



WHAT CAN RESERVE FUNDS BE USED FOR IN 2020?



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Good question! There are two ways to answer a question regarding the appropriate use of Reserve Funds in 2020, depending on how it is asked. But first, it helps to know what the purpose is of a Reserve Fund.

All buildings begin to deteriorate the moment they are built. Anyone who owns a home quickly learns that they are guaranteed to have repair costs and replacement expenses down the road. But owners of homes in Association-governed communities face a unique challenge. These communities may be known by different acronyms — Condos, Co-Ops, HOAs, POAs, or PUDs — but they all have one common need: A Reserve Study so the Board can make informed decisions, avoid special assessments, budget responsibly for predictable repairs & replacements, save money, and protect property values.

The purpose of a Reserve Fund is simply to have enough funds set aside to pay for inevitable repair & replacement expenses when needed. Not only does this keep the property in good repair, but helps to limit financial surprises to the owners.

Board members and managers of condos, HOAs and other forms of association-governed communities are often confronted with a major repair or replacement expenditure they think should be a Reserve expense, but cannot find it on the Reserve Component List. Your Reserve Component List is a good first place to look because it identifies specifically what you are reserving for. Components that might be on this list could be projects like repainting, reroofing, or resurfacing the common area driveway.

But what if the repair doesn't appear in your latest Reserve Study. Can you pay for it from Reserves in 2020? Here are two ways to know:

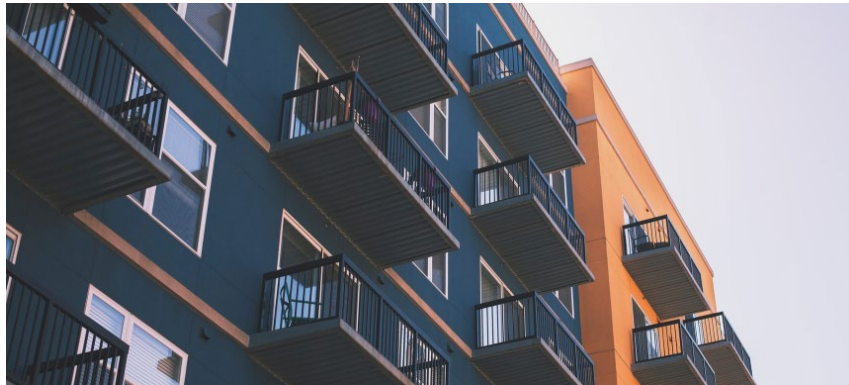
USE THE FOUR-PART TEST

While it is simple to look to the Reserve Component List to determine if an expense should be paid from Reserves or not in 2020, best business practice is to rely on the governing documents and National Reserve Study Standards. These documents provide the ultimate authority on what Reserve Funds should be used for.

Governing documents may or may not address this important issue, but National Reserve Study Standards dictate a simple four-part test. If all four parts pass the test, then it would indicate a component is eligible for Reserve Funding:

Is it a Common Area Maintenance responsibility?

If the project in question affects the common area, then the repair or replacement would be eligible for Reserve Funding. The association's governing documents should define common area and common area maintenance responsibility.



Is it Life Limited?

To qualify for reserve funding, the component must also have a limited Useful Life or UL. A limited UL is a time period that is defined (vs indefinite). This is based on industry standards regarding the anticipated amount of time before the brand new component reaches the end of its UL. For example, building walls are expected to last indefinitely and are typically excluded from the Component list. But even the best asphalt job will predictably develop cracks and require re-surfacing, making it eligible for Reserve Funding.

Does it have a predictable Remaining Useful Life?

Aside from having a limited Useful Life (UL), the Component must also have a predictable Remaining Useful Life (RUL). This is based in large part on the UL and how much time has passed since the component was brand new. But RUL is affected by many other factors including the quality of original materials or construction, weather, usage, wear & tear, etc. Your association's

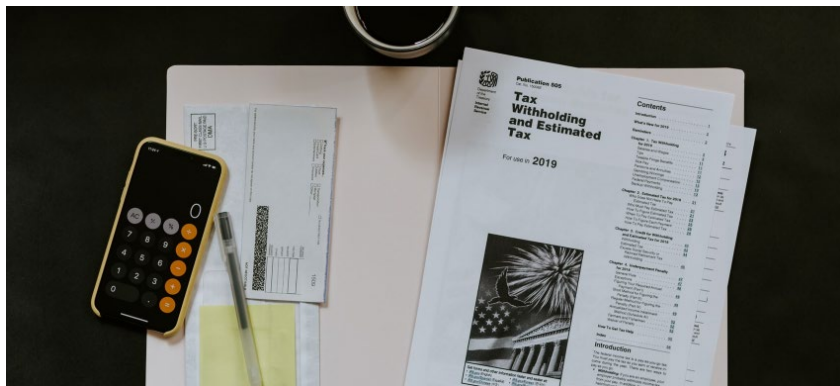
Reserve Study should identify the RUL for each item in the Component List. For example, if the roof is ready to start leaking in the year 2020, then the Remaining Useful Life (RUL) for the roof would be zero.



Is its Cost above a Minimum Threshold of Significance?

For purely practical reasons, the cost of the repair should be higher than a minimum threshold of significance. This minimum threshold level is determined by the board members. Typically, it ranges from .5% to 1% of the Association's total budget.

If the project passes the above four-part test but does not currently appear in your Reserve Component List (whether due to human fallibility or newly revealed factors), it is appropriate to spend the cash from Reserves, and then add the component to the Reserve Study during the next update. How frequently you update your Reserve Study will depend on the type of service you select - Whether it's a FULL Reserve Study, a Reserve Study Update With Site Visit (WSV), or a Reserve Study Update with No Site Visit (NSV).



PARTIAL PROJECTS OF LEGITIMATE RESERVE COMPONENTS

The other question board members often have has to do with a partial project done to a listed Reserve Component. For instance, your association needs to repair a section of a fence or roof. Both of these have “replacement” line items in the Reserve Study. Would these component repairs be a legitimate use of Reserve Funds?

If it is a normal, ongoing repair, then the answer is no. Ongoing, partial repair projects are usually not funded through Reserve Funds. However, if completing the project serves to extend the Remaining Useful Life (RUL) of the component listed on the Reserve Study, it is a legitimate Reserve expense. So for example, if the RUL for re-roofing the building was listed in the Reserve Study as 6 years, but the repairs would extend the RUL by one or two more years, then this would be a legitimate use of Reserve Funds.

For cases of “missing” or partial” projects, be sure you incorporate the appropriate change to your next annual Reserve Study update, by adding the “new” component or extending the Remaining Useful Life (RUL) of the repaired component.



PLAN CONFIDENTLY IN 2020

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