Aug 23, 2023

Get on Board: Successful Strategies for Funding Reserves

by Robert M. Nordlund, PE, RS www.ReserveStudy.com

Miss the webinar? Watch it here.

"Get on Board" is a webinar we created to help you have Reserve funding success at your association. Audience comments from prior webinars pointed out interest in a webinar dedicated to applying the Reserve Study concepts we've addressed in other webinars at their association. So this webinar is all for you – to help you clearly understand and articulate the challenges you face offsetting deterioration, sharpen your skills in using the tools at your disposal (budget and communication strategies), and then clearly present the benefits from Reserve funding that are waiting for you to savor.

The webinar starts by reminding the audience that Mother Nature and Father Time are forces not to be taken lightly. They are at work, gradually but consistently, trying to take your property down to the ground. And they will succeed unless you put up a good defense. But fortunately, the Governing Documents at your association give you all the power you need. We then add a little encouragement and strategy, to make sure you have success.

We then spend time in the webinar arming you with strategies to lay out clear positions and arguments for Reserve funding, to boost your courage and settle your nerves. "Doing the right thing" is in your power, and in this section of the webinar we show you how to overcome a number of real-life challenges.

Finally, we draw the webinar to a conclusion by articulating the benefits of responsible Reserve funding – the rewards the board *and all owners* get from their association being one of the 30% across the country that are successfully keeping up with ongoing deterioration. These benefits are both emotional (quality of life) and tangible/measurable (higher home values). Two ways to enjoy the fruit of your hard work!

You're not in this by yourself. We help thousands of associations each year find out where they stand, and what to do from this point forward. We do this by preparing reliable, cost effective Reserve Studies in compliance with National Reserve Study Standards that guide our clients toward an improved future.

Enlist the support of a team that has prepared over 70,000 Reserve Studies for clients in all 50 states over the last 36+ years! Launch a free online proposal request by clicking here. Or click here to see our network of offices across the country (serving clients in all 50 states!).

Est. 1986

ASSOCIATION RESERVES™

Planning For The Inevitable™

Over 70,000 Reserve Studies Nationwide

Webinar Questions Asked By Attendees

General Reserve Questions

Q: Is a reserve study based on Savings account, or Savings + Operating accounts combined?

A: Just the savings (Reserve) account. The Operating account is needed for Operational expenses.

Q: I get pushback that common area expenses should always be paid for out of Reserves vs budgeting for them from Operating especially if they are known costs that will be paid in under a year. Does it matter if it is an Operating Budget Expense or Reserve Expense? Still being paid from the same bucket of money.

A: Owner money is owner money, and bills are bills. So, they come from the same place, and they go to the same place (care and operation of the association). But it is prudent to pay for and budget for Operational expenses from the Operating account, and Reserve expenses from the Reserve account. That's how you maintain financial order and are able to plan for upcoming expenses. Every expense should be preceded with the question "How does this fit into the budget?" Then you can look and see if (for instance) poolside furniture is an Operational Expense or Reserve Expense, and you can pay for it from the correct "fund". Otherwise, you'll never know where the association stands financially.

Q: What about wanting to increase the amount of Reserve funding but some owners/Board members are concerned about our assessments being higher than other associations in the vicinity, especially when potentially selling a unit?

A: Your responsibility is to budget to sustain the association, not to budget to match assessments with other adjacent properties. Every property is different, and has different needs. In addition, if other associations are failing to adequately fund Reserves (as is all-too common), you can smile all the way to the bank as your property values increase because local Real Estate agents <u>know</u> those other associations have special assessment reputations, and your association is in such better physical condition.

Q: What about the lack of getting appropriate interest on Reserves balance?

A: By all means maximize your interest, earned on safe investments (no loss of principal). Remember that interest will always be outpaced by inflation, and in addition, inflation works on the entire project cost while interest is earned only on the cash sitting in the bank. That difference is built into your Reserve Funding plan. Expecting to offset inflation with interest has always been, and always will be, an economically and mathematically unrealistic expectation.

Q: Can the board have different responsibilities for common grounds vs. "limited common grounds"

A: That's best discussed with your attorney, who has studied your Governing Documents. Generally, all "common areas" (limited to use by one owner or open to all owners) is the maintenance responsibility of the association.

Q: How can I persuade my board to get an annual update for our Reserve Study? I'm in CA, but my board only wants to update their Reserve Study every 3 years.

A: Remind them that the annual Civil Code §5570 "Assessment and Reserve Funding Disclosure" requires updated Reserve Study results. So, the association cannot file that required form without a Reserve Study prepared for that year. Getting in compliance requires just the small cost of a "No-Site-Visit Update" Reserve Study in those "in-between" years.

Q: What about the members that say "we don't use the common area"?

A: Usage is immaterial. All owners are required to pay their fair share as defined by the Governing Documents. First floor owners can't avoid paying for the roof over 9th floor owners, and people who take public transportation can't avoid paying for the garage door openers. Everyone in the community is bound to pay as stipulated by the Governing Documents.

Q: Would you put up the slide of Boards who are responsible for million $ properties and they are inexperienced - What could go wrong?

A: Glad you enjoyed that slide. Champlain Towers South is a great reminder of how precarious this industry is… relying on the effective leadership of untrained volunteer boards of directors.

Q: Do you have examples of executive summaries of good reserve plans?

A: Yes. Please see our website here. The sample Executive Summary is just behind the Table of Contents, and contains a page of text and summary numbers, then a page showing the Component List. That pairing is typical throughout the industry.

Q: Based on your industry knowledge, do you anticipate any regulatory requirements relevant to reserve funding in the future?

A: Yes. Legislators nationwide are concerned about avoiding tragedies in their state and are tightening up Reserve Study or Reserve Funding requirements. Fannie Mae and Freddie Mac are also tightening up their lending standards. And look for a national scoring system to emerge by which all associations will be measured (like a personal FICO score). See more here.

Q: What is the standard for charging a year of HOA assessment to all new buyers to the association?

A: There is no standard. Some associations charge a "welcome fee", some don't. That is an unreliable income stream (it depends on how many units/homes are sold per year, which can vary greatly), and it sends the message that homeowners aren't paying their fair share… they're relying on newcomers. In other words, it is asking the wrong people to pay. People using up the common areas while they gradually deteriorate should pay for the deterioration that occurred during their time of ownership. It's only fair.

Q: Should the complete reserve document be available to owners?

A: In my opinion, yes. Many (most?) associations proactively send the Executive Summary to owners at budget time of year, making the entire Reserve Study available (on their website, or upon request).

Q: Due to the new laws in our State, our Reserve funding will increase. That's in addition to the rising cost of insurance on the building. This is going to be a significant increase. What is your suggestion for the board to reply when the unit owners who are on a fixed income say they can't afford the increase?

A: Tell them the bills are what they are, and like any other bill, they need to be paid. The board has no choice in the matter. Blame Mother Nature and Father Time for deteriorating the building, and natural disasters for the rising cost of insurance. The board is not to blame. Homeowners feeling the pinch of high costs can choose to sell and leave if it gets too expensive.

Q: Curious of your professional opinion, especially since COVID inflation. What do you think is "regular" updating of a reserve study? Once a year update and then a brand new one every 3 years?

A: Best Practice (found in the updated Reserve Study Standards) is for a With-Site-Visit Update every third year. It is best to add an inexpensive No-Site-Visit Update in the in-between years, to make appropriate inflationary tweaks and other adjustments. That's a nice and cost-effective combination.

Q: Reserve responsibility for coops in Illinois?

A: We prepare Reserve Studies for all types of associations in Illinois. If you have specific legal questions, please contact your local Illinois attorney. Where the board has responsibilities for common areas, remember that the board is also responsible to plan for (budget for) the care of those common areas.

Reserve Component Questions

Q: **We are a homeowners association with ~640 homes, and the association has no maintenance responsibility for the homes. Our largest asset consists of the roadway system and the stucco walls lining the streets (valued at about $1.5 million in our last Reserve Study). But the firm contracted to provide a Reserve Study wouldn't include those walls in the Reserve Funding, claiming the Reserve Study Standards exempted them. This rendered the study useless. Is this the norm?**

A: I don't have enough details to know the answer. Reserve Funding is required for common area assets, where a necessary project related to those common areas is reasonably anticipated, and that cost is "material" in magnitude to the association. Please ask your Reserve Study provider why that asset was not included in light of this three-part test.

Q: **We have a luxury home community in Arizona with a 25 year old irrigation system. Irrigation is leaking more and more. Any thoughts on repair vs replace considerations, and for replacing plants with hardscape as a way to reduce repair? We have a good reserve (I think) but don't know how much to replace irrigation.**

A: That's a good question for your Reserve Study provider. They likely know your grounds and your irrigation system and should be able to provide an opinion on repair vs. replace. That discussion might also be best if it involved your landscaping company.

Q: **What is the avg. number of components in a Reserve Study?**

A: Most Reserve Studies have less than 50 components. More complicated associations (with multiple phases, building types, types of recreational amenities, etc.) can have hundreds of components.

Reserve Funding Questions

Q: **How do I know if my association has a 'healthy' reserve? Is there a calculation or way to determine that?**

A: Reserve Fund size/strength is reported in terms of "Percent Funded", a comparison of the cash in Reserves (at the beginning of the year) to the amount of Reserve component deterioration at the association. Download our eBook on evaluating Reserve Fund strength here. Basically, "over 70%" is strong (special assessments are rare), 30-70% is fair, and "under 30%" is weak (special assessments and deferred maintenance are common).

Q: What about a reserve study for common areas that consist of the desert? We a 21 years old association, and need several common area landscape projects: removing trees, shrubs, and grasses for our 300 acre, 958 lot community within the desert. The operational budget has only been reactionary but that was 2002-2022, and now in 2023 I have huge trees and shrubs. How can I save for such a large ongoing project to keep the community at standards once we overhaul common areas within 3 feet of lot lines into the common area?

A: Initiate a conversation between your landscape provider and your Reserve Study professional, so they can plan for the long-term care of your common area grounds.

Q: Do you recommend a minimum reserve balance at all times for unanticipated expenses, i.e septic system or water tank explodes? I think it wise but I don't know what amount this should be?

A: In general, a strong Reserve Fund (over 70% Funded) provides margin for the unexpected. In addition, unofficially most Reserve Study providers ascribe to the idea that your Reserve balance should never drop below 10% of the prior year's expenditures. That way one large project will not completely deplete your Reserve Fund.

Q: The HOA president doesn't believe in your Reserve Study & cringes whenever I bring up that you show a "high risk of a special assessment," which I shared in a recent newsletter. Our Manager says that different associations have different special assessment risks.
Afterwards, I thought about keep a running tab on deterioration, i.e.:
Column 1: additions to reserves, subtract each charge to reserves, noting which are anticipated for listed components, such as replacement & routine maintenance vs. unanticipated repairs/maintenance/improvements (= not in the reserve study, for they're unpredictable) to get a running balance.
Column 2: start with the estimated deterioration from your latest reserve study, each month add the monthly depreciation from the reserve study.
Total each. Calculate the updated % of reserves/estimated depreciation to show how difficult it is to move the #.
Thoughts on this?

A: That sounds like a lot of work, for a volunteer! Reserve planning is considered an annual exercise. Compiling the minutia of monthly adjustments or sub-tallies will likely not convince anyone of anything. It sounds like their minds are already made up. I think the best thing you can do is save some $ for the inevitable special assessment you'll soon face.

Q: We're looking at a possible catastrophic failure for our 100 year old co-op. Can we borrow to create a healthy reserve (currently nonexistent, we lived out of a checkbook)? Correction of the structural issue will cost about 8 times our annual budget. small building 15 units.

A: I don't have enough information to answer specifically about your building. I trust you've been informed of this issue via a professional's structural evaluation. If so, then the cost is (unfortunately) what it is. It may be special assessment time to collect the funds to fix the building. Building a "strong Reserve Fund" doesn't sound like a real priority at this time. Fixing your building is your priority. After that's accomplished, you can commission a Reserve Study to make sure you are funding Reserves sufficiently to offset ongoing deterioration, so this type of problem doesn't occur again.

Q: Our reserves are not properly funded. It will raise the quarterly condo fee by $300 in 2024 if we fund them accurately. Can we do something else to lessen the blow of increasing the reserve requirements all at once?

A: You can discuss a phased approach with your Reserve Study provider, using all the time available (to prepare for upcoming projects, or to comply with local laws) to gradually raise Reserve Funding over multiple years. In most cases, it doesn't have to be done all at once.

FL Specific Questions

Q: My understanding of Florida SB 154 is that we will <u>not</u> have the flexibility to raise reserves incrementally. Is that correct?

A: Again, no legal opinion here, but we fought hard to give the Reserve Study provider the power to design a flexible Funding Plan. It is our understanding that SB 154 gives associations the ability to raise Reserves incrementally over the years.

Banking/Investment/Legal Questions

Q: What type of investment accounts are appropriate for reserve funds (e.g., certificates of deposit)?

A: Investments that have no chance of losing principal. Please see our webinar on this topic here. Safety is the primary concern, yet one must also consider return (interest earned) and liquidity (having it available to spend when you need to spend it).

Q: Are Co-Ops in Illinois covered by Illinois condo law?

A: Sorry, that's a question better asked of an Illinois community association law attorney.

Q: Will a reserve study evaluate plans to determine the separation of property between two entities like HOA or CDD to determine maintenance obligations if there is a disagreement between those entities on where ownership lies? Or does a boundary survey dictate this?

A: Disagreements of property responsibilities between two entities should be resolved by attorneys sorting these things out after a review of Governing Documents. Once the responsibilities are sorted out, then the Reserve Study provider is able to tell each entity the strength of their Reserve Fund and a recommended multi-yr Funding Plan.

Miscellaneous Questions

Q: Does our association have the right to add a fee to the seller or buyer to fund reserves?

A: Most associations have this power. Check with your attorney to see if it is possible with your Governing Documents and State Law. But remember – buyers are not the right ones to be paying a fee. They are not the ones who "used up" the common areas. So it is always better to collect funds on an ongoing basis from the people (owners) who were there, enjoying the assets. Also – all sales-based fees are irregular because sales are not always consistent from year to year. Deterioration is steady, and it is best to offset deterioration with a steady income stream to Reserves (paid by people who live there and own those common areas).

Q: One of my communication challenges is that not everyone has email. We've tried to make it mandatory, but we still have 3 homeowners without (no computer, no smartphone). So I print out my email notifications and then deliver them by hand to these three people. This is not ideal. Any suggestions?

A: It is a small annoyance. It's only three. Those three owners pay the same assessments as everyone else, and having an email address was never a requirement of them becoming a member in your association. Take good care of them, smile when you deliver the notices, and earn their vote to support your budget ideas.

Q: Please differentiate Co-Op and condo - differences in board authority/responsibility.

A: Good question. Both commonly look the same. But ownership is very different. You can check with an attorney to be sure, but in general in a condo you own the air space up to the finished wall surfaces. In a Co-Op, you are a shareholder owner in the entire building, with a “right to occupy” one of those living spaces. So everyone owns everything. Be careful, some of the definitions of “common areas” are building-specific in Co-Ops. See more here.