Reserve Studies 103 – The Funding Plan

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Miss the webinar? Watch it here.

Every year, every boardmember is confronted with the Reserve Funding question "What do I do now?". It's tempting to say "Reserves are for the future", and leave Reserve funding to future boards and future budgets. But Reserve funding offsets ongoing deterioration. Just because the roof doesn't send a "deterioration" bill each month doesn't mean it is a bill that can be ignored. The expense will happen. Your choice is whether homeowners pay in little increments each month as part of their ongoing assessments, or as an "unexpected" and unwanted special assessment when the asset eventually fails. That's where we come in… helping the board know the smoothest and fairest path to the future.

Deterioration is real and expensive. There's no dodging those huge expenses.

So it's up to you to decide how those Reserve expenses will be paid. You are responsible, per your Governing Docs, to provide for the care of the common areas. Your responsibility is to have the funds available one way or another, so the owners can enjoy their homes and enjoy maximized home values. We are guided to help you reach these goals with four Funding Principles that we balance and apply when crafting your Funding Plan (see at right).

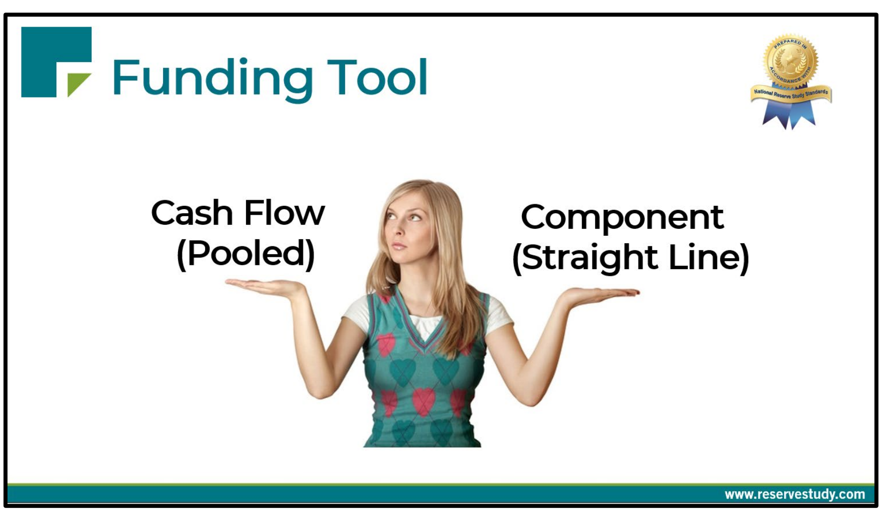
RESERVE FUNDING PRINCIPLES

Now we address the question of how big the Reserve transfers need to be at your association. Your Reserve funding needs will be unique and different, even from similar associations, because of four influences:

There's almost nothing you can do about your Component List. The assets (roofing, painting, hallways, a tennis court, etc.) exist. At your association, they are your responsibility to maintain. It's not like you can responsibly choose to "ignore" the needs of your roof. Starting Reserve Strength is another factor. But that's the starting point prior boards handed you. Your challenge is how best to go forward from here.

Margin for the unexpected is where you begin to have some choices. Our recommendation is that because nothing ever goes exactly according to plan, it is in your best interest to plan for some margin. Since Reserve projects are so expensive, the amount of margin included in your Reserve funding plan is just a small portion, typically 10-20%. And that's the little more "margin" that can shrink your exposure to unsettling special assessments from around 50% to <u>almost zero</u>.

Then there's the issue of which mathematical tool you use in developing the Funding Plan. Usually, you don't care which tool a business partner uses... which software your attorney uses to draft new governing documents, the accounting software used by your mgmt. company in tracking owner accounts, or the financial software used in preparing your monthly financial reports. But with Reserves, the tool matters. The choice is the Component Method or the Cash Flow Method.



One (Component) funds each Reserve component separately, line by line. The other (Cash Flow) funds Reserves based on the cash outflows each year, no matter if those outflows are one component or a cluster of expenses. Because the Cash Flow Method fundamentally uses Reserves funds more effectively (none is socked aside waiting for a future expense when it can be used for another legitimate Reserve project), the Cash Flow Method is preferred by professionals nationwide.

The Cash Flow Method also allows more flexibility in designing the Multi-yr Funding Plan. This means Cash Flow Funding Plans can more effectively achieve the four Funding Principles stated earlier (especially Equitable Distribution and Fiscal Responsibility) with a plan that gradually floats upwards over the years, matching inflationary trends. The Component Method fundamentally starts high and decreases over the years. As a result, while the overall 30-yr total of funds going towards Reserves will be about the same, in the initial few years Cash Flow Reserve Funding recommendations may commonly be half or even less of the Reserve Funding recommendations calculated by the Component Method.

Making wise decisions about Reserve funding takes a seasoned guide, someone who has crafted successful solutions for their clients hundreds *or thousands of times* before, someone like Association Reserves!

ASSOCIATION RESERVES™

Planning For The Inevitable™

More questions? Download our eBook on Funding Plans, or find more information on the Resources tab of our website here.

Want out help? Click here for a Reserve Study proposal for your association, or click here to find the Association Reserves office in your region. Don't expose your association to unsettling surprises because of poor Reserve Funding choices!

Webinar Questions Asked by Attendees

GENERAL RESERVE STUDY QUESTIONS

Q: Does a Board have responsibility for spending HOA dollars to meet the request of a homeowner, a request that is not covered or required in the Governing Docs or the fed / state law or Reserve Study?

A: No. The Board takes its direction from the Governing Documents or fed/state law, not homeowners. The plan is found in the Reserve Study. As with any legal question, please check and confirm with your association's legal counsel for specific guidance.

Q: How often should an association have a reserve study?

A: Best Practice is now for a With-Site-Visit Update at least every third year, with inexpensive No-Site-Visit Updates in the in-between years.

Q: How do I find what state laws say about Reserve Study restrictions and requirements?

A: CAI maintains a good summary page here.

Q: Do you have a template for a simple presentation to individual association owners to explain their RS results and payments they will need to pay? How to convince them…

A: Not specifically, but that is a great suggestion. But remember that homeowners have a responsibility to pay their portion of association expenses via their ongoing assessments. Remind them that everything deteriorates, and that owning Real Estate is expensive, and via Reserve Funding they are paying their small share every month to offset deterioration and avoid future special assessments, ensuring that the community remains financially healthy and well-maintained.

Q: How do you persuade key contractors and vendors to recognize the importance of their active participation in our association's reserve study research? It's a sales job!

A: Yes, it's an exercise in salesmanship. Key contractors know we don't direct work their direction, but two things: We can thank them in the Reserve Study for their help establishing pricing, and we make it clear that in some future year when the association needs the work, it will be easier winning that work if the association has a correct expectation how much it will cost, and has the funds ready to be spent. That's usually worth a few minutes of their time.

Q: I have 60 days to respond to adjustments on my reserve study, what kind of adjustments should I be thinking?

A: The most common adjustment to a Reserve Study is incorrect starting balance. So check that what has been provided to us matches your understanding. Sometimes there are outstanding loans (due to, or due from) the Operating Budget of which we are unaware, another CD that someone forgot to tell us about, etc. The second most common adjustment is the timing of a recent major project ("I just learned that the last roof project was in 2020, not 2018, and it was only three of our four buildings…").

Q: We pay our annual assessment in full in January. How do we "sell" an increase because it seems like a large increase all at once? Should we separate the annual assessment from a reserve designated assessment?

A: An increase is an increase, whether assessments are collected monthly, quarterly, or annually. Don't complicate your budget, or separate Reserve funding from the Operational budget. Keep things simple for your homeowners. Everyone knows about inflation. Remind everyone that roofing, painting, asphalt, etc. costs have been increasing with inflation just like everything else (insurance, utilities, pool service…), and thus Reserve funding needs to increase along with the rest of your budgetary line items. Train your homeowners to expect an increase every year.

Q: If there is a surplus of money from a project in Reserves, would that be noted in the Reserve Study?

A: Not likely. If a project comes in under-budget, we use that information to adjust our expectation for future instances of that project, and the money unspent is used to strengthen the Reserve Fund, offsetting the inevitable projects that come in over-budget.

Q: Is it safe to consider reserves to be the same as "depreciation"?

A: That's generally an accurate understanding. Everything deteriorates, and when it reaches the end of its service life it needs to be replaced or restored. That "deterioration" is similar to the accounting term "depreciation", describing how the value of something drops over time. Reserve funding offsets ongoing deterioration (depreciation), so the board has the cash to maintain and protect the physical assets of the association.

COMPONENT QUESTIONS

Q: Do you have an average cost per sq ft or other unit of measure for asphalt replacement?

A: Yes, but that varies in different regions across the country, and due to geometry of the site, and possible economies of scale of the actual project. You can find some generic regional values for your association by consulting local asphalt service providers, or with cost-estimating guidebooks/databases. That kind of information is generally common knowledge among Reserve Study professionals in your area.

Q: What is the best way to address asphalt valuation and schedule. Because the asphalt at a number of small communities is well maintained every 5-7 years, or more, it is in very good condition. Is it more appropriate to extend the useful life in this type of situation or do we just have it moved out further but leave the same useful life?

A: Asphalt is generally modeled with two components – sealing and repairing on a short cycle (every 4-7 yrs), and either resurfacing or mill-and-replace on a longer cycle (every 20-30 years). Regular sealing significantly extends the interval between costly resurfacing or mill-and-replace projects.

Q: Please tell us which sources you recommend we consider for next year's reserve inflation cost estimating ~ component materials and effort.

A: We recommend putting your Reserve planning into the hands of a qualified professional. We study trends among projects our clients accomplish each year, compare to regional metrics like the Consumer Price Index (CPI), and consult with contractors and vendors for current pricing.

Q: Is there a place where I can find what goes to operational costs vs reserve?

A: There is a Reserve Study Standards <u>three-part test</u> we cover in our Reserve Studies 101 webinar to guide the selection of Reserve projects. <u>They need to be a common area maintenance responsibility, reasonably anticipated, and above a cost that is "material" (significant) to the association</u>, meaning something large enough that it cannot be easily absorbed into the ongoing Operational budget.

Q: What is the best advice for differentiating maintenance vs repair or replacement? For example, road crack sealing we think of as maintenance and funded from Operating vs. asphalt repair as Reserves.

A: There are some projects that can go either way. Reserve projects must pass the Reserve Study Standards <u>three-part test</u>, one of which is that the project is above a level of significance making it not readily absorbed by the Operating Budget. Minor ongoing maintenance should be routine, and handled from the Operating Budget. Reserves are for those specific major projects needed by the association. Discuss with your Reserve Study provider to get further clarification for your association.

Q: Can a preventative maintenance plan be part of a reserve study?

A: Yes. Major projects can be scheduled as Reserve projects (seasonal roof cleaning, tree trimming, trim touchup painting, etc.) if the project passes the Reserve Study Standards <u>three-part test</u>.

Q: How is a component's current value calculated?

A: A component's current repair or replacement cost is estimated on the basis of the costs our clients have experienced, online research, or research with local service providers. A component's "deteriorated value" (its Fully Funded Balance) is the fraction of life used up times its current repair/replacement cost.

Q: How would you advise when a current reserve component amount is 2x more than appears in our last Reserve Study?

A: Pricing goes out of date quickly (that's why a Reserve Study is for one year at a time). Get your Reserve Study updated regularly. Especially in these last few years of high inflation, many clients relying on a Reserve Study from 10 yrs ago are being shocked by how much things cost. As costs increase, your Reserve funding needs to increase, or you're association will get caught unprepared. If your association got "caught" unprepared for a big expense, get the project done, and update your Reserve Study to be better prepared for other projects in the future.

Q: What protections does an association member have against a board that wants to spend reserves for a new capital project, for example to build Pickleball courts?

A: Reserve Study Standards clearly state that Reserves are for existing assets, not for Capital Improvements. Going against industry standards can create accounting and liability problems for the association. Note that there is no responsibility for an association to replace "like for like", so if a tennis court needs to be resurfaced (a legitimate Reserve project), it may be wise to re-stripe it for Pickleball use also in that same project at a minor extra expense. That's smart, not a Capital Improvement.

Q: When you do 'phasing' - say mailboxes you have 25 of them at $2500 each - are they tracked inside that reserve study line item? How does part of the asset line item be broken out for tracking what part is done and what part is not?

A: Track separate phases with separate Reserve Component Line items. Every Reserve Component should have its own Useful Life, Remaining Useful Life, and Replacement cost. Five mailbox kiosks at $2500 each of different ages may deserve five different line items in your Reserve Study (just like five different phases of roof ages, etc.).

Q: Can the reserve plan cover periodic inspection and maintenance, or is it just for replacement? I'm thinking of components that don't need repair every year.

A: Yes. Updated 2023 Reserve Study Standards clearly state that professional inspections and major preventive and corrective maintenance projects can be funded through Reserves.

Q: What process(es) do you have to ensure the maintenance/replacement costs in the reserve are accurate based on the specific geography?

A: To ensure accuracy, we use localized cost data, consult with regional contractors, and consider specific geographic factors such as climate and local construction costs. That is easily done from our 17 regional offices.

Q: What do you recommend for a 55-year-old HOA with approximately 1,000 members that has 6 lakes with 6 earthen dams that would cost many millions to repair or replace (e.g., $10-30 million to replace the largest dam), but has only reserved $150k to date for minor repairs? Some board members argue that the dam's useful life is uncertain (dams can last centuries, but earthen dams generally last 75-100 years), the dams do not pass the RSS 3-part test for "reasonably determinable cost and useful life) so, therefore, do not qualify as a reserve component—so a meaningful amount of funds are not being accumulated.

A: Retain a credentialed Reserve Study provider, and commission a "dam inspection". Such an important decision should not be addressed and resolved by a discussion among board members.

Q: Is the cost for a Reserve Study a Reserve expense or an Operating expense?

A: Due to its relatively low cost, the cost for a reserve study typically falls below the level of significance necessary to qualify as a Reserve component. There are some exceptions, so in some cases you'll find a "Reserve Study Update" component.

Q: Will you please talk about the term "capital" and the confusion around capital improvement vs capital replacement, especially WRT reserves?

A: "Capital improvement" refers to adding new features to the association that currently do not exist. There is no confusion on the matter that Capital Improvements are an inappropriate use of Reserve funds. Some people use the term "capital replacement" to identify a project that the IRS deems as "capital". But what the IRS defines as "capital" or "non-capital" is irrelevant to a discussion about Reserves. Reserve projects are best called a "Reserve project".

Q: What if the estimated component life is shorter than the actual experience for the component life expectancy? For instance, concrete spalling problems in Miami aren't the same as for Phoenix. How can real experience be taken into account to ensure more realistic funding?

A: Real-life experiences and localized conditions should be considered when estimating component life expectancies. Regular inspections and adjustments to the reserve study based on actual performance and environmental factors help ensure more accurate planning.

Q: Your presentation speaks about the deterioration of components and reserve funds that need to be collected to deal with repairs and replacements of existing components. When cities impose new requirements that require HOAs to install new components, then is a special assessment the only way to fund these projects?

A: It is inappropriate to use Reserves for new assets added to the association. New assets are to be funded outside of Reserves – by accumulating an Operating surplus, special assessment, loan, or other means.

Q: In a reserve study, will you provide details on how pricing for items like detention pond refurbishing is determined? I'm concerned about discrepancies between the estimated pricing and the actual costs.

A: Yes, that is usually explained in the Reserve Study. If not clear in your Reserve Study, please contact your Reserve Study provider to get that clarified and documented for the record.

Q: What about budgeting for replacement of systems (like plumbing or electrical infrastructure) that have no set lifespan?

A: For systems without a set lifespan, it's important to provide funds for periodic inspections and upgrades. That is based on regular Reserve Study site inspections, historical data, and industry standards.

Q: We just have a reserve study done and there was no mention of reserve for elevators. We are wondering why?

A: That is unfortunate. Elevators are a significant cost, and a modernization project or cab remodel project regularly passes the three part test. Please check with your Reserve Study provider to find out why it does not appear as funded in your Reserve Study.

Q: If crack sealing is done annually would it be in the operating budget not reserves?

A: Annual projects can be done from the Operating Budget or Reserves. If the project is done throughout the year, it leans towards being an Operational expense. If done all at once, it can readily qualify as a Reserve project if it otherwise passes the three part test.

Q: How are landscape items handled that are not ordinary monthly costs, like replacements?

A: Non-routine landscape replacements, such as tree removal, major tree trimming, or replanting large areas, regularly passes the three-part test and thus should be included in the reserve study. Routine maintenance tasks remain in the operating budget.

Q: If an item is not eligible to be in the Reserve Study as a component, say due to unpredictability for replacement, should reserves be charged for its initial expense? The ineligible item was a retaining wall.

A: If an item is not included in the reserve study due to unpredictability, it should not be charged to the reserve fund. Reserves are for common area projects, predictable in nature, above a cost level that is significant to the association (the three part test). Perhaps you should consider a proactive, periodic scheduled “repair” project for the retaining wall, to ensure it never gets significantly deteriorated.

Q: Should/Can new infrastructure be funded out of existing reserves and then increase assessments to cover funding for the same?

A: No. Capital improvements (new infrastructure) should be accomplished without the use of Reserves. Once in place, its future repair and replacement should be funded from Reserves, which means your Reserve funding obligations will increase at your association.

FUNDING QUESTIONS

Q: Our Reserve Funding is based on the Component Method. When we tried to change the residents objected. They like that the money is specifically allocated in the component method. Thoughts? And is it possible you change going forward while leaving the existing component money as is?

A: First - why are you letting the residents (owners) dictate board decisions? To your question, by specifically allocating cash to different Reserve components (in the Component Method), you are using your Reserve cash inefficiently and increasing the recommended Reserve funding required of the homeowners. Estimated component costs are what they are. That doesn't change. It is in the best interests of your residents/owners to calculate Reserve funding requirements with the Cash Flow method. Consider your Reserves as one "fund", for use by all component expenditures, and move forward planning for the future more cost-effectively. You don't need to change bank accounts to move from Component to Cash Flow – just tally it up to one number.

Q: Don't we use components to create the analyses and then use cash flow for the funding plan?

A: Yes, as we demonstrated in this webinar. Using exactly the same Component List, one can describe the Component Method as an "up-and-down" way to calculate recommended Reserve funding, while the Cash Flow Method is a "left to right" way to calculate the recommended funding – for exactly the same component list.

Q: Is California a Cash Flow state or Component state, or either or?

A: California law has historically been silent on the matter of Reserve funding methodology, so the predominant Reserve funding method in CA is the Cash Flow Method.

Q: Isn't the Cash Flow Method more likely to be abused = i.e. spent on the wrong items and spent more than necessary because the money is 'available'?

A: No. Project costs are what they are. Some will come in under budget, some will come in over budget. Humans are the cause of abuse, not mathematical computations. In the Component Method, if costs come in over budget Reserve funds are "re-allocated" (made available), which means there are no true limitations to overspending or spending inappropriately. Normal financial checks and balances prevent abuse, not choice of Reserve Funding methodology.

Q: How do we move the money from the Component Method to the Cash Flow Method?

A: No money is "moved". Instead of having multiple accounts or breaking down the Reserve Fund into a number of individual "funds" (and tracking those changes on a monthly basis), the Reserve Fund is viewed as one entity from which all Reserve funds, for any project, are drawn. It is a simple change, and minimizes monthly administration requirements.

Q: What is the financial impact of transitioning from Component to Cash Flow method of funding?

A: Recommended Reserve transfers go down, because the "catching up" process can be spread over many more years than in the Component Method, and overall multi-yr profile of the Funding Plan can be smoother and more equitable for the homeowners.

Q: Can you mix the funding methods? e.g. Component funding for state-required components and all other components handled via the Cash Flow Method?

A: That would be possible, but that would require two separate Reserve Studies, a complication that would likely negate any benefits and complicate your Reserve planning process. It is better and simpler to use the Cash Flow Method for all your anticipated Reserve planning.

Q: If our association is behind, is it going to be more evenly distributed if we start out with Component Method for X number of years, then switch to Cash Flow Method once we are more on track?

A: No. The Cash Flow Method allows a smoother and more evenly distributed multi-yr Funding Plan, especially for associations in "catch-up" mode (most associations!). There's no value waiting to make the change.

Q: Our association is currently 1.1% funded, 1st year: roof replacement, intercom replacement, and balcony inspections. 2nd year: fumigation. Years 3+: exterior paint and carpet replacement. Is there any way to avoid special assessments or keep them as minimally as possible until we can get major repairs out of the way? What would that look like?

A: Work with your Reserve Study provider to most effectively craft a plan to navigate the years ahead.

Q: Is an over 70% funded level (rather than over 100%) over a 30-year reserve plan adequate? Most of your reserve studies show funded levels at over 100% over the 30 years.

A: Reserve Adequacy is actually a combination of your Reserve Fund Strength and a Funding Plan that <u>together</u> provide sufficient cash for your Reserve projects to occur in a timely manner. While being over 100% is often considered the "bulls eye", a Reserve Fund at or above

70% Funded is the range where special assessments (due to inadequate cash) are rare. So "above 70%" is a good place to be, but 100% remains the center of the target. Aim for the bulls eye, not the edge of the target.

Q: What is the mathematical formula used to calculate the monthly reserve amount for the cash flow (pooled) method?

A: There is no formula. The Cash Flow Method involves several "guesses" to find a stable multi-yr Funding Plan that provides sufficient cash in a smooth manner that achieves the desired Funding Goal. It is what is described as an "iterative" process.

Q: One national study provider states that any reserving above baseline is "over funding". What is your reaction?

A: Either they are misinformed, or you are misinterpreting their counsel. National Reserve Study Standards state in the definition for Baseline Funding that it is not recommended as a long term solution/plan (see here, p16).

Q: Any special considerations for HOAs with one huge asset (streets) with infrequent, but large requirements for repair?

A: Yes. It is even more important for associations with one or a short list of dominant Reserve projects to be well funded, because of the high demand on the Reserve Fund in the year that project occurs.

Q: Our HOA has a large deficit - how does a cash flow address a deficit?

A: The cash flow method first allows the association to find a way to stay cash positive in light of starting Reserve balance and upcoming expenses, then secondly addresses the deficit by building the size of the Reserve Fund gradually over the years above and beyond just the minimum $ necessary for anticipated projects. First things first.

Q: Is the Cash Flow (pooled) Method mathematically more complex?

A: Not more complex (it is just adding and subtracting), the Cash Flow Method is just plain different. As explained in the webinar, The Cash Flow Method isn't a straightforward calculation, as in the Component Method. The Cash Flow method involves trial and error, looking for a suitable Multi-Yr Funding Plan that achieves the desired objective (sufficient cash, budget stability, equitable distribution over the years, and fiscal responsibility). It can be done relatively quickly with software, testing variations until a satisfactory result is attained.

Q: D you have a cash reserve policy adopted template? Willing to share?

A: Yes, please see here.

Q: Can funds be reallocated between categories or lines within the Reserve Study?

A: In the Component Method, re-allocation is a regular annual process, shifting funds from one "component" to another. Some associations do this so often they are almost effectively running a Cash Flow Method analysis.

Q: We are using cash flow as our funding plan but have a minimum of $50,000 minimum balance. Is that a responsible method? Our total assessment is $500,000 per year with 50% going to reserves.

A: It is more effective to measure "margin" on a Percent Funded basis. That gives you a better idea if $50,000 is a "lot" or a "little" for your association. Ask your Reserve Study professional to see this information for your association.

Q: Is there any statutory prohibition from sequestering the funds for one building into a separate account, with a dedication of funds in the account to that building? The effect on the full funding on one property would necessarily reduce the total reserve account by that amount.

A: No, but I believe it is a bad idea. It takes compartmentalizing Reserve Funds to an even higher level… an overall bad idea. Unless your Governing Documents define buildings as different financial entities, it is always best to see the community association as one whole entity. Legally you are all in this together.

Q: How does the term Percent Funded play into the cash flow method?

A: Percent Funded is a measure of Reserve fund size/strength, so it allows you to develop a Funding Plan that provides for the desired amount of insulation from the risk of special assessment by looking at the Percent Funded of the cash balance you are accumulating.

Q: Should associations use the RS as a schedule for replacement? Ex. 15 year anticipated lifespan, so replace it now even if it's working fine?

A: No. The Reserve Study is a budget and cash flow document, not "scripture". Hopefully a regularly updated Reserve Study keeps component life expectancies pretty accurate, but in most cases if the component is continuing to serve its intended purpose just fine, leave it in place. Check with your Reserve Study provider for specific guidance on these types of decisions.

Q: Previous boards over the past 20 years have been scared to raise fees by more than 20-30 dollars per quarter. Is it prudent to assess the community a large amount to get our 50% fund up to at least 75-80%? Our fees are now $2100.00 per quarter. We have almost 1100 single-family homes and 450,000 acres, & lots of roads.

A: Best to check with your Reserve Study provider, to determine the appropriate balance between strengthening your Reserves rapidly (a good thing) and unsettling your owners with higher-than-required assessments (a bad thing). Note that in general, it is a good idea to raise your assessments annually, to keep pace with inflation and train the owners that annual increases are to be expected.

Q: What is the best plan if the state requires the component method? Especially for "savings" for catastrophe events that are not planned for in component funding?

A: I disagree with your characterization on State Law requirements. Reserves are for predictable projects, not catastrophic events. Check with your local Reserve Study professional on the Funding Plan that serves your association best and complies with State Law. That will generally be the Cash Flow Method. For catastrophic events, consider setting aside contingency funds within the operating budget or creating a separate emergency fund.

Q: When is a Special assessment necessary?

A: Special assessments are Reserve funding of last resort, as they are fundamentally unfair, placing a financial burden on "current" owners, a burden that should have been carried by all owners over the years who enjoyed the use/service of the assets that deteriorated. Special assessments are necessary when there is not enough time, with ongoing funding, to accumulate the necessary funds to perform a project. Discuss with your Reserve Study provider for further details.

Q: We have a large dollar value project that needs to be addressed now but the current reserves will not be able to pay for that item. What is the best way to deal with this situation?

A: See if the project can be phased, or special assess. Then update your Reserve Study and fund as recommended to avoid this happening again in the future.

Q: We started our fiscal year on April 1, 2024 at 125% funded. We are in the midst of a project which was estimated to cost $250,000 but will now cost $600,000. That will drop our reserve fund funding to 70-75% as of the end of the fiscal year. Should we pay the entire $600,000 from our reserve fund since 70-75% funded is still at a low risk of special assessment?

A: Yes, pay the entire project from Reserves. That is one of the benefits of having a strong Reserve fund… you are able to move forward successfully when projects are more expensive than anticipated.

Q: If your condo is part of a master association, how do you set aside cash for expenses that might come from the master that relate to common items? Can this be done through reserves? For example, the pool in our area is part of the master.

A: The Master association should have its own Reserve Study for the component projects for which it is responsible (entry gates, roadway, clubhouse, the pool in your area, etc.). Reserve Funding should be included as part of those ongoing master assessments. If not, begin a grass-roots effort to get them planning responsibly, so their oversight won't cause a special assessment some time in the future.

Q: Can you provide educational material for the two methods? I found it hard to understand the pool method.

A: Absolutely. You'll find our e-book on the matter here. But trust your Reserve Study professional – they should have this under control.

Q: Can you switch from the component funding to cash flow funding on an annual update?

A: Yes.

Q: Can an association switch from the component to the cash flow funding method when having a new reserve study done?

A: Yes.

Q: We're in a low funded HOA. If our operating fund is strong, is it okay to charge what would ordinarily be a reserve expense to operations in order to bolster reserves?

A: The simple answer is yes. If the Reserve Fund is weak, it may be effective to pay a Reserve bill from the Operating fund, if there is sufficient "margin" in the Operating fund.

INTEREST/INFLATION QUESTIONS

Q: Can interest and inflation be included in the component method?

A: Yes, interest and inflation can and should be included in any Funding Plan methodology. Both are economic realities, and they significantly affect the results of Funding Plan calculations.

Q: We've found recently that anticipated expenses are increasing beyond inflation. What advice would you have?

A: Increase homeowner assessments more than inflation, so the association is financially prepared to pay its bills.

Q: How do we deal with 30-50% inflation costs on roofing (and even more)? Everything is going up rapidly. How do we know what amount to plan for?

A: Your Reserve Study provider sees these things day after day. Fortunately, for most Reserve components, you still have years before the expense actually occurs, allowing you a "catch-up" opportunity. Your Reserve Study is crafted with best estimates of current costs, and projections for future costs (see inflation comment above). The Funding Plan is where it all comes together. Regular updates will keep your Reserve Funding Plan "on-track" with today's ever-changing financial landscape.

Q: Interest paid on our funds is minuscule compared to the rapidly increasing inflation on the costs. How do we keep up in the reserves?

A: Raise your Reserve Funding as appropriate. Interest will always help, but mathematically it will never keep up with inflation because inflation works on the entire projected cost of the project, while interest is only earned on the funds actually on deposit (a lower number). So set your Funding appropriately, understanding that owning Real Estate is indeed expensive.

Q: In a reserve study by your company, what are the assumptions for inflation for say the Denver area of Colorado over say a 20-year useful life, like for a roof or siding? Also, if I heard you correctly, what are the perhaps offsetting earnings rates, if any, assumptions for funds being reserved for that expenditure? Or would your study just not account for one or the other?

A: As a Reserve Study is a 30-yr (at least) projection, our Funding Plans utilize an inflation rate that is averaged over a 30-yr period, with perhaps some adjustments for "near term" projects. As stated above, get maximized safe interest (no possibility of loss of principal, and not "tied up" when the funds need to be spent). Reserve Studies should incorporate best estimates for interest and inflation, with the mathematical understanding that interest will never fully offset inflation. Your Funding Plan should be based on this reality.

Q: How much inflation, if any amount, is included in your cost projections?

A: A stable multi-yr inflation rate is in the range of 3%. We fully expect there will be short times when it is higher, and phases when it is lower, but that is a safe multi-decade perspective.

Q: What is the rate of inflation used? Why are earnings on reserve funds included as many HOAs don't invest or don't invest the same?

A: See above. Every association with Reserves should hold those funds in an interest-earning manner. It's great to have "the bank" assist homeowners in funding Reserves.

FL SPECIFIC QUESTIONS

Q: My HOA, which had an Association Reserve study in 2022, changed to "pooled" reserves. It appears the board believe this makes money easily available to spend; that is, the money is all in a pool to be used flexibility as needed, regardless of the plan. Things come up; use the cash in the pool. From the webinar, I learned that "pooled' refers to how the reserves are FUNDED. Rather than funding by individual components, a steady, consistent amount is put into the reserves, like "dollar cost averaging' in investing, to be used within flexible constraints of the component analysis. Can you please comment?

A: The Cash Flow Method is a description of the way the multi-yr Funding Plan is developed. Restraint is still required of the board, whether income to the Reserve Fund was developed by the Cash Flow or Component Method. It is still the board who determines how the limited, budgeted Reserves are spent. The Cash Flow Method does not mean the board can spend without restraint. The Component Method (where funds are commonly "re-allocated" as necessary) also requires the board to show restraint. Reserve funds are there for a specific reason. Every dollar has a job.

Q: Can you mix the funding methods? e.g. component funding for mandated components and Cash Flow for all other components?

A: Yes, you can, but Cash Flow method is always preferred, so it is best to use Cash Flow for both.

Q: Does FL allow pooled for SIRS components?

A: Yes, Florida allows pooled reserves for mandated Structural Integrity Reserve Study (SIRS) components and nom-mandated components.

Q: FL condo requires a member vote to use the $ for other than the component. How do we get it to the pooled method?

A: Check with your legal counsel. It involves a few short administrative steps.

Q: Are the S.I.R.S. components mandatory to the time factor in the study? Non S.I.R.S?

A: Sorry, I don't understand the question. Every Reserve Component has a time factor – its Useful Life and Remaining Useful Life. This applies to all the mandated SIRS components, and all the other non-mandated Reserve components for which the board is equally responsible to maintain. Fund <u>all</u> your Reserve components.

Q: Can the board vote not to do an item? Need new study?

A: Please check with your legal counsel, because it has gotten messy in FL. The board is fundamentally responsible to care for the physical assets of the association by virtue of the Governing Documents, and that is facilitated by Reserve planning, offsetting ongoing deterioration with budgeted Reserve funding. Yet at this time FL law says funding is only mandatory for the Legislators' pet list of SIRS projects. Failing to accomplish a necessary project leads to deferred maintenance, owner discontent, and property values that are not maximized, and eventually, a special assessment. Take good care of your facilities. Get regular Reserve Study updates to provide updated guidance, fund your Reserves, and perform Reserve projects in a timely manner.

Q: Can money for allocated Non-S.I.R.S. be used for S.I.R.S.?

A: Speak to your Reserve Study provider. Specific guidance is not articulated in FL Law. Generally, funds are allocated in an optimum manner, to allow the board to fund their SIRS components while not completely abandoning the board's responsibility to provide funding for non-mandated components. I recommend a clear "paper trail" showing what has been done, why, and when, to provide a defense if necessary.

Q: Are funds for S.I.R.S. projects interchangeable?

A: All Reserve Funds are collected for a specific purpose, caring for the Reserve needs of your property. If your SIRS Reserve Funding is accomplished with the Cash Flow Method, arguably none of those funds are designated to one particular SIRS project or another. In that case, it is one "SIRS Reserves" fund.

Q: Do you know if the SIRS fund in Florida starts with the 2025 or 2026 budget year? Our budget will be completed in Sept 2024. We are on a calendar year budget.

A: SB 154 states this is effective "For a budget adopted on or after December 31, 2024". Check with legal counsel if this is not clear to you. But remember, caring responsibly for your association goes beyond state-mandated minimums.

Q: Does the state of Florida allow the pooling method?

A: Yes.

Q: Can HOAs in Florida include an inflation factor?

A: Yes, HOAs in Florida can and should include an inflation factor in their Reserve Funding Plans.

Q: Who has final authority to determine the annual transfers to reserves for structural items? The SIRS analyst or the Association Board?

A: The Reserve Study provider makes the recommendation, it is the board's job to implement. Please check with your legal counsel if you choose to do something different (less) than recommended in your Reserve Study.

Q: Can you address the way it stands with Florida and the new laws that take place 1/2025?

A: Please see our FL Legislation FAQs page here. Please see the Structural Integrity Reserve Study section of our website here for additional information.

Q: Why are elevators to be not included in Florida's SIRS? Is it simply because they are NOT STRUCTURAL?

A: Yes/correct. It is an inconvenience for a building's elevators to not function, but it won't kill you (although it is arguably a health concern for a few). The Legislators drafting this legislation made a number of imperfect choices.

UPLANIT QUESTIONS

Q: If the starting balance for year two is substantially different than that shown in the original study, can we change the year 2 starting balance in uPlanIt?

A: The yr 2 starting balance is based on yr 1 starting balance, anticipated Reserve income, and Reserve expenses. The yr 2 starting balance is therefore not an editable field.

Q: I am the treasurer for my HOA so this was very enlightening since this is my first HOA community. Is there a place where I can input the numbers and get a graph such as the one you displayed today?

A: Some of the graphs in the webinar came from uPlanIt, some were from MS-Excel because I felt the that would more effectively illustrate teaching points. uPlanIt is a powerful but amazingly simple online Reserve calculator allowing you to try various "what if" ideas on your completed Reserve Study, or do your own in-house analysis. See more here.

Q: Why does UPlanIt access go away part of the year? We like it as a tool. But taking it away makes its use limited.

A: Reserve planning is a perishable, budget-cycle driven project. Access to uPlanIt is similarly perishable. Access is subscription based, not perpetual. If you wish, you can renew a subscription annually. See more here.

INSURANCE/BANKING/INVESTMENT/LEGAL/MISCELLANEOUS QUESTIONS

Q: What should a member do when receiving the return of excess funds (unspent for a reserve project that came in under-budget) from a personal IRS reporting perspective?

A: First, we do not provide tax counsel. You will need to seek that from a qualified tax professional. Second, I am disappointed to learn unspent Reserves were refunded. They should have been left in the association's Reserve Fund to offset the projects that go over budget..

Q: How do we prepare for inevitable the need to pay for large insurance deductibles? Is there a way to use Reserves?

A: Reserves are for major predictable projects, to minimize disruptions to an association's budget. Life still throws us some surprises. That's what special assessments and Operating Contingencies are for. Not Reserves. That said, in many cases your association may "borrow" from Reserves and set up a repayment plan, if that can be accomplished before those Reserves are needed for their intended purpose (elevator, roof, asphalt, etc.). Check with your legal counsel for guidance if you are thinking about borrowing from Reserves.

Q: Can you comment on the failure of a board to maximize investment return… is this a breach of fiduciary duty, and something that opens the board and its individual members to litigation?

A: Please seek legal counsel on this matter, as our expertise is in the field of Reserves, not breach of fiduciary duty.

Q: Reserve loans and repayment for insurance—How should these be treated on your financial journal entries? Operating? What should the description be?

A: Please seek counsel from your accounting professional on this matter, to effectively communicate what has transpired for all to clearly see.

Q: Does it make sense to have reserves in a high-yield savings account or purchase CDs?

A: Yes. Significant interest earnings are possible at this time. Please seek the counsel of a Reserve Fund investment professional (someone familiar with community associations!) in your state for guidance.