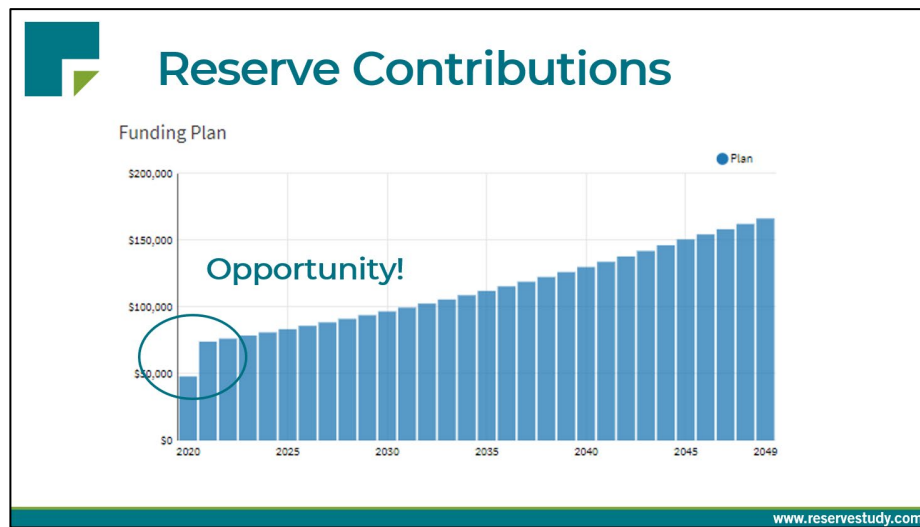
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Defer any Inconsequential projects. Carefully consider any Re-Evaluate or Obsolescence projects (doing only the ones with true merit). Move forward without delay to perform projects that have Asset-Protection or Catastrophic consequences. Remember the Hippocratic Oath – first, do no harm! Don't defer any projects that will cause damage to the association or its members. And remember – deferred projects do not represent “savings”. Any deferred projects still need to be accomplished - likely next year!

Next, how might the association Re-Allocate Cash (from Reserves to Operating)?

First, understand that whether Reducing reserve contributions, Suspending reserve contributions, or literally Borrowing cash from Reserves, all are effectively “borrowing”. Check with your legal counsel to see if you have restrictions arising from your governing documents or state law on this matter. If you are depriving your Reserve fund of cash through one of these three strategies, expect to replenish those funds at a future point in time. That requires a payback plan.

Whether reducing Reserve contributions or Suspending contributions, the opportunity may be significant. Document what you've done, and create a plan to restore those funds to Reserves. The roof still needs to be replaced in a few years, and that can't be done if the funds aren't there!

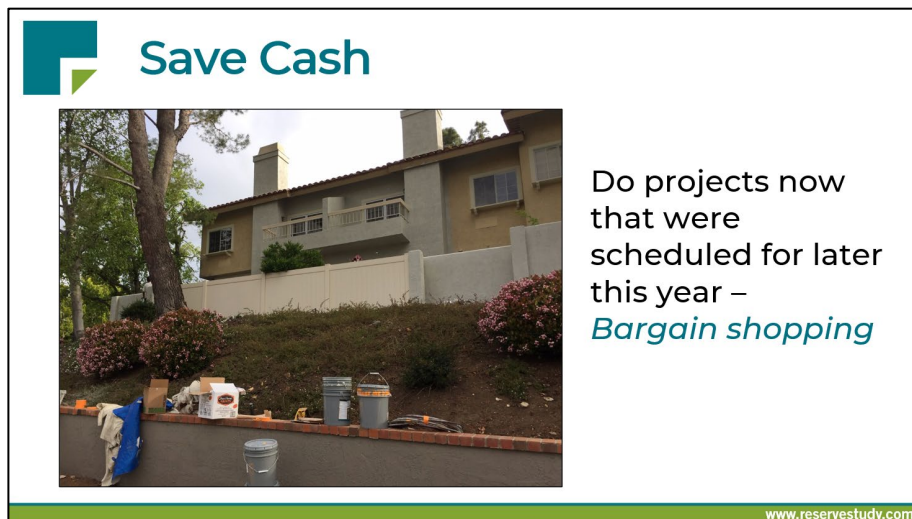


Borrowing from the Reserve fund is similar... look at your Funding Plan over the years, and see what “margin” you have and how long until the funds will be needed. Note that the associations that have healthy Reserve contributions (those who are “Fully Funding” their Reserves) and those who have healthy Reserve funds (again, those who are “Fully Funding” their Reserves) are the ones with the most margin to offer the Operating fund.

For associations “Baseline Funding” their Reserves, the contributions might already be close to bare minimum (barely enough to keep above the 10% FHA minimum), and the fund may have a minimal balance. Expect that you’ll need to work with your Reserve Study professional (or a software tool) to test and document your plan, both the borrowing and the restoration of those funds.

Finally, how might the association Save Cash?

Enjoy some bargains! Many service providers (asphalt, painting, roofing, etc.) are not running their crews at full capacity during this pandemic. Launching Reserve projects (that pass the “with merit” test) now that were scheduled in your Reserve Study for “sometime in 2020” can be a great way to save from “full price”! Some associations are reporting 5% - 10% discounts being offered. And the great thing – those are savings that don’t need to be repaid!




The slide features a green and white logo on the left with the text "Save Cash" in a bold, teal font. Below the logo is a photograph of a two-story residential building with a white fence in front. In the foreground, there are various items like bags and containers, suggesting a construction or maintenance site. To the right of the photo, the text reads: "Do projects now that were scheduled for later this year – *Bargain shopping*". At the bottom right of the slide, the website "www.reservestudy.com" is listed.

So what is your appropriate response?

Document your predicament, and “tell your story” of how the board acted in good faith, in the best interests of the association, and after asking enough questions to determine it was a responsible strategy to implement. Know your three options:

- Conserve Reserve cash (stop spending!)
- Re-allocate Reserve cash (to Operating)
- Save Cash (bargain shop)

And make sure you document what you've done. To make your "what-if" Reserve budget testing and documentation easy, consider using uPlanIt!



Documentation Strategy

- Online Reserve Calculator
- All calculations per National Reserve Study Standards

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uPlanIt is the Online Reserve calculator included free with all Association Reserves professional Reserve Study engagements. uPlanIt is also available on a subscription basis for \$149/yr. See the video of how it was used in the preparation of examples for this webinar [here](#).

For additional information and resources, please visit:

www.ReserveStudy.com and www.AdamsStirling.com

WEBINAR QUESTIONS ASKED BY ATTENDEES

Q: Are you currently performing on-site reserve studies?

A: Yes.

Q: I would think a septic pump station would fall into the category of catastrophic?

A: Agreed!

Q: What if the community isn't making sustainable Reserve contributions, has high delinquencies, and has a number of upcoming projects that fit the description of "catastrophic" and can't be deferred?

A: That's very unfortunate. Bad things are likely to happen at your association. See what you can do to prevent expenses (some Preventive Maintenance?) to "buy some time" to build your Reserve cash balance.

Q: What if the association has never taken out a loan? Would now be a good time to take out a loan for immediate repairs?

A: It's always easier to get a loan when your financial position is strong enough that you don't need a loan. But presuming your association is in a jam and you don't have the cash to do essential immediate repairs, start scrambling. That likely includes trying to find a bank (familiar with community association lending) that can quickly advance the association some cash.

Q: We are a 273-unit community. We were getting ready to paint in our community, but due to COVID-19 and homeowner concerns, the painting was finally put on hold. We were concerned that the painting job was 38% higher than the reserve study indicated. Our Reserve Fund has shrunk from its size when I was on the board. The board gives no answers to our financial concerns. We are told not to communicate with board members. As Homeowners, do we have any power over this board and property management company?

A: You mention so many issues. The most common reason painting prices are higher than stated in the Reserve Study is that the Reserve Study is many years old. But as mentioned in the webinar, now may be a good time to launch an exterior painting project, as it may be less expensive now than after things have "returned to normal." As a member of the association, continue to communicate with the board. Give them some grace & patience as they are trying to run the association in these trying times (don't make their job harder!). But as a homeowner, the board speaks for the owners. You have no authority over the board or the management company. It sounds like it

is time to run for the board again and become part of the solution.

Q: Is fixing the walkways in the catastrophic category? Is fixing the driveways, which are as bad as the photo shown, in the protection category?

A: If walkway slabs are lifting, they become a safety hazard that could lead to injuries and lawsuits. An inexpensive temporary solution is to use a company to grind down the edges to remove the trip hazard and then put aside monies into your reserves for the eventual replacement of those sections of the sidewalk. Usually in the “Re-Evaluate” category, one reason to move forward at this time would be to eliminate any safety concerns.

Q: Our Governing Documents mandate that if any money is collected for Reserves that they be put into our Reserve Account. However, our Board has put \$0 money into the Reserve Account for over 14 months. They never gave notice to the Membership of this and nor did they provide a plan to repay. This seems illegal to me. Shouldn't they have to disclose since lending agencies rely on this data?

A: This is all very unfortunate. Reserves funds are to be used for Reserve projects, not re-allocated to the Operating Fund unless in a (short term) time of financial crisis. While this is inappropriate, fiscally irresponsible, and exposes the board to liability, it falls short of being an illegal act.

Q: I'm interested in a reference for the law requiring member notification for using Reserve funds for Operating. Is there a way to cure, if the BOD didn't give notice before hand?

A: Different states have different laws governing this question. Please check with your association's legal counsel on this matter.

Q: In terms of prioritizing Reserve Expenses. Where would you rank landscape renovation in terms of the Reserve prioritization, i.e., inconsequential, re-evaluate, obsolescence, protection, catastrophic, etc.?

A: Landscape Renovation could fall into different categories depending on the project. Tree limbs banging and damaging buildings are “Protection”, sprinkler systems could be “Re-Evaluate”, and simple “fresh color” could be “Inconsequential”.

Q: What will happen to our special assessments during COVID? We are currently paying \$1500 every six months for 5 years. Our members have hard time to pay the regular assessment.

A: It depends on the purpose for the special assessment. If it is to repay a loan, you can talk to the lender to see if the repayment period can be extended and the payment

amounts lowered. If the special assessment is for rebuilding your reserves or preparing for an upcoming expense, the board, management and your reserve study provider should meet and discuss whether the assessment can temporarily be suspended or lowered, or if the payment schedule can be lengthened.

Q: How much flexibility does a board have in using funds that are reserved on a component basis?

A: Not much. Just another example that the Cash Flow Method of funding and accounting for Reserves (see our Reserve Studies 103 webinar [here](#)) is more advantageous to the association because Reserves funds can be used on whichever Reserve project has priority.

Q: An association just had a substantial CD mature and is contemplating re-investment. Should they hold the funds in savings or reinvest in a CD at this time?

A: That is a question best posed to your financial advisor. Our thinking at this time is that there is value keeping the funds readily available for a few months in these uncertain times rather than committing them to a long-term investment. If you hold the funds rather than reinvesting them in another CD, be careful that your funds on deposit (operating and reserve) do not exceed the \$250,000 FDIC limit per depositor per institution.

Q: What can you do when the board is protected by our attorney and management company and does not notify residents, uses reserves for operating expenses and does everything in secret and ratify at meetings?

A: You can file suit but that is rarely a good option. The other is political, rally fellow homeowners to put pressure on the board to follow applicable statutes and governing documents. Also, consider running for the board (or moving to a different community).

Q: What can be done from an ex-board member who was shut out?

A: Board activity and board communication is for the board, not former board members. If you miss being part of “the action”, consider running for the board again.

Q: Can boards deny delinquent owners and/or their renters' use of the common areas if they do not agree to an acceptable repayment plan?

A: Unless your governing documents or applicable laws state otherwise, very likely, yes.

Q: Why would one defer a fire alarm upgrade? Couldn't failure to upgrade result in damage to property? The same as the flat roof? Damage to property?

A: One might defer if it is just "the latest" available equipment. But if it is code-mandated, or if there is some concern about the functionality (being out of date) of the current equipment, that would slide it perhaps from "Obsolescence" to "Protection". Flat roof could be "Re-Evaluate", and like Adrian said that decision could be strongly influenced by the written opinion of your roofer familiar with your association.

Q: A 33-unit HOA suffers \$10k of hurricane cleanup expenses. Do you suggest the Board calls for a Special Assessment of \$333 each and collect currently, or borrow from the reserves and repay over x years? If answer is different from the "COVID-19" situation, why? Are we not treating owners as different "classes" almost? Current vs future?

A: The answer depends on if the cash flow (margin) in the Reserve Fund is sufficient to tolerate a \$10k withdrawal (and repayment over x years). As mentioned in the webinar, borrowing from Reserves should never be first choice. Now will likely be an unpopular time to levy a special assessment, so it will require wise decision-making at the board level.

Q: How often should reserve funds be reported to the association?

A: At least annually, some states mandate quarterly.

Q: Should the association have a set amount that goes to the reserve funds each year and should homeowners be notified of that amount?

A: It is wise to communicate effectively and often, keeping all owners informed what the association is doing with their money. So yes, best practice is to inform the owners. In some states it is required that the budget be published and provided to the owners in advance of the fiscal year.

Q: Besides suing the association, what can homeowners do if the association does not follow the governing documents or state law?

A: Along with some other like-minded owners, run for the board.

Q: I thought there was a short time limit (1 year) to pay back a loan from reserves?

A: In CA, yes, payback is required within one year (unless documentation can support a longer payback period). In WA, Reserve loan payback is a 2-year time period. Other states or governing documents may stipulate different payback requirements.

Q: Where could we find more information on uPlanIt? Is a recorded presentation specific to it available?

A: We are preparing for a public launch in Jun. A link to a short video of how it was used in preparing the charts for this presentation is available [here](#). See a sneak preview of the marketing launch overview video [here](#).

Q: Reserves are limited to use for existing reserve items. How do HOAs generally handle raising money for new capital assets?

A: Generally, that is done through a special assessment or a temporary increase in homeowner assessments.

Q: If you drop/reduce the reserves, do you need to amend the budget?

A: Check with legal counsel, but generally no. Best practice is to communicate with the homeowners, documenting what was done and why, but generally it is not required that the budget be re-published and re-distributed. The budget is a guide.

Q: Would you need an owner's vote to borrow money from the reserves?

A: Check with your legal counsel and your governing documents. In some states, there is a specific process that needs to be followed.

Q: Do boards need a membership vote in order to take out a loan?

A: Many (most?) governing documents require a membership vote. Check with your legal counsel and your governing documents.

Q: What are your thoughts about the board applying for a line of credit with our bank?

A: Could be a great idea! No harm in applying – and a line of credit could offer yet another way to manage cash flow at the association.

Q: What are your thoughts about changing the homeowner assessment “late date” to the end of the month instead of the 10th?

A: Our thinking is that for owners affected by unemployment, the end of the month is no different than the 10th. The more important issue is identifying those who are struggling to pay, and work with their unique circumstances. A “blanket” change to changing the “late date” may prove ineffective.

Q: Our board is considering reducing the monthly assessment by reducing the contributions to the reserves. Your thoughts?

A: As stated in the webinar, our counsel is to maintain ongoing assessments. Don't try to create a blanket solution for all association, many (most hopefully) who are perfectly capable of continuing on “normally”. Our encouragement is to focus on the circumstances of individual owners facing challenges.

Q: Regarding dues, you are not saying to reduce the amount of assessments/due but rather to re-allocate how the dues are split between Operating Funds and Reserve contributions, correct?

A: Correct. If your association is currently collecting \$10,000/month, with \$2,500 of that going towards Reserves (25%), that means \$7,500/mo is flowing to the Operating Fund to pay bills. Our counsel is that if due to delinquencies your revenues have dropped by \$500/mo (down to \$9,500/mo) even after all your belt-tightening, our suggestion is to consider dropping your Reserve contributions to \$2000/mo. That way the Reserve contributions are \$500 less per month and the Operating Fund continues to receive \$7,500/mo.

Q: Won't reallocating the Reserve Contribution amount change the % Funded?

A: For the next year, yes, your Percent Funded will be less than expected because your Reserve balance will be less than expected.

Q: Can you give examples of banks that lend to HOAs?

A: That varies for different regions of the country. Please check with your local CAI chapter or do a Google search.

- Q: We have seen HOAs in Colorado waive 2nd quarter dues. We highly recommended against it. Do you agree?**
- A: Highly agree. Don't make a blanket change to all members. It is likely that most owners are unaffected. Apply a solution (payment plans, etc.) only to affected owners.
- Q: What is the minimum reserves a 10-15 year old HOA should have?**
- A: The 0-30% Funded range is the "danger" zone, where special assessments and deferred maintenance are common. For the best interests of the association and its members, we highly recommend not lingering in this zone, no matter how old the association. Please see our Reserve Studies 102 webinar [here](#) or download our eBook on Reserve Fund strength [here](#) for more information on this topic.
- Q: Is there not some assumption that money not received on-time will be recovered at a later date through liens or collection efforts?**
- A: Yes. That will increase the association's cash flow and ability to rebuild either the Operating Fund or Reserve Fund (or both) "at a later date".
- Q: I assume interest and inflation is added on each year?**
- A: It is typical that Reserve Funding Plans incorporate assumptions for interest and inflation.
- Q: My HOA passes partial funding of reserves. Are there ever any justifications for partial funding?**
- A: The excitement of living with the risk of special assessments?
- Q: When you do your projects from reserves, doesn't the % funded go up?**
- A: Actually, since most associations are underfunded, the % Funded actually goes down. See more [here](#).
- Q: When you say 25% of total budget, are you referring to the Operating budget? Reserve Fund?**
- A: 25% of total budget means exactly that... 25% of total budget (not Reserve Fund balance). If your association collects \$10,000/mo, 25% of that going to Reserves means \$2,500 gets transferred to Reserves while \$7,500 remains in the checking account to pay Operating expenses. Similarly, if your individual homeowner assessments are \$400/mo, then 25% of total budget going to Reserves means \$100

of that goes to Reserves, with \$300 (the remaining 75%) going to the Operating Budget.

Q: What's your opinion of lowering the assumed inflation rate (given the current low interest environment) to keep the reserve fund closer to adequate funding level?

A: Unwise. Since Reserve Funding projections are made on a 20- or 30- yr basis, it is best to keep a very stable projection of inflation rate, and not be adjusting a 30-yr plan on the basis of our current temporary economic environment. That would give a false figure for planning purposes. Use a supportable value for inflation and adjust your budget, don't decide on your budget and adjust inflation to match.

Q: If we reserved \$100,000 for building painting and only spent \$90,000, can we reallocate the remaining to a needed item and do we need to repay?

A: In you are funding Reserves using the Cash Flow methodology, funds are not associated with a particular component and they are used where and when they are most needed. If you are using the Component method, Reserve cash is designated towards particular components and any "unused" funds will need to be re-assigned. This is a great example why the Cash Flow methodology is favored over the Component funding methodology. See more on this matter in our Reserve Studies 103 webinar [here](#).

Q: If we lower our reserve contribution for a period of 6 months, when does the money need to be paid back into reserves?

A: How soon those funds need to be replenished depends on the Reserve needs of the association, your governing documents, and your local state law. The answer could be one year, two years, or a multi-yr payback. Check with your Reserve Study provider and legal counsel on this matter.

Q: Do you believe that Reserve Study providers should recommend a 1-2 year decrease of Reserve Contributions if an HOA has a strong Reserve Fund and they're concerned about the current financial hardship of the owners?

A: No. We trust this is a short-term situation, so we believe a blanket 1-2 year decrease at this time is unwarranted. It is best to recommend a normal Funding Plan and adjust as necessary (both time and magnitude) based on specific feedback from that association's board.

Q: We're in the process of a major repair of our locker rooms as a result of water intrusion. Assuming insurance proceeds only cover like for like, can reserves be used to upgrade tile, counter tops and fixtures without a homeowner vote, assuming the dollar amount is in excess of the Board's spending limit of \$10k?

A: Sounds like a FL question (given your concern about \$10k). In general, Reserve replacements do not have to be “like for like”. I would support Reserves being used to augment insurance proceeds to create an effective space that meets the current needs, sensibilities, and aesthetics of the association. But Reserves are not to be used for “vanity” upgrades. Be sure you have a Locker Room renovation Reserve component (or add one in your next Reserve Study update), so the funds are being set aside for the next renovation project.

Q: We have had to defer reserve contributions in order to pay other unexpected and unbudgeted expenses. Are the deferrals considered borrowing? Do we have to make up these contributions later? What is the procedure for doing so?

A: There is a difference between the legal and practical interpretation of “borrowing”. On a practical level, if the Reserve Funds aren’t getting to the Reserve Fund, future Reserve projects will be deprived of those funds and they will need to be replaced in the future (either with catch-up special assessments or higher future Reserve contributions). That is in essence “borrowing”. Do your “due diligence” on this matter and check with your legal counsel to stay in compliance with your Governing Documents and State Law.