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Back on Track: Successful Strategies for Funding Reserves

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Miss the webinar? Watch it here.

"Back on Track" is a webinar we created to help you have Reserve funding success at your association. Of course we want you to have success. But what does that look like when you're "not there yet"? So this webinar is for you… giving you the opportunity to see what other associations have done, and learn from those decisions… both what to do, and what not to do! We want you to see the effects of decisions other boards have made, so you can get a sense of what will likely happen if you do something similar at your association.

We use the actual history from three different client associations:

Stumbling Forward – a large age-restricted planned community with significant common area amenities, that through the years skimped and skimped to the point where in our last engagement we had to recommend a special assessment. They simply had failed to offset ongoing deterioration, falling father and farther "behind".

Pursuing Success – in this example we follow another large planned community through the years as they commit to strongly funding Reserves… so much that they actually overshoot. See what happens then.

Steady Progress – this is a medium-sized mid-rise condo. Starting with a challenging year (a recommended special assessment), watch as they make slow but steady progress through the years, a little up, a little down, but trending up to a point where they have a solid, strong Reserve Fund.

Follow what these associations do through the years. You may hear familiar themes (we want to strengthen our Reserves… we can't afford a higher rate of Reserve funding, we can only do so much so leave this problem for next year's board to solve, let's see how much progress we make with a small adjustment this year…).

The bottom line, learn from the stories of these associations. See the effects of shirking your responsibilities, and see the multi-yr effects of being steadfast to "following the plan". We draw the webinar with a summary of the many resources we have available for your use in addition to our Reserve Study services (our online Reserve calculate “uPlanIt”, our podcast, a book, and a plethora of online resources) to help you have Reserve funding success that leads to an improved owner quality of life and maximized home values at your association.

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!).

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Est. 1986
Planning For The Inevitable™
Over 70,000 Reserve Studies Nationwide

<u>Webinar Questions Asked By Attendees</u>

General Reserve Questions

Q: Unfortunately, we are not as fortunate as other communities. We only have 24 units, our condo was built in 1971. The reserve study that was done in 2018, when asked the board about the results, and they said they didn't have to follow the Reserve Study results because those results were "wrong". What can you do? The board had convinced the homeowners that the last Reserve Study was useless.

A: It's hard to say. I've seen some "wrong" and "useless" Reserve Studies! Shame on that prior board to not ask for a revision to correct what they felt were factual errors in that report. A Reserve Study provides guidance, mapping the association's way forward. Without such guidance, the association is aimless drifting forward towards "special assessment land". But since Reserve Studies are fundamentally "perishable" documents, it's time to get an update – one that speaks to the heart of the board, providing them the guidance the association needs.

Q: The $/home numbers you quoted represent the increase of HOA dues per house per year?

A: The $/home/month numbers I mentioned were the cost of Reserve Funding per month. For some, they need an increase. For many, they are already doing just fine (by following the guidance found in their Reserve Study)… as long as they "stay the course".

Q: Is it appropriate for a Board to exclude Reserve funding from the annual budget and then ask for the owners to approve a special assessment? The logic: Keep monthly fees low to attract buyers

A: Per the Governing Documents, the board's primary responsibility is to the association (not individual members), providing it the cash it needs to survive. If the board knows of expenses and doesn't budget for them, they're inviting liability exposure and the potential to <u>not</u> have sufficient funds to take care of the property. They're also setting up new owners to be unpleasantly surprised (angry?) to find the true cost of ownership at the association is more than they were told, when inevitable special assessments happen. That's never good.

Q: In the case of the 1st example, was part of the issue that they were not raising Annual Dues? Do you know what their Annual Dues were approximately?

A: Sorry, we didn't gather that information. But it is likely that the board was focusing more on "keeping assessments low" or "keeping assessments the same as last year" instead of doing their job, which is to provide for the needs of the association.

Q: What is your general advice to nonprofit organizations that are struggling and have very low funded reserves?

A: Increase your assessments. Homeowners have a right to the truth of the matter, so they can make informed decisions regarding if they can afford to continue to live in the association rather wait in fear for the inevitable special assessment.

Q: Is the estimated cost of California's Balcony (exterior elevated elements) inspection requirement, Civil Code §5551 included in your Reserve Component List?

A: Yes, for applicable associations.

Q: Where does the depreciation schedule and ensuing list of items we spent on figure in our Reserves and annual budget?

A: The list of projects to be funded through Reserves comprise the "Component List" in your Reserve Study. Different Reserve Study providers handle or document prior expenses differently. Our hopes and intentions are that the board includes the recommended funding presented in the Reserve Study into the next year's annual budget.

Q: Are Reserve Study numbers different for condos than HOA's?

A: Yes. Every association is different. Reserve Funding in condos is regularly higher than in HOAs, because in condos the deterioration of residential building elements are funded through Reserves. In HOAs, since each owner is responsible for the costs to maintain/replace the elements of their own home, the HOA's common area maintenance responsibilities are less, and thus Reserve Funding requirements are less.

Q: Robert, do you attend meetings and educate Board of Directors so they have a better understanding of the components of the Reserve Study?

A: Hopefully our webinars and our podcast (HOA Insights: Common Sense for Common Areas) provide a baseline of education. In addition, Association Reserves Project Managers regularly make themselves available after completion of a Reserve Study to "talk through" the completed Reserve Study. Generally one online meeting is included at no additional cost.

Q: Can we send in our internal study to match up with your Pro Study?

A: Certainly! While that's not in the "scope of work" when we prepare a professional Reserve Study for a client, regularly our Project Managers are available for an hourly fee to perform special projects for our clients, such as reviewing a client's in-house Reserve Study. Note that uPlanIt, our online Reserve calculator tool, allows all our clients to test all their "what-if" ideas starting with exactly the components found in their Reserve Study. This allows boards to easily test their "internal" ideas to what was presented in their professional Reserve Study without having to create their own "internal" Reserve Study.

Q: Is there a recommended % of total budget to be utilized for reserve?

A: One of the three results of a Reserve Study is a recommended funding set-aside in order to offset deterioration and prepare for upcoming projects. While that is not characterized as a "% of total budget", we *observe* that the resulting Reserve funding recommendation is commonly 15-40% of an association's total budget. Read more here.

Q: Deferred maintenance. Underfunded 13%. Now funding 33%. Every 3 years on site reserve study. Presently 30% funded. Owners are unwilling to pay increases for deferred deterioration. How do you handle this for board fiduciary responsibilities? Questionable on-site evaluation by reserve specialist for Level 1.

A: I'm not sure I totally understand your question. But share your concerns about the on-site evaluation by the Reserve Study provider, making sure you get the quality report you paid to receive. Then do your job as the board to set the budget to provide for the needs of the association. Set the budget appropriately. Then the homeowners can decide if they wish to stay in the association, or move to less expensive housing.

Q: How do you build your reserve so that is resistant to economic inflation, lack of real investment options (only CDs & bonds), and rising maintenance/labor costs?

A: Generally that's done a little at a time, through the years. The interest being earned on the cash in Reserves will never keep up with the inflation that increases the costs of ALL components at the association. That's why you get a Reserve Study, to learn how much you need to be setting aside towards Reserves to offset deterioration and prepare for those upcoming projects in light of the reality of inflationary forces.

Q: What additional recommendations does Associated Reserves suggest for HOA's where reserve expense occurs over longer intervals, with larger costs when it does. Major road maintenance work is one example, which typically is a 25-30 year cycle.

A: Two things. Build expectations for interest and inflation into the Reserve funding model. That gets you into the ballpark. Then update the Reserve Study regularly (Best Practice is a With-Site-Visit update every third year), which can be further enhanced by No-Site-Visit updates in the in-between years to make sure you never get three years "behind".

Q: Any estimated range of cost for a reserve study?

A: Every association is different based on size, age, location, mixture of common area amenities, etc., but in general a "Full" Reserve Study is often in the range of 1% of an association's annual budget. But please be reminded that a "Full" Reserve Study is needed only once. After that, every association will find their Update With-Site-Visit and Update No-Site-Visit to be significantly less expensive.

Q: So if our annual budget is $2,000,000 a full first-time Reserve Study will cost us $20,000?

A: That 1% figure is just a ballpark number (again, for a "Full" Reserve Study). Get a no obligation proposal for your association by clicking here, and see what the cost would be for a Reserve Study for your association. I think you'll be pleasantly surprised.

Reserve Component Questions

Q: We have an insurance fund that we reserved more than we needed for this year's premiums. We consider it escrow only to be used for insurance premiums. We want to keep the amount collected this year to pay for next year's premium. Since we never know what next year's premium is, we consider this a reserve item. Are there any rules against this?

A: Please contact your tax professional, as there may be tax considerations for such "retained earnings" (which the IRS may consider "profit"). Insurance premiums do not pass the National Reserve Study Standards three-part test, so they do not qualify for Reserve fund designation.

Q: We are not required to have a structural integrity study. We have funds set aside for "utilities" projects, e.g., sewage collection and water distribution systems with a useful life of 85 years and we are in year 28 (Remaining Useful Life of 57 yrs). Are these considered mandatory components for a reserve and can these funds be reallocated to our state's "mandatory" components (projects such as paving) that are underfunded?

A: Yes. The components in a Reserve Study should be considered as a whole. Please discuss this issue with your Reserve Study provider. The objective is to provide for the needs of the association and comply with all local laws, not keep pockets of cash tucked away "nicely" for certain particular projects (whether in the distant future or not).

Q: I believe that there is a set number of years that reserve study companies use for various components. What if the HOA feels that those years are too conservative? For example, our lobby furniture can last a lot longer than the estimate.

A: From my perspective, Reserve Study companies learn a lot from their clients, so we do have well founded general expectation ranges for how long we expect "various components" to last. Please be reminded that components "fail" for more than physical reasons. Sometimes they fail for "aesthetic" reasons (they simply go out of style), or for some mechanical or technology based projects the replacement parts simply become unavailable after a certain amount of time. Please discuss with your Reserve Study provider, to seek adjustments (perhaps based on the Preventive Maintenance you are doing that they weren't aware of), or to get more comfortable that they are indeed modeling actual behaviors and expectations at your association.

Q: Can fee for reserve study be funded by reserve account?

A: Generally no, as it typically falls below the "materiality" requirement for being considered a Reserve component. In other words, it's usually too small of a cost to quality as a Reserve component.

Q: Have you ever placed major landscape components installed when the community was developed as a replacement reserve item?

A: Yes. We actually do that very regularly.

Q: Is there an industry standard for including, or not including infrastructure items like community main water, sewer, telecom and electrical lines (the ones under ground or in building structure)?

A: The industry standard is the Reserve Study Standards three-part test (common area maintenance responsibility, reasonably predictable in timing and cost, and that cost being above a level of materiality to the association). So if the project is a responsibility of the association (due to age and deterioration) that can be anticipated, and is large enough that it would be unsettling to the Operating Budget if not planned through Reserves, it should be a Reserve component.

Q: You mention the "level of materiality" that is relevant to be considered as part of reserves, is there a basic number to consider? I've heard $5000.

A: A good starting point is that it needs to be above the manager or the board's "signature authority" to spend, or .5% - 1% of the association's annual budget. That usually puts you in the right range. Please discuss with your Reserve Study provider.

Q: Is there a state law that determines a threshold to whether use operating or reserve account? Or just whatever HOA's governing documents states?

A: See above. Florida says $10,000 but for many (most?) associations in FL, that's too high of a number to be practical for Reserve planning for their association. That would allow too many "expensive" and predictable projects to regularly unsettle the Operating Budget.

Q: My HOA wants to use the reserve for new things (things that were not there) and I keep advising them this is not allowed but they cite other states that allow this. Do some states allow this?

A: No state allows the use of Reserves for anything other than Reserve projects. "New things" (Capital Improvements… things that weren't there) are not Reserve projects, as they fail test #1 of the three-part test (because they currently are not a maintenance responsibility of the association. In fact, some states require any borrowed Reserves be restored to the Reserve Fund within a certain period of time (12 months or 24 months).

Q: **Our units share a water meter for three lots related to domestic and backyard irrigation. Present billing is not equitable. Can reserves be used for sub-metering per lot therefore having equitable billing per household?**

A: Sub-metering in your situation would be a great idea. Check with your utility company to see if they would sub-meter at no cost to your association. Otherwise, look into the cost to have that accomplished, and budget (outside Reserves) to set funds aside to get that (good) project done.

Reserve Funding Questions

Q: **I attended an ECHO talk on HOA Reserves given by another reserve study analyst. He told us that trying to achieve 100% full funding is not necessarily the ideal goal for all HOAs. In some situations, an HOA might need to be 200% fully funded and in other situations, an HOA that is only 65% fully funded is in good shape. It all depends on the HOA. What are your thoughts about that?**

A: 100% Funding is a fiscally responsible goal for most associations. There is a minority of somewhat unique associations or situations where it may not be ideal. Please check with your Reserve Study provider to ensure the Funding Goal established for your association provides for the Reserve needs of the association, with sufficient margin to protect the owners from unsettling special assessments and deferred maintenance.

Q: **What is % funded of WHAT?**

A: Percent Funded is a national standard term that defines Reserve Fund size/strength. Fundamentally it is the ratio of actual Reserve funds compared to the $ value of deterioration at your association. Please see more here.

Q: **Why would your funding recommendation require 50% increase in reserve dues in one year instead of a more gradual approach like 10-15% increases until goals are reached?**

A: Funding Reserves is sometimes called both an art and a science. Some associations need to be smacked in the face about the need to increase their rate of Reserve funding. Some associations can be coaxed forward in a more gradual manner. Some associations have a large expense in the very near future forcing them to increase Reserve Funding in a more aggressive manner (almost like a mini-special assessment). Please discuss with your Reserve Study professional to see what flexibility exists for your association. Again, this would be a great “what-if” idea to test on our uPlanIt online Reserve calculator, available free through their budget season to all our professional Reserve Study clients.

Q: Your examples show the yearly % funded number. Reserve Studies can be 30-year plans and the % funded is different each year of the 30-year plan. Should we look at a 30-year average rather than a single-year % funded value?

A: Each year, the Percent Funded reports the size/strength of the Reserve Fund. Each year matters ("Do we have the funds to do what needs to be done?"). So using just an "average" is not prudent planning. Each year the Percent Funded reports where you are, and watching the multi-yr trends show you the trajectory of the association.

Q: Percent funded is one metric, are there other metrics? If so, how do you decide which to use?

A: Percent Funded is the industry standard metric for measuring size/strength of the Reserve Fund. There is no other comparable metric.

Q: You recommended funding over the 30 years is always to be at or over 100% funded. Can an association use more of an over 70% approach over a 30 year plan?

A: At Association Reserves, our default recommendation is that our clients pursue a Full Funding (100% Funded) Funding Goal. That said, once an association is up out of the "0-30% danger range", we are comfortable guiding them forward to being above 70%, with no rush to get them up to the 100% level.

Q: How do you measure deterioration to determine the percentage funded?

A: See the definition of "Fully Funded Balance" here (p16). For example, for a pool resurface project that is expected to currently cost $10,000, if it has a 10 yr life and is two years old (8 yrs Remaining Useful Life), the Fully Funded Balance, which describes the $ value of deterioration, is $2000.

Q: This graph hides detail... if our roofs are brand new, we won't be anywhere near 75% funded. Comment?

A: If your $500,000 roofs are one year old, and they have a 20 yr Useful Life, then your Fully Funded balance is 1/20th of $500,000, or $25,000. You would therefore be 75% Funded with only $18,750 in Reserves. That's not a lot. You don't need much Reserves on hand to be well funded when the $ value of deterioration is low.

Q: Does a special assessment only need to pass the majority of the board, or does the majority of the ownership need to pass it as well? If so, what happens if it doesn't pass and, say, roofs are leaking? The range of scenarios is wide, and this is significant since we have only one annual meeting per year.

A: Please ask this question of your community association attorney. That is both a state-dependent and Governing Document-dependent question. But it's just another example of the value of responsible Reserve planning. When you fund Reserves now, with every owner paying their fair share along the way, you'll have the right amount in Reserves in the future when those expenses happen, and problems like this go away.

Q: Our reserve study shows we are over 80% funded, yet the Construction Management team we have hired for a long overdue reconstruction project says this is nowhere near the amount of funds we need for the project. How to answer homeowners' questions as we obviously need a special assessment.

A: You may wish to ask your Construction Management team to have a conversation with your Reserve Study provider, so they can both get on the same page. Both professionals should be providing consistent guidance to the board, so they can communicate clearly an effectively to the homeowners.

Q: Is the % Funded at the 30 year percent per their reserve study?

A: I'm sorry, this sounds like an incomplete question about one of the examples used in the webinar. The numbers quoted in my examples were the Percent Funded figures reported in their Reserve Studies.

Q: Did any of these associations borrow from or against their reserves to meet short term cash flow needs?

A: We don't learn the facts to that level of detail. For Example #1, the facts would suggest that the association simply didn't collect the funds necessary to offset deterioration, allowing the association's Reserve Fund to drop in strength to the point where they eventually needed a special assessment to repair or replace their deteriorated common area assets.

Q: What is the general % funded amount where we need to worry about lenders not lending to prospective homeowners? Can you speak of blacklisting condos?

A: Each lender has their own "secret sauce" they use to screen to find profitable loans. At this time, there are frankly not enough associations with "current, credible" Reserve Studies (prepared by a credentialed individual, within the last 36 months) for lenders to have built a database of specific Percent Funded criteria. Fannie Mae and Freddie Mac, who control approximately 70% of residential condominium loans, have their own particular requirements and their criteria is not publicly shared. It is clear that they want to see at least 10% of budget going to Reserves, and they want to see an absence of unresolved physical deterioration at the association.

Q: Does % funded mean for a project or reserve funding?

A: Percent Funded is an evaluation of Reserve Fund size/strength… the cash the association holds compared to the deteriorated value of all the Reserve components. See more here.

Q: Do these associations maintain a single reserve fund, or do they use multiple enumerated smaller reserves, for roofing, paving, painting, etc?

A: The example associations all use a single Reserve Fund (FL associations would call them "pooled" Reserves). This is the most effective way to manage Reserves, as it keeps Reserve Fund from being "tucked away" unused in particular funds attributed to particular projects (called "straight line" in FL). Only in FL is this inefficient method of funding Reserves still practiced on a large scale, and it is because of a legacy of ill-advised restrictive legislation (long ago relaxed) that many associations still follow.

Q: % funded? - say you only have one component, one elevator that has a 20 year life and has a current replacement cost of $1M. If the elevator is 10 years old and you have $500,000 in reserves then you are 100% funded, is that correct?

A: Correct.

Florida Specific Questions

Q: Is there a "formula" for determining how much to fund the new required SIRS in Florida from the regular reserve fund?

A: No. But we expect that in the next few years many association will be at the high end, or slightly above the high end, of finding that they need to set aside 15-40% of their total budget towards Reserves while they catch up from decades of underfunding Reserves (due to waiving Reserve funding). Remember… Mother Nature and Father Time didn't waive their effects all those years!

Q: When phase one is completed in regard to SB-4D, how will this affect our reserve?

A: When associations get through the first set of Reserve Studies required by this new legislation, many associations will "wake-up" to the news that they've allowed deterioration to get WAY AHEAD of their Reserve Funding, and they need to do some serious catching up. Remember- this is not making anything more expensive for homeowners. The legislation just requires associations to begin funding Reserve projects on an ongoing basis, which otherwise would have caused special assessments. Same costs to homeowners, just paid monthly instead of "surprise" catch-up special assessments.

Q: In Florida we are REQUIRED to be "Fully Funded". Where exactly in the percentage range does this fit?

A: That is a fallacy. The ability of homeowners to "waive" Reserve Funding is being phased out. Boards will be require to start responsibly funding their Reserves. No Funding Goal (Fully Funding or otherwise) is legislated.

Q: With the new bill, how will the condos meet their reserve needs?

A: By increasing their homeowner assessments, to increase Reserve funding (so the association will be preparing to pay for the cost of ongoing deterioration through monthly assessments instead of special assessments). The project costs won't change. Only the method of funding will change.

Q: New legislation requires reserve funding - Why wasn't this mentioned?

A: This is a national webinar. We prepare local webinars (like this one for a FL audience) addressing the specific Reserve Funding needs of FL associations in light of recent legislative changes.

Q: Do condo buildings 2 stories or less have to have Fully Funded reserves?

A: No. See above. The new law applies to associations which contain one or more buildings three stories tall or taller. We recommend, of course, that all condo associations responsibly fund their Reserves. Costs are real. Ignoring the ongoing cost of deterioration doesn't make those costs go away.

Q: We recently had a Milestone study (Fla) which recommended Reserves. In the new Reserve Study and funding recommendations there were items previously included in our reserve Study that were NOT included in the SIRS survey. (1) Do we have to break up our Reserves into Structural and Non Structural (dock, seawall, Insurance deductible, pool, asphalt) and manage each separately from a balance sheet persepctive? (2) We have included a "reserve" item for a hurricane (windstorm) deductible. Is this a common way to handle funding of this "expected" expense?

A: Per the new FL legislation, let's call them "mandatory" components and "non-mandatory". No, an association does not need to break their Reserve Fund up into two funds. Associations can maintain their mandatory Reserves, and on top of (or in addition to) those financial assets, maintain their non-mandatory (but very real) Reserve funds in the same account. Remember – Reserves are for predictable, foreseeable projects that pass the national three-part test. "Surprise" expenses like insurance deductibles, are not predictable, and are not appropriate for funding through Reserves. If you wish, you can set aside a particular insurance deductible fund, but they are not "Reserves".

Q: Given there has not been any change in the reserve mandate, how much percent funding are you recommending for 2024 if full reserve funding kicks in in 2025?

A: Full Funding does not kick in beginning 2025. The only major change is that homeowners lose their power to "waive" Reserve funding. Boards are still empowered to chose their own funding strategy ("Full Funding" is not required). We still recommend Full Funding, guiding our association clients forward so they gradually strengthen their Reserves to a point where they can perform their scheduled projects in a timely manner, with a low chance of submitting the owners to an unwanted (and unfair) special assessment.

uPlanIt Questions

Q: How can we utilize the uPlantIt calculator?

A: Log in online through our Client Center portal with your user account.

Q: Did you say that the UPlanIt calculator was free or you had to subscribe to it?

A: Access throughout an association's budget season is free to our professional (Full, Update With-Site-Visit, and Update-No-Site-Visit) clients. Other associations can purchase a budget season subscription for $399. See more here.

Miscellaneous Questions

Q: Our managing company enters full payment on the "Income & Expense" Report even though probably 10% of homeowners are consistent delinquents on assessment and water payments. Should our managing assoc. enter actual payments and not just enter full owner payments?

A: Sorry, I don't have the expertise to address such accounting questions. This type of question should be directed to an accounting professional.

Q: I think it was Association Reserves that started a website that was/is supposed to be akin to a "report card" on individual HOAs. Type in the HOA name and financial and other info about it shows on screen. If AR, how is that coming along? I think that if this type of thing ever becomes "mainstream" some of the doubters of the needs for reserves might come around.

A: Yes, Association Reserves is the parent company of a new Public Service called Association insights & Marketplace. We have developed the overall association scoring system called the FiPhO® score, which scores an association on their Financial, Physical, and Operational behaviors. It is a broader score than just an association's Percent Funded, and gives boards a virtuous metric to pursue, unlike the destructive goal of "low monthly assessments". See more here, or go straight to ourFiPhO.com. We continue to build a national base of users. Major lenders and other powerful companies in the community association industry are watching our progress closely, eager for us to achieve a "critical mass" of users so they can begin to ask for an association's FiPhO score for their purposes.

Q: Our accountants list "Transfers to Reserves" as an Income line item, following things like Assessments, i.e., a subtraction from Income. To me, it would make more sense to be listed as an Expense. Your thoughts?

A: Sorry, I don't have the expertise to address such accounting questions. This type of question should be directed to an accounting professional.