Funding Reserves… And What Happens when you Don't!

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www.ReserveStudy.com
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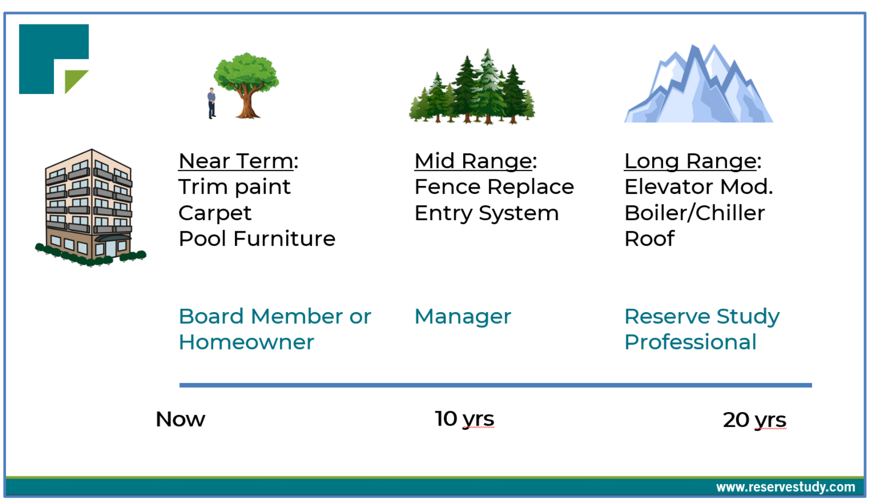
Miss the webinar? Watch it here.

You can lead a horse to water but you can't make it drink. That reminds us that action doesn't happen until someone is properly motivated. For years managers, attorneys, accountants, and Reserve Study professionals have been telling boards to get a Reserve Study and make adequate Reserve contributions. But looking across the country, the majority of boards continue to nod their heads and say "we should do a better job of funding our Reserves…", and then do nothing about it.

Boards make the decisions that create the future of the association. But I think we need to appreciate that no matter how much we counsel and coach and remind boards to make adequate Reserve contributions, nothing is going to change until they begin to feel the need. They need to feel thirsty. That's the purpose of this webinar.

First, we address the concept that everyone's perspective on the common area assets is different, based on their point of view and background of experience:



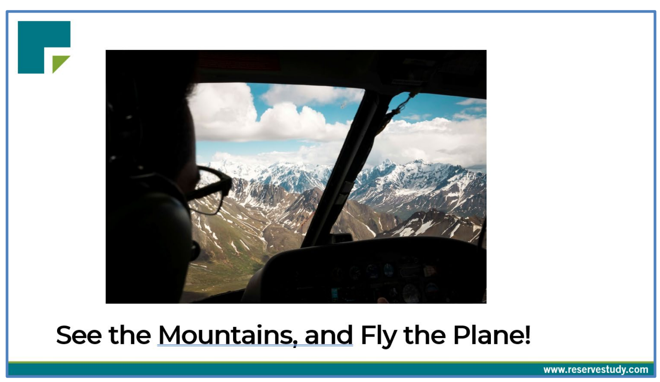
Then boards are reminded that even though they might not be skilled at seeing ahead to Mid-Range or Long-Ronge projects, they have a responsibility to the owners and the association to provide for the care of all those assets. Those distant projects are approaching rapidly!

Fortunately, the board has help to "see ahead" – with management and experts like Reserve Study professionals acting like Air Traffic Control, guiding a speeding airplane on its journey over a mountain range from coast to coast.

While it may seem slow, deterioration waits for no one. Enjoy being reminded in this comedy sketch from the old I Love Lucy TV show about Lucy and Ethel in the Chocolate Factory having to "pick up the pace" to keep up [here](#).

We then address the question of "What happens if…" the board doesn't prepare the association for these known upcoming expenses (deferred maintenance, special assessments, declining property values…), and the true cost of not preparing.

We make the point that in all other areas of our life, we expect leadership to include the total cost of ownership (which includes maintenance and future replacements of major assets) into the "usage cost". Think of health clubs, hotels, rental cars, etc.



In conclusion, we stress that board members are the flight crew, responsible for navigating their association successfully to the future. They are not passengers casually sitting back in seat 23A. Without their diligent hands on the controls, the association, and all its members, will suffer very undesirable, yet entirely preventable, unpleasant consequences. We stress "See the Mountains, and Fly the Plane!" And by seeing their responsibility clearly, and understanding that the expenses are known, they'll start getting thirsty for change.

Get an expert on your side to provide you with the information you need to make the wise decisions that guide you and your association toward an improved future! We can help by preparing your Reserve Study update, ensuring your Reserve Fund

Strength is calculated correctly and a Funding Plan is custom prepared for your association.

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Q: How is inflation determined for the 30 year reserve plan?

A: For a 20-30 yr projection forward, we assume a historical rate of approximately 3%. Given current high interest rates (that are not expected to be the "new normal"), it is important to update your Reserve Study and get a fresh set of "current" pricing of all your components. The combination of regularly updating your Reserve Study to "current" pricing with a good long-term inflation rate should serve your association well. See more here.

Q: What do you say to residents about why you have to increase monthly dues?

A: The association needs money to function, everything costs more than last year, and it's your job to provide for the needs of the association. If they don't like it, they can move. Life is expensive.

Q: Our Property Manager said just last week, "I hate reserve studies. They tell you the money you need today for expenses tomorrow." The rest of the board follows the PM and their self interest, since most of our large reserve expenses are several years away, when most won't live here. The focus on our recent budget meeting was all about "keep our dues low." Having "contributions to reserves" at the bottom of income on the income statement seems to be one mistake. Wouldn't this be better listed somewhere else on the income statement, or even separately (separate budget)?

A: A few points to remember:

- The board's job is to provide for the needs of the association, not "keep dues low".
- The association needs $ to function, and if it doesn't have the $ it needs to survive, property values will suffer. That's a big mistake, like shooting yourself in the foot. And homeowners will sue when they learn you thought a few bucks less per month would be a "great idea".
- Reserve funding pays to offset ongoing deterioration (last month's roof deterioration, asphalt deterioration, carpet deterioration, etc.). It doesn't pay a dime for anything in the future.
- Call it "Reserve Funding", not "Reserve Contributions". They are not optional. All of those bills (roof replacement, carpet replacement, etc.) <u>need to be paid</u>.
- Different associations position Reserve funding near the top, right under total income. Operating Expenses are then shown next. Perhaps that is a better solution for your association.

Q: **HOA from CA, how do I find Banking institutions that will handle HOA Operating & Reserve funds?**

A: Check with your local CAI chapter (click here). There are a number of banks specializing in community associations eager to compete to handle your association's funds.

Q: **The PM wanted to adopt the "baseline" number from the reserve study, as it is lower than what we're contributing. However, the first year number is lower, but then it goes up, unbeknownst to them. Wouldn't a better approach for the "baseline" plan be to start at the current contribution level or slightly higher?**

A: Your multi-yr Reserve Funding Plan (Full Funding, Threshold Funding, or Baseline Funding) was designed with many factors in mind. Every multi-yr Reserve Funding Plan needs to be viewed as a multi-yr plan, not just a one-yr number.

Q: **I notice that insurance companies and mortgage lenders are asking more questions about our reserves and reserve study. Does this mean that some insurers and lenders are beginning to decline to insure or lend in HOAs without a recent reserve study or HOA's not following the reserve study recommendations?**

A: Yes. Expect insurers and lenders to be much more picky about how well the board is caring for the property. That means asking to review the most recent Reserve Study, and seeing if the board is following the recommended funding and spending plan.

Q: **How much should an HOA with an Operating Budget of $560K a year have in Reserves account? What's a healthy number for reserve funding?**

A: A healthy Reserve Balance is determined by a Reserve Study. It could be a high number right before a few large projects, or a much smaller number right after some big Reserve projects. Regarding Funding Reserves – same answer. You lean what your association needs to set aside on a regular basis in order to offset ongoing deterioration in a Reserve Study. Reserve funding is often 15-40% of total budget.

Q: **What % of the annual budget should be dedicated to a Capital Reserve Account?**

A: Most associations find it takes 15-40% of total budget to offset their property's ongoing deterioration.

Q: RCW 64.38 for HOAs characterizes a Reserve account as for replacement or major maintenance of Reserve components. RCW 64.90 for Common Interest ownership groups seems to indicate Reserves can only be used for replacements of Reserve Components. We have an HOA/Incorporated NP from 1980 and believe that major Repairs should be covered. We have a member who claims they cannot be. Which interpretation is appropriate?

A: This sounds like you are referencing Washington State Law. Please ask your association's attorney for their informed opinion on this matter.

Q: Our CCRs are out of date and confusing. The board is unwilling to pay a lawyer to review any changes. Could the board merely adopt a policy document that covers their interpretation of the CCRs?

A: Please ask this question of your association's attorney. As a Reserve Study provider, my perspective is to spend the $ to get your Governing Documents updated, rather than "band-aiding" the problem.

Q: How do you overcome the argument that the particular homeowner or board member won't be there when the big project arrives, so they don't want to save for it or "pay" for it? Or they don't care to work towards being fully funded in 30 years because "I won't be here".

A: First, remember that in most cases their payment is not optional.. it is the board's job to set the budget to pay the bills of the association. As in the webinar, remind them that every month, they're only paying for the deterioration that occurred that last month. They're not setting aside a dime for the future. Help all your owners understand that everyone pays their fair share along the way, the future takes care of itself.

Q: In bid processes, it is rare I find that costs of replacement meet estimates from the reserve study. Why do National Reserve Standards usually reflect costs that are actually unrealistically small?

A: Usually that is because you are referencing an outdated Reserve Study. National Reserve Study Standards state that replacement costs are to be current and all-inclusive of permits, installation, disposal, etc.

Q: What about "hidden" infrastructure issues (e.g. 70 yr old buried drainage pipes needing repairs)? Should on-site Reserve Specialists roll up their sleeves and check out such issues?

A: Retaining a Reserve Specialist <u>does not</u> mean you can avoid the necessary involvement of other subject matter experts (structural, plumbing, asphalt, roofing, HVAC, etc.). More and more you are going to see your Reserve Study professional recommending that you retain other experts to provide input to the Reserve Study.

Q: **Investing reserve funds. If the reserve funds are invested in fixed-income securities that have maturities beyond one year, when interest rates go up, like in 2022, the value of the securities go down. Should the funds be left in money market funds to avoid that risk?**

A: Please ask this question of your Reserve investment counselor.

Q: **Our CC&Rs say that assessment increases over 20% in any given year must be approved by the majority of owners. Let's say that the roof fails, and the board needs to replace it, and the cost way exceeds what is in the reserve, but owners vote no. Can the board assess the owners anyway?**

A: Often budget increases are handled differently than special assessments. Check with your legal counsel for a clear opinion on this matter, and to find if "emergency powers" may be granted to the board.

Q: **When you have to use your reserve for a large expense do you have to use it all or can fund the rest with assessments? The fear is not to have any or enough left to build on for even smaller projects to handle.**

A: A Reserve Study provides a plan to perform your Reserve projects in a timely manner, not limping along crossing your fingers that some supplemental special assessments will pass. Plan your Reserves to provide for the property's needs. The money all comes from owners anyway, and it is fiscally responsible to be up-front with them and allow them to budget for what it costs to enjoy life in the association.

Q: **How far in the future (years) should be considered in a reserve study?**

A: At this time, Reserve Studies are required to include projections 20 years into the future. Expect that to go up to 30 years in 2023 with updated National Reserve Study Standards.

Q: **Does the reserve study tell us how much we should have saved each year (more than the minimum required for FHA). For instance, by 2030 we should have saved 220k?**

A: FHA, Fannie Mae, and Freddie Mac all want to see at least 10% of total budget going towards Reserves. They don't look at your Reserve balance. Look at your Reserve Study to see what the particular funding requirement is for your association, and how the balance will grow through the years to prepare for upcoming projects.

Q: **Is it ok for an HOA Board to determine what is an 'acceptable risk' for a Special Assessment and plan that into the Reserve Funding to deal with the 'mountains' if/when they materialize? This would obviously be documented in the HOA AGM minutes.**

A: My understanding is that the board can do whatever they want to do. Of course, that comes with consequences. Check with your attorney and your D&O insurance provider to learn the risks and consequences of doing anything other than following the Governing Documents and budgeting to meet the needs of the association.

Q: My board seems to think it is okay to cut the amount sent to the Reserve from the Operating Account. This occurs when there is an increase in expenses in the Operating Account. They seem to think it is okay to use Special Assessments to make up the difference but never get to what the Reserve Study is asking us to contribute. Last year, I finally got them to increase what the budget is sending to Reserves to decrease Special Assessments. But I am finding that they don't see the difference in how the money is getting to reserves. Comment?

A: The roof doesn't care, the asphalt doesn't care. They will fail pretty much on schedule, causing a cash flow crisis if the money isn't there when needed. And property values will decline as a result. Ignoring the true cost of homeownership doesn't change the reality of that cost. And homeowners are wising up to their ability to sue the board when the board fails to use their powers to fulfill their responsibility to budget for the needs of the association.

Q: How often are Reserve Studies prepared and how often is an onsite vs. remote study prepared? In other words, how often should we be reaching out to "Air Traffic Control"? with respect to Reserves?

A: Reserve Studies are only valid for one year. National "Best Practice" is to have a With-Site-Visit update every third year, with inexpensive No-Site-Visit updates in the in-between years.

Q: Please expand more on "danger of litigation" by giving an example.

A: Some of my expert witness work supports homeowners suing their boards who pursue the false goal of "low monthly assessments" instead of doing their job to budget for the needs of the association (not getting a Reserve Study, not following their Reserve Study, etc.) . When the result is special assessments and declining property values, it is an easy lawsuit to file and win.

Q: Beyond getting owners to serve on board, there's the problem of individuals with good experience. In this post-pandemic era with labor and logistics problems, how does a board get the proper navigation from its property management firm? Tired of being promised expertise, but a failure to deliver.

A: Perhaps it is time to get a new management company. Creating a pipeline of qualified board candidates is an important job of every boardmember… demonstrating competence, communication, and enough delegation that it doesn't look like a burdensome position.

Q: Our small building in Ft Lauderdale FL has 27 units…so fairly small. In the past two years, we have redone our roof, completed a concrete job with painting, and also new gutters. Sea wall 4 years ago…so our owners are tapped out! Will the state take this into consideration when mandating the new rule for funding reserves?

A: No. It sounds like yours is a beautiful, but expensive association in which to live. The cost of homeownership is what it is. The reality is that you may need to consider selling and moving to a less expensive home.

Q: If a loan is secured by association fees, in the event of one or more homeowner defaults would it still complicate a sales transaction/real estate closing?

A: Yes. The bank will use all its power to get paid back. If they fear lack of repayment cash flow (due to homeowner defaults), they may insist on higher monthly assessments for the remaining homeowners (the same higher monthly assessments that would have avoided needing a loan in the first place).

Q: What is a good route to getting a state like SC to make reserve studies a mandate, like VA and DE?

A: Reserve Studies are a responsible step forward in all 50 states. You don't need a law to get the information necessary to learn how much your association needs to set aside to offset ongoing deterioration. But you can apply pressure by being a member of the Community Associations Institute, and getting on your local Legislative Action Committee.

Q: If our reserves are underfunded, are we allowed to raise fees to catch up? If we have an operating surplus, can we transfer it into the reserves and not get in trouble?

A: If Reserves are underfunded, the board has a responsibility to raise assessments to provide the cash needed to offset deterioration and prepare for upcoming projects. Regarding lump sum un-budgeted transfers, generally that is not a problem, but it would be best to clear that with your association's accounting expert.

Q: Does FirstService manage HOAs in X (many locations submitted as webinar questions)?

A: Yes! Go to their website here.

Q: How do you combat Board members' perspective that they will not be in the community when those future expenditures happen so they do not care if it is funded?

A: Their job is to provide for the needs of the association. Roofing, painting, carpeting, elevators, asphalt, etc. deteriorates every year. Reserves pay for that ongoing, monthly deterioration. The future is not an issue.

Q: **How much should associations expect to increase their assessments this coming year?**

A: This year the increase should likely be in the 5-15% range, following inflationary trends.

Q: **It's a basic concept for LA fitness, car rental firms, hotels, etc., but as Robert said, not for HOAs. How do you change the attitudes of HOA board members who only see their annual dues and that they won't be around when the big expenses hit?**

A: Lead your association well. Make sure your association has a sustainable budget, just like is required in the Governing Documents. Those expenses are all going to happen, and they are predictable. Let your owners prepare, and not be surprised, with ongoing assessments that care for the property, maximize property values, and protect them from unsettling and undesirable special assessments.

Q: **What are the credentials for a reserve study professional?**

A: There are two. The Reserve Specialist (RS) is administered by the national trade organization "Community Association Institute". The other is the Professional Reserve Analyst (PRA), administered by the trade organization "Association of Professional Reserve Analysts". They are roughly equivalent credentials.

Q: **What can an association member do if the HOA board continues to underfund road reserves and the reserve specialist company buys into the obvious component replacement underfunding parameters?**

A: Set aside funds towards your own "special assessment" fund. It will happen. And lobby for a Reserve Study professional with a backbone to tell the truth, to help the association prepare for known upcoming expenses.

Q: **Is it more favorable for the HOA to establish monthly dues vs. annual dues? What is the overall norm for a small association (12 homeowners)?**

A: Neither has a strong advantage. For small associations, it may simply be less bookkeeping to collect the income once a year. But 12x/yr is easier on owner cashflow.

Q: **How should an HOA vet reserve study professional's performance?**

A: Look to ensure they are credentialed (RS or PRA), and ask for sample report (or view one on their website) and ask for references.

Q: **What % of your clients are reserved at 80%+ of recommended reserves?**

A: 70% Funded is the normal threshold for defining an association with a "strong" Reserve Fund. In the last three years, 24.6% of our clients were at or above the 70% Funded level.

Q: **What happens if the Homeowners keep voting NO to an assessment and what are the best practices to present a special assessment to the community?**

A: If homeowners have that kind of budget control, that is unfortunate (owner ability to waive Reserves is shortly going away in FL). We've seen many cases where the board obtains special powers from a local judge to levy assessments for "safety" reasons. Contact your attorney to inquire about that possibility. Seriously consider selling, as property values at deteriorated properties always suffer (get out before it gets worse). But in general, best practice is to increase assessments every year, and communicate regularly and openly to the owners that Reserves just offset ongoing deterioration (they are not a gift to future homeowners) so they know where the funds are going (and how costs are increasing!), and have a healthy turnover of boardmembers so owners see that the are a trustworthy group of individuals and not an evil/secret "cabal" trying to "take their money"!

Q: **How do you recommend approaching HOA homeowners regarding increasing dues significantly?**

A: Communicate clearly and regularly. Be transparent with income and expenses (association finances). Remind them of inflation, and that Reserve funding is for ongoing deterioration… not a penny of it is being set aside "for the future". It just covers deterioration, a month at a time.

Q: **How are reserve funds typically invested?**

A: Safe (no potential for loss of principal) interest bearing accounts. See more in our recent "Investments & Inflation" webinar here.

Q: **Can you recommend where to place the reserve funds to earn the highest return? What about CD's do you recommend using them?**

A: Please contact a community association investment counselor. You can get some ideas on our recent "Investments & Inflation" webinar here.

Q: **Do you have any experience with communities investing in solar systems for eliminating common area electric bills thus adding to the funds available for reserves?**

A: Yes. Any capital improvement is a non-Reserve expense, so it needs to be done with Reserve funds that are borrowed, not used. So do the project, repay Reserves, and enjoy the improved cash flow for your association. We've seen this done for common area lighting improvements (saving electricity), digging a well (to reduce water bills), solar systems, etc.

Q: **My property had a professional reserve study conducted and our Reserves are currently 23% Funded. This seems low, but the BoD feels that this is perfectly acceptable and is unwilling to raise fees to increase funding. Thoughts?**

A: Anything in the 0-30% range means there is a relatively high chance of a special assessment in the next three years due to having insufficient Reserves. See here. It is best to build the strength of the Reserve Fund so it is better prepared to support the Reserve projects getting done in a timely manner.

Q: **We are responsible for storm drains, sewers, water system, streets, etc. How do we determine the remaining useful life of the invisible assets?**

A: Hire a Reserve Study professional to create the framework of the Reserve Study and inventory and evaluate your streets, and expect to hire an expert plumbing or drainage specialist to provide guidance about your drainage system.

Q: **In Florida, are condos with 2 stories required to be 100% funded by the end of 2024?**

A: No. So much misinformation about Senate Bill 4D. The higher requirements are for buildings 3-stories and taller, and the big news is that FL association homeowners will no longer be able to veto board Reserve funding. That is a far cry from being required to Fully Fund the Reserves, and a far cry from being "Fully Funded" by 12/31/24.

Q: **When we say that a member is paying their part of the deterioration, they say that they paid it already because they paid the special assessment to put the roof on. How do you overcome that statement?**

A: It's unfortunate they got hit with a special assessments for that roof, that the prior owner didn't pay for. In a stand-alone home, the home inspector will suggest a price adjustment due to an aged roof. But this is not a stand-alone home. The way everything stays fair is to grow replacement cash in Reserves at the same rate that deterioration grows. Note that new buyers are more commonly looking at the Reserve Study and asking for a price discount if Reserves are underfunded. So current owners should be responsibly funding their Reserves, or preparing for a buyer to ask for a discount. Even if you tolerated paying for a special assessment for a roof that you didn't "use up", new buyers have no interest in paying a special assessment for a roof you used up.

Q: **How do you deal with the argument that current unit owners are not likely to be living in the community in 20 years and so let those future unit owners deal with the replacements that are needed then, just like the unit owners of 20 years ago left the replacements up to them today?**

A: Again, it's the board's job to budget for the needs of the association. Legally, they really don't have a choice. Owners thus have an obligation to pay for the deterioration that occurred during the time they owned a home in the association. Home values suffer if Reserves are low or if maintenance or repair & replace projects have been deferred. It is always more cost-effective to care for the home on an ongoing basis. Funding Reserves pays for itself in maximized home values.

Q: How do you deal with a community of owners who are quite elderly and believe since they don't have long to end of life, planning ahead is not a concern?

A: It is the board's job to manage the affairs of the association, setting a budget that provides for the sustainability of the association for current and future owners. They don't really have a choice. Reserve funding offsets ongoing deterioration, it is a bill like any other bill at the association, part of the cost of living at the association. If boards fail to budget per their job responsibility, current owners living longer than anticipated will face a big special assessment they cannot afford to pay, losing their homes. Better for all involved to pay the bills along the way.

Q: Is an engineering or architectural evaluation a legitimate reserve expense?

A: They typically pass the National Reserve Study Standards four-part test to be a component, so generally "yes".

Q: When would you recommend that an HOA dissolve?

A: Sorry, that's a better question for your attorney.

Q: What if the Property Manager is part of the problem? They think that reserve studies are a waste of time and are costs for the future. Any ideas as to how to counter?

A: Two thoughts. The board is always in charge. First, thank the manager for their opinion, and get a Reserve Study. Then #2, get a new manager (or management company), as clearly that manager doesn't have the best interests of the association in mind. That manager wants you stumbling forward into the future without a plan. That's reckless.

Q: Do special assessments have to be figured out at the same time the operating budget is done? Some members of our board and trying to rush this through now at the time we are simply trying to finish up the operating budget currently.

A: The budgeting process should include the Operating needs of the association <u>and</u> Reserve needs of the association. Then you figure out how you'll pay all those bills. If the bills are too huge to cover with ongoing assessments, then you unfortunately realize you've joined the "whoops – we need a special assessment" club.

Q: Are there any state requirements for minimums for reserve levels?

A: Most state laws address Reserve Study preparation or Reserve Fund disclosure requirements. Only two states, to my knowledge, have Reserve funding requirements (HI and MD). Check with your attorney to be sure.

Q: Is there any difference in using your DIY study for a budget planning vs a professionally-prepared reserve study based on an on-site inspection by a credentialed Reserve Study professional?

A: Yes, a huge difference. The foundation of every Reserve Study is the component list. In a DIY product, the component list is provided by the client, and is used without review or edit by a professional. You may be lucky and have "most" of the components listed, with correct estimates for useful life, remaining useful life, and current cost, or you may not be so lucky. And what are the owners to think? They can have confidence in a Reserve Study prepared by a credentialed Reserve Study professional, but they may fight the Reserve increases based on something based on an "in-house" component list. Credibility and accuracy is a big deal.

Q: Is Reserve Spending and funding typically overseen by a designated officer/director?

A: It is always the responsibility of the board, overseen by the manager. Commonly there are leaders on the association side of things… either the treasurer or a "Reserve Budget Committee" handling the details and reporting to the board.

Q: What do we do about items that have been paid from operating but were really reserve projects and vice versa?

A: After the fact (before the end of the month or the end of the year), you can create transfers to rectify the issue. Either way, it is still homeowner money and still projects that needed to be done.

Q: Special Assessments require more than just the Board decision? (I thought I heard you say that all of the homeowners need to agree)

A: Governing Documents and state law dictate how special assessments are passed. In many cases, the board has limited power to implement small special assessments, but require owner approval for larger special assessments (of the magnitude typically needed when the board realizes it doesn't have enough cash to perform a necessary Reserve project).

Q: Our board borrowed from reserves two years ago and the new board has not paid it back in full. What can owners do to see this is rectified? Apparently, it is also not legal in California.

A: Correct. In CA, borrowed Reserves are to be restored within 12 months (Civil Code 5515). As a homeowner, you have little power. Bring this up regularly at board meetings, expressing your concern that Reserves will be inadequate without funds restored, and making it clear that you support the higher assessments necessary to repay Reserves and avoid an upcoming special assessment.

Q: When conducting a reserve study, where do you come up with the actual cost?

A: Due to the large number of clients we serve, our primary source of repair and replacement costs are the "actual" expenses experienced by our own clients – ones in your city or neighborhood with similar assets, served by similar service providers.

Q: We are preparing the budget and the assessment increase we can do without votes is 5%. Inflation is killing our reserves - how do we sell that increase to owners?

A: Say that you are sorry, that "inflation is killing us all", making it clear that the association needs additional cash or property values will suffer and special assessments will be the result. Make it clear that you see the bills, you know this has to happen, and that you will have to pay the same higher monthly assessments as everyone else. Invite others onto a "budget committee" to help study the problem (you don't have to carry the entire burden of responsibility yourself). Communicate clearly, regularly, and honestly.

Q: If a majority of homeowners approve a special assessment but there are a few who do not or cannot pay, what can be done? Monthly assessments were too low for too long and now there are insufficient funds to fix the leaky roof. As a new president and homeowner who inherited this problem, what can I do?

A: Sounds like you'll be saying "goodbye" to some homeowners who have to sell and move to less expensive housing. Prior boards let them live beyond their means for too long, undercharging them for the cost of living in the association. Now you've got a mess on your hands.

Q: One approach to dealing with future expenses is to eliminate them. Are there any legal ramifications with eliminating amenities like a Jacuzzi to reduce future assessments?

A: Yes. The boards job is to protect, maintain, and enhance the assets of the association, not gradually prune them away. You may be able to have only one "unisex" sauna or bathroom, but you're going to run into legal problems eliminating a pool or roof or entry gate or…

Q: How do you beef up the reserves if you're already behind if you don't want a special assessment?

A: Increase assessments each year. We call this the "exercise plan". Tackle a multi-yr plan (usually it just takes 3-5 yrs) to raise your Reserve funding giant step by giant step. Hopefully you can do that before your Reserve projects need to be accomplished. Check with your Reserve Study provider to work out a plan.

Q: Why does the reserve study need updating if done correctly in the beginning?

A: Because a Reserve Study is a projection of future events, all of which are in a constant state of change. Weather, the size of the Reserve Fund, the quality of materials used in construction, quality of construction, wear and tear by homeowners, delinquencies at the association, Reserve projects that are higher or lower than expected, and interest and inflation that are higher or lower than expected. You don't just look at the weather report on Jan 1 and say to yourself "well, now I know!" You look regularly, to get the latest information.

Q: If an association had a reserve study completed say 4 years ago, is there such a thing as a refresh of that study? Is there a reduced option in cost to provide them with an update?

A: Yes – after the "Full" Reserve Study (usually only needs to be done once), there are two Update products, the Update With-Site-Visit and the Update No-Site-Visit

Q: Are there different types of reserve studies? What is a general range of cost for one? Say, for a 250 unit community of townhomes that are 40 years old.

A: There are three types of Reserve Studies: a Full (created from scratch), an Update With-Site-Visit, and an Update No-Site-Visit. Generally a "Full" only needs to be done once, and regularly costs in the range of 1% of the association's annual budget. Update With-Site-Visit and Update No-Site-Visit reports are significantly less expensive.

Q: We have a Reserve study being done by your company at this time. HOA members refuse to understand the reasons for the reserve study. Best way to communicate the need for reserve study and to accept the professional reserve study findings?

A: Make it clear that the common area assets are deteriorating every month. The Reserve Study tells you "how you're doing" with respect to your Reserve balance (do we feel good about it, fair, or scared?), and "what you should be doing" with respect to Reserve funding – guiding the association to budget sustainably to offset ongoing deterioration and prepare for upcoming major projects. I guess bottom line is that funding Reserves prevents both unwanted and unsettling special assessments, and helps them make money by maximizing their home values.

Q: As silly as it sounds, what happens if the building is not covered with 100% Reserves by 1/1/2025?

A: If you are concerned about new legislation in FL with a 12/31/24 deadline, no worries. Nothing in the law mandates you be "Fully Funded" by that date. The primary feature is that owners lose their power to waive Reserves, allowing the board to follow the multi-yr plan recommended in the Reserve Study, which likely will project a much longer time span to build up the strength of the Reserve Fund (dodging special assessments along the way!).

Q: **The 12.6% home value boost that was mentioned in associations with a strong Reserve Fund, is that based on the total value of all of the properties?**

A: No. That was a direct comparison of individual condo sales on a $/Sq Ft basis in a uniform neighborhood full of different, but similar 2 and 3-story condo buildings. Condos sold for more $/Sq Ft in associations with a strong Reserve Fund.

Q: **If an expense is on the Reserve Study, but the Board wishes to pay it from the operating, instead of the reserve account, is there any issues with doing so?**

A: No problem. Perhaps best to run that by your Reserve Study provider and your treasurer, so it only is being budgeted one place (Operating or Reserves), not both.

Q: **We're re-doing our Elevators this year (A to Z). We're using up all Elev Reserves, plus a loan. By 1/1/2025 do the Elevator funds have to be 100% funded again, if they'll not be done for another 30 years?**

A: This sounds like a FL question, as the new SB 4D speaks to a 12/31/24 deadline. The answer is no, but your fears are unfounded. 100% Funded means you are "on pace" to be ready for the upcoming expense, not that you have all the funds on hand. In simple numbers, if your elevators are $150,000 ea to modernize, and have a 30-yr life, at the one-year old point, they would be Fully Funded if you have 1/30th of $150,000 on hand, or $5,000. No big deal.

Q: **If your reserve funding level has fallen from 50% to 35% over six years, and you've had two major special assessments, and the 70% funded level won't be reached for 30 years, what resources do you recommend sharing with fellow members to get their attention on the problem?**

A: We can bring a horse to water but we can't make it drink. If the board fails to follow the Reserve plan, inviting special assessments, they also invite personal liability exposure and are doing themselves and the owners an additional disservice by causing property values to lag. I suggest asking the board to hear their attorney's opinion on what happens if they continue to ignore recommended Reserve funding advice, and you can always point them to our research on how home values are maximized with a strong Reserve Fund. Curb appeal is real, folks!

Q: **Our Reserve Study fails to include as components, or in any way even mention or account for, two very expensive items which our 45 year old "aging infrastructure" community is now facing:**

1) Replacement of 23 main electrical panels which have been known to the Board for 5 years to be obsolete, failing and in need of replacement;

2) repairs or likely total replacement of around 30 wooden carport structures that are, not surprisingly, seriously deteriorating and structurally failing. The replacement of the torch-on roof membranes for the carports are reserved, but

inexplicably, not the structure itself! Again, Board knowledge of this issue for 5 years or so.

How is it that the Reserve Report from a fully accredited "specialist" somehow misses the two largest expenditures the HOA is now having to deal with? The last "onsite inspection" was one year ago. Not until I flagged the main electrical panels issue with the reserve consultant did the Reserve Report for 2023 now include a line item and a tentative Reserve of $10k - knowing full well the Board had already gotten some preliminary cost estimates of between $175k and $350k. And - to make matters worse - the reserve report DOES include a line item for "electrical subpanel replacement for each unit" and this work was done about 4 years ago!!! When asked about this and other items not in the Component list - our Community Manager (again fully accredited with the highest level credentials) says that "it's up to the Board to decide what ends up on the Component list. The consultant advises and the Board decides." I almost died when I heard this. The potential for a highly manipulated Reserve study speaks for itself. Your comments??

A: Your story is unfortunate. There are various competencies among both credentialed managers and credentialed Reserve Study professionals. In my experience and world view, that as you suggest, the board decides based on what their advisors recommend. But I would like to believe the Reserve Study provider would do a better job of identifying the significant predictable expenses at the association.

Q: How do you recommend that the conversion of grass areas to "desertscape" - at significant cost even after allowing for subsidies - should be funded, and dealt with in future Reserve studies or operating budgets? Adding new irrigation systems, sod removal, rock boulders, plantings etc are all very significant departures from grass. And desertscape does require plant renewal and ongoing increased costs that may or may not exceed any $ saved on water usage.

A: Commonly landscaping refurbishment qualifies as a Reserve component, so it can be funded and accomplished through Reserves. Converting from "turf-based" landscaping to something with significantly lower watering requirements can be attractive and cost-effective. Talk to your Reserve Study professional to suggest this is in consideration, and they will evaluate if it meets the National Reserve Study Standards four-part test at your association.

Webinar Questions Asked By 2021 Attendees

Q: How can reserves be invested to increase the balance?

A: Reserves can and should be separated from normal Operating Account funds. Reserves should be invested under the philosophy "Protection of Principal" (meaning investments only such that the principal balance can never go down). Note that maximizing interest returns are a good idea, but maximized returns should never have a higher priority than protecting the integrity of funds on-deposit.

Q: Please explain how calculating Reserve contributions using the "Pooled" (Cash Flow) method can result in lower contributions than the "Straight Line" (Component) method.

A: With exactly the same expenses to fund, that's a great question. Over the long term, there is no difference. But in the first few years, there can be a huge difference, as we show here.

Q: What is a good method of catching up, if underfunded, without raising monthly fees too much?

A: Incremental annual increases. We call it the "$10 Solution". Read more about it here.

Q: How do you itemize that $10 extra per month in your reserve study?

A: It's just $10 higher Reserve contributions. For instance, that means your $350/mo homeowner assessments rise to $360/mo, in order to accommodate your $35/mo Reserve contributions rising to $45/mo.

Q: Our reserves are extremely underfunded (10-12%). Moving overnight to a fully funded or close-to position is unthinkable. What ways can you suggest to gradually improve our position? I have heard of special contributions to reserves from Owners when they sell or alternatively special contribution to reserves of New owners. What do you think?

A: As stated above, implement the "$10 Solution" plan. That is something you can control. Please check with your association's legal counsel before launching any new fees. And please be reminded that you can't control that income stream… it is dependent on sales transactions that are notoriously unpredictable through the years (strong in some years, weak or absent in other years).

Q: Our waterfront association is in the process of replacing our bulkhead and will need to make an assessment. The replacement was not included in our original reserve study (years ago) because we knew the replacement was near and it would have greatly skewed the study. Is it OK to "borrow" money from the Reserve Account to help fund the replacement if we reimburse the fund once assessment money is received?

A: No need to call it borrowing. If the asset is a Reserve Component as defined by the National Reserve Study Standards (NRSS) four-part test, it is a legitimate Reserve expense. A Reserve expense is not defined by appearing on your Reserve Component List (or not). That only dictates your contribution calculations! Spend the funds from Reserves, update your Reserve Study, and expect a considerably adjusted Funding Plan.

Q: How do you calculate Fully Funded Balance?

A: Please see here and here (p3). For additional information, watch our "Reserve Studies 102" webinar (or read the webinar outline) which you can find here.

Q: How many real estate agents really use Percent Funded number during a sale of a condo?

A: Very few. Even so, Percent Funded is a wonderfully useful metric, right up there with % owner-occupied (who lives there) and % 60-day delinquencies (how good is the board doing managing cash flow from the owners). We are busy training boards and owners, so they know which documents to request and what questions to ask!

Q: This is probably a Reserve Studies 101 question, but could you review how to calculate a minimum threshold amount; is it 1-3% of the annual income of assessments?

A: Yes, that is covered in both our Reserve Study Basics and Reserve Studies 101 webinar curriculum. You can find the written outlines and recorded webinar here. For all but very small or very large associations, that minimum threshold of significance (above which a trivial periodic project should more appropriately be budgeted through Reserves) is in the range of .5% to 1% of the association's annual budget, or the board or manager's "signature authority" for expenditures. That means for a $500,000 annual budget, a starting point for considering your Reserve threshold is in the range of $2500 - $5000.

Q: **If reserves are funded below a certain percent (i.e. <20%) is the ability for homeowners in the HOA to get a mortgage or refinance their home impacted? Are there other legal consequences to be aware of as they plan to boost their reserve fund?**

A: Let's be careful. Major lenders look for Reserve contributions to be at or above 10% of total budget (if your total budget is $500,000/yr, they want to see $50,000/yr going to Reserves). Yet it is likely *far more influential* that they know the actual strength of the Reserve Fund, reported in Percent Funded. But they're generally not asking that question. Reserve contributions and Reserve fund strength should be considered when talking about Reserve adequacy, as you can read here. One is cash going to Reserves, one is cash in Reserves (available to sustain the common area assets).

Q: **Why don't more reserve studies capture the maintenance and costs expended on reserve items in the past? Also, there is often yearly maintenance items, such as elevator inspections and service, that impact longevity. Where is this captured?**

A: Many Reserve Study companies capture this information and report it in their component detail information. Reserve Study companies continue to find a balance between capturing an overwhelming amount of background or related information, and the "bare bones" of key information.

Q: **How do we motivate uninvolved owners?**

A: Communicate regularly and in multiple ways (mail, email, newsletter, signs, community forums, Memorial Day or 4th of July gatherings… etc.). Build the reputation of the community and remind them of all that is going on to run the business of their association (landscape choices, janitorial choices, new pool-side furniture coming in June, etc.).

Q: **How to make sure homeowners understand what boards need to be doing? They only seem to look at what the monthly cost is and don't understand this whole process.**

A: See above. Communicate regularly and in multiple ways. Establish committees, where time involvement is minor, and they can feel like they are contributing to creating a great future for their association, protecting their investment and keeping it a nice place to live.

Q: Boards generally feel uneasy having more than $100k of funds in the bank. They start to splurge and spend it on the wrong items. How can they be reined in?

A: Remind them of their Percent Funded… the ratio of cash in the bank to cash needs of the association. That $100k might look mighty tempting ("look at how much money we have!") until you realize the Reserve needs of the association are now $457,922 (because of upcoming asphalt and roofing and boiler replacement projects). Then that $100k looks mighty small!

Q: Your comparison of costs for the roof - reserves vs special assessment vs loan was eye-opening. Is an increase in costs of 1/3 unusual?

A: Not unusual. In rough numbers expect it anywhere from ¼ to 1/3 more expensive to have your owners pay for a project through a loan instead of ongoing contributions. If you truly wish to keep Reserve contributions low, you'll set them appropriately through ongoing contributions, so all Reserve deterioration is offset on an ongoing basis.

Q: Can Reserves be used for renovations in a HOA owned unit used by a caretaker?

A: Yes, if the projects pass the NRSS four-part test. That is likely the case, if it is a HOA unit, and you wish to schedule kitchen renovation or bathroom renovation or new carpet or paint every x years. Very reasonable.

Q: How do you define a "strong" reserve?

A: See here. Generally it is 70% Funded or above. And remember that you'll need the ongoing Reserve contributions to keep it there! See more in our Reserve Studies 102 webinar (outline and recording can be found here).

Q: How do you compel homeowners to get the Board to do a reserve study or to put all components in the reserve (beyond the few specific items in regulations)?

A: It's the board's job to lead the association forward. If they are short-sighted, that is unfortunate. There are likely to be special assessments and lagging home values. The board needs to appreciate that they serve like the flight crew of a commercial airliner, not passengers sitting casually looking out the window in seat 23A.

Q: Have you seen owners compel a board to budget for reserves?

A: Not to my knowledge. I've seen managers threaten to abandon the account if the association doesn't have a Reserve Study and budget responsibly (because otherwise the association will become a nightmare account), and I've seen attorneys state in writing that the board has significant liability exposure if they continue to move forward without a Reserve Study or Reserve funding or both. But owners do have a say. It is those motivated owners who then run for open Board positions and implement sound financial practices.

Q: What interest rate did you use in the loan slide?

A: 7% interest over 7 years, plus 1.25% loan origination fees.

Q: The useful life of some of our HVAC has reached their end of the Remaining Useful Life. It is still working with significant corrosion and dirt. Our Property Manager suggests to the Board that we don't leave any useful life in the table. We had a Mechanical Audit Reserve Study done and it estimates the HVAC still has 2 years of remaining useful life. Isn't that risky relying on an estimate of useful life?

A: Good for you to have a Mechanical Audit done to update your estimate on the Remaining Useful Life for your major mechanical equipment. Please be reminded that all Remaining Useful Life estimates are just that… estimates. Different components "fail" differently, and implications of "failure" are also different depending on the component. See here. From what you've said, it seems reasonable to move forward another year without performing the project. Consult with your Reserve Study professional, and have your HVAC systems technician review it again. Failure during the summer would be something you'd want to avoid, so there is some reason to replace "early". Another reason to replace "early" is if you can replace with a new energy-efficient unit that will begin to "pay for itself" in energy savings.

Q: What percentage of the recommended reserve fund is typically funded by HOAs?

A: We don't specifically track the "compliance" factor, comparing what our clients actually budget for Reserve contributions compared to what is recommended. In some informal feedback (webinar audience polls), we believe the literal compliance is about ¼ to 1/3. Because so many associations are feeling budget pressure to not follow the recommended Reserve contribution, we developed uPlanIt, our online Reserve Study calculator tool. uPlanIt allows the user to test various "what-if" scenarios, to make sure any adjustment they make is not going to cause future problems.

Q: **For associations who do not wish to fund the reserve at 100%, what is a typical goal? 60-70%? This is assuming homeowners are okay with some kind of assessment every 6-10 years for milestone projects.**

A: Please see here to consider your risk factors. The statistics seem to support the idea that if you wish to keep your special assessment risk down at or below the 10% level, you need to keep your association above 50% Funded.

Q: **Your thoughts about a bank loan to fund a project today?**

A: As I stated in the webinar, it is an alternative to an unpalatable special assessment, but it is a very expensive way to fund predictable Reserve projects.

Q: **Are there any ways to finance new roofs for an HOA that has not put away enough to pay for them en masse (special assessment)?**

A: Some banks serving the community association industry have loan programs (which are an expensive way to pay for a project, as mentioned in the webinar), and some service providers may have payment terms.

Q: **Are those transactions fees allowed by law?**

A: Yes. Bank fees have existed since the beginning of banks.

Q: **What would the ideal time of year be to request a reserve study? Maybe after 4th quarter numbers come in or is it not dependent on the financials, so to speak?**

A: A Reserve Study is fundamentally a budget preparation tool. A good schedule is to begin considering Reserve Study proposals six months in advance of your Fiscal Year End, in order to get the Reserve Study started four months in advance of Fiscal Year End, in order to have it in your hands two months before Fiscal Year End (when you should be busy updating your budget for the following year!).

Q: **Is there a general rule of thumb to know what Percent Funded your reserves should be every year?**

A: A strong Reserve Fund, where the association has low risk of unsettling cash flow events, is 70% Funded or higher. It is good for an association to stay in this range, adjusting their Reserve contributions so their Reserve contributions offset ongoing deterioration, and the funds exist on-deposit to perform your Reserve projects in a timely manner.

Q: Do we really need to have 100% funded reserves?

A: No. Measurable absence of special assessments begins when the association is above 70% Funded, which you can see here. Being 100% Funded remains a responsible target, because it is the center of the bulls eye. When surprising events occur to an association that is "Fully Funded", their Reserves are usually strong enough to handle that expense without a special assessment that might be necessary in a similar association with a weaker starting point. And remember Reserve adequacy requires a combination of a strong Reserve fund and strong enough ongoing Reserve contributions to keep that Reserve fund strong.

Q: How does a Board project funding for water and sewer repairs, upgrades and replacement? Roads are easier since road paving contractors can assess timing of repairs and full resurfacing. Who can assess something they can't see underground?

A: You may wish to enlist the services of a specialist – someone with remote camera technology. Please understand that not everything is predictable, so you may have to get comfortable with some unknowns and some levels of uncertainty. The point of Reserve planning is to minimize the number of surprises in an association's future, not completely eliminate surprises.

Q: Is there any FL law that relates to adequate reserves?

A: Legal questions should be directed to your local legal counsel, but my understanding is that FL law relates to minimum Reserve Study preparation standards (a minimum list of components that should appear in the Reserve Study…), not Reserve adequacy.

Q: Is there a minimum percentage you recommend for monthly reserve contributions as a percentage of the monthly dues taken in?

A: Most associations need to set aside 15-40% of their total annual income towards Reserves, with the most common amount being in the 25% range. Every association is unique, and they find that % in their Reserve Study. See here.

Q: **Any best practices on how to update or manage your reserve reporting as components are repaired? I find it challenging to manage the planning and budgeting part of it as things change each year with their contributions and what components were completed.**

A: Keep a file or a log for the expenditures. The annual budget and your annual financial statement should be a good enough record documenting the actual funds (compared to budget) that were set aside. And we recommend tracking the Reserve Fund as a whole (the Cash Flow method), not tracking individual Reserve Fund "accounts". See more here.

Q: **How are the repair and replacement costs estimated or calculated? Often, we get a reserve study that has numbers nowhere near the actual cost. For example, we got a roof repair estimated at 35k when in reality it was closer to 250k due to the type of roof (rock) and the need to remove the rocks/logistics and sq. ft.**

A: Your experience is unfortunate. Some providers reference a standardized "cost estimating" resources. Those are generally reliable. Our firm takes it up a notch by comparing to actual costs experienced by similar associations in your area, and your own association's expenditure history (we have some clients we've been assisting for over 30 years). We find most cost estimates that are significantly low to be from one of three factors: they are many years old, they were identified/scoped incorrectly, or they have unique property factors (poor access, etc.).

Q: **What is required of a BOD to use reserve funds when their reserve contributions were calculated using the pooled (Cash Flow) method?**

A: The same as when their Reserve contributions were calculated from the Component (Straight Line) method. Make sure the expense meets the NRSS four-part test and aim for the amount budgeted in the Reserve Study.

Q: **Any special information relating to the big freeze?**

A: We are finding that the "big freeze" in TX affected some paint processing plants that make a particular ingredient found in many paint types. This has affected the cost and availability of a large number of paint brands and types throughout the country, so your paint projects might be a bit more expensive this year.