NJ Reserve Study Legislation FAQs

As of January 2024

Legislation text here.

Q: Why?

A: To prevent tragedies like the Champlain Towers South collapse in Surfside, FL that claimed 98 lives, from affecting New Jersey families.

Q: When does this go into effect?

A: Immediately, 1/8/24

Q: Won't this increase the cost of our home ownership?

A: No. The expenses (costs) that the homeowners are responsible to bear are unchanged. The law just requires the association to fund these inevitable Reserve projects on an ongoing, budgeted basis, rather than wait and suffer expensive and potentially dangerous deterioration while last minute funding via special assessments or loans are pursued.

Q: Who does this apply to?

A: All NJ community associations (6.a), unless the association's combined common area assets are less than $25,000 in value (6.d)

Q: What qualifies as a Reserve Study?

A: A Reserve Study prepared by a qualified individual (RS or PRA) or an engineer or architect licensed by the State of NJ, in compliance with National Reserve Study Standards (see here) (6.a)

Q: What type (Level of Service) qualifies?

A: Presumed to be one involving an on-site inspection, meaning a "Full" (Level 1) Reserve Study or a With-Site-Visit (Level 2) Reserve Study Update. (6.a.3)

Q: How often must a Reserve Study based on a site inspection be performed/updated?

A: At least every 5th year (6.c) Note that industry Best Practices (per the national trade association "Community Associations Institute", and Fannie Mae and Freddie Mac requirements) is every third year.

Q: When must our Reserve Study be prepared or updated?

A: See above. At least every five years. This means that if your last qualifying Reserve Study is more than 5 years old (completed before 1/8/19), or if your association doesn't have one, you must update your Reserve Study (or get your first Reserve Study completed) before 1/8/25 (6.b)

Q: What about if we're a brand new association (for new associations formed after 1/8/24)?

A: Within two years of the newly elected board. (6.b).

Q: Must we fund the Reserves?

A: Yes, per the plan, so that the 30-yr funding plan provides sufficient cash to perform all the anticipated Reserve projects without reliance on future loans or special assessments. (7.a)

Q: Can we overspend on a Reserve component (more than indicated in the Reserve Study)?

A: Yes. Reserve Studies are based on estimates, and overages are expected to occur. Your association can "overspend" from Reserves on a project as long as it doesn't interfere with the association's Reserve cash availability to perform other Reserve projects for the next five years.(7.b.1), and the association's executive board resolves to restore the overage within five years. (7.b.2) This will require regular (perhaps annual) updating of your Reserve Study's financial plan.

Q: What if something fails early and we don't have enough cash?

A: Special assess or get a loan. (7.a) This law does not prohibit special assessments or loans in true "surprise" situations.

Q: What if we don't have any (or very much) Reserves? How do we comply?

A: The board can take up to 10 years to increase Reserve Funding to attain a funding rate that provides for the anticipated Reserve expenditures of the association via increases of 10% of the last year's budgeted assessment income. Otherwise, the association must use a higher annual increase to reach that rate of Reserve Funding within 10 yrs, <u>or</u> by the year in which without such increases planned Reserve projects could not be accomplished. (7.c) In other words, annual 10% of total budget increases are ok, unless you need to increase at a higher rate to get there within 10 yrs or to prevent running out of money.

If the association can reach a rate of Reserve Funding that provides for the anticipated Reserve expenditures of the association with annual Reserve Funding increases <u>less</u> than 10% of the last year's total budget within two years, you must do so. No dragging it out. (7.d)

Q: Must we be "fully funded" (100% Funded) by any point in time?

A: No. "Fully Funded" is a measure of Reserve Fund size, where the cash in Reserves equals the cash value of deterioration at the association. The law does not require associations to build their Reserve Funds to any such specific level. The law only requires associations to have a <u>plan to fund</u> Reserves on an ongoing basis such that for the next 30 years, Reserve cash will exist when necessary to accomplish all anticipated Reserve projects (also known as "Baseline Funding"). In other words, <u>at a minimum</u>, the plan must be to "not run out of Reserve cash at any time in the next 30 years". Note that "more than the minimum" is highly recommended in order to protect owners from special assessments, since the future rarely works out exactly according to plan.

Example 1: An association with a $500,000 annual budget, not funding Reserves at all.

<u>First year</u>, increase Reserve funding from zero to $50,000 (10% of prior yr budget). With this increase, and $40,000 of other Operating Fund increases, new annual budget is $590,000.

<u>Second year</u>, increase Reserve funding another (equal amount as prior year) $50,000 to $100,000/yr. With this increase, and another expected $40,000 of other Operating Fund increases, new annual budget is $680,000.

<u>Third year</u>, another $50,000 increase (same as prior years) to Reserve funding is needed, to bring Reserve Funding to a level that is anticipated to provide for all upcoming Reserve projects without reliance on future special assessments or loans. Reserve Funding is now $150,000/yr. With another year of just $30,000 in Operating Fund increases, total budget is now $760,000. Reserve Funding is now approximately 20% of the association's total budget, nicely within the "normal" range of 15-40%.

<u>Summary</u>: three equal years of $50,000/yr Reserve funding increases.

Example 2: An association with a $500,000 annual budget, setting aside $10,000/yr towards Reserves, with a big $250,000 (Reserve) roof project in two years and only $50,000 currently in the Reserve Fund.

To comply, the association must provide for its upcoming expenses <u>and</u> get to a funding rate where their Reserve Fund provides for the needs of the association within two years (collecting at least a quick $200,000 in that time period).

Yr 1: Calculate that without the cash flow crisis, a stable Reserve Funding rate would be $150,000/yr. That's $140,000/yr more than they're currently doing. Divide that by two years, so increase Reserve Funding $70,000/yr. But they need at least $200k for the roof project. So pass a two year special assessment of $50,000/yr ($100k total). This $100,000 special assessment, plus the starting balance plus the $140k being collected for Reserves over the first two years, will get them ready for the roof project with a little margin. So first year Reserve Funding goes up from $10,000 to $80,000, and with $40,000 of Operating Increases, new annual budget is $610,000/yr. (Remember, plus a $50,000 special assessment for the roof).

Yr 2: Reserve Funding increases another $70,000/yr, so Reserve Funding is now up to $150,000/yr. Operating budget increases another $40,000. So total new annual budget is $720,000/yr. (Remember, plus a $50,000 special assessment for the roof). So $100,000 collected via special assessment + $140,000 collected via Reserve funding + initial $50,000 Reserve balance means they have $290,000 in Reserves to accomplish a $250,000 roof project and not completely drain the Reserve Fund. $150,000 of Reserve funding from a total budget of $720,000 means their Reserve Funding is approximately 21% of the association's total budget, nicely within the "normal" range of 15-40%.

Yr 3: Just "normal" inflation offsetting increases to their Reserve Funding rate that was $150,000/yr, and operating budget that was at $570,000/yr. The steep budget increase years are over!

Example 3: An association with a $500,000 annual budget, setting aside $50,000/yr towards Reserves.

First year, increase Reserve funding by $45,000 (less than 10% of budget) to $95,000. As this is less than a 10% annual increase, they need to get to Reserve Funding stability by the second year. Total annual budget, with $35,000 of Operating increases, grows to a total of $580,000.

Second year, increase Reserve funding by $50,000 (less than 10% of annual budget, not required to be an identical Reserve increase from the prior year) to $145,000. Total annual budget, with $30,000 of Operating increases, grows to $660,000. Reserve funding is now at a rate anticipated to provide for all upcoming Reserve projects without reliance on future special assessments or loans, and is approximately 22% of total budget (nicely within the "normal" range of 15-40% of total budget).

Summary: small enough annual increases they could each be done for under 10% of annual budget, and funding compliance could be reached within two years.