ASSOCIATION RESERVES®

Planning For The Inevitable

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

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Miss the webinar? Watch it here.

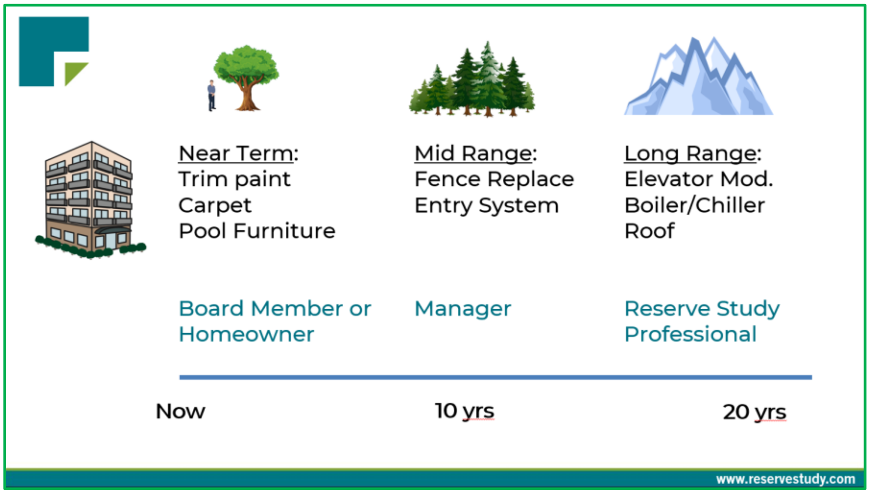
Link to the CAI Research Foundation's "Breaking Point" report on addressing aging infrastructure

Link to chapter 1 of "Understanding Reserves"

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

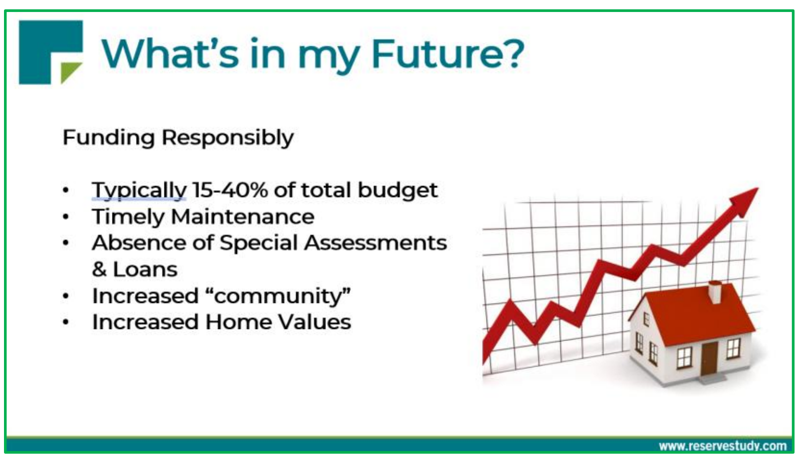
How does this happen? Boards make the decisions that create the future of the association. We need to appreciate that no matter how much we counsel, coach, and cajole boards to fund their Reserves as recommended, nothing is going to change until they begin to feel the need. They need to feel thirsty. That's the purpose of this webinar.

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



Boards are reminded that even though they personally might not be skilled at seeing ahead to Mid-Range or Long-Range projects, others have that skill. It is only the board, however, who has the responsibility to the owners and the association to care of all those assets by funding to offset that ongoing deterioration. Mother Nature and Father Time ensure that those distant projects are approaching rapidly!

In the "What's in My Future" section of the webinar, we outline the consequences of underfunding, and then adequately funding, Reserves, making the future very clear. Spoiler alert – funding Reserves responsibly is well worth it!



Finally, we get to action steps… what to do. And this is all about planning to collect Reserves, spend Reserves, update that Reserve plan regularly, and get wise counsel on other specialized matters (structural inspections, etc.). Because, indeed, deterioration is real, ongoing, and unstoppable. Proper financial preparation takes years.

Get an expert on your side to provide you with the information you need to make the wise decisions that guide you and your association toward an improved future! We can help by preparing your Reserve Study update, ensuring your Reserve Fund Strength is calculated correctly and a Funding Plan is custom prepared for your association.

Enlist the support of a team who has prepared over 90,000 Reserve Studies for clients in all 50 states over the last 30+ years! Launch a free online proposal request from Association Reserves by clicking here. Or click here to see our network of offices across the country (serving clients in all 50 states!).

Additional Resources at
www.ReserveStudy.com

ASSOCIATION
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Over 90,000 Reserve Studies Nationwide

QUESTIONS & ANSWERS

FAQs

Disclaimer: We're grateful for all the questions shared during our live webinar sessions. Due to the high volume of inquiries, similar or duplicated questions may already be addressed in the FAQ section below. If your question requires a more detailed explanation or if you're seeking further information on the topic, we encourage you to contact your local reserve study provider — you can find their contact information [here].

Q: What is the difference between an Operating expense and a Reserve expense?

A: Most attendees seek clarity on this. The key rule: a Reserve expense must be a common-area responsibility, with a reasonably predictable life expectancy, and a cost that is "material" (significant) to the association, meaning commonly above 0.5% to 1% of the annual budget.

Q: What is the three-part test for including something in the Reserve Study?

A: See above. Per national Reserve Study Standards, it must:

- Be a common-area maintenance responsibility
- Have a reasonably predictable life expectancy
- Have a cost that is "material" (significant) to the association, meaning commonly above .5% to 1% of the annual budget.

Q: How often should we update our Reserve Study?

A: National "Best Practice" is a With-Site-Visit update at least every third year, with no-site-visit updates annually in between. That's because all Reserve Study information (Reserve balance, conditions, costs, interest, and inflation) all drift from "the plan" within a year's time.

Q: Is 70% funded "good enough"?

A: Yes. Your target should be the 100% Funded level (Fully Funded), where the cash in Reserves is equal to the dollar value of deterioration at your property. But studies show that there is essentially no further reduction in special assessment risk once an association is above 70% Funded.

Q: What if our Reserve Study doesn't include a component we know we need?

A: Reach out to your local credentialed Reserve Study provider. It may be added if it passes the 3-part test. Timely updates ensure your plan is accurate through the years, helping you plan effectively for the care of your property.

Q: How do we convince reluctant board members or homeowners to fund Reserves?

A: In most cases, you don't need to "convince" the homeowners. It's their duty to pay the rate of homeowner assessments that the board sets. For board members (and in the associations where homeowners vote to "approve" the budget"), remind everyone that deterioration is real, maintenance and replacements are expensive, and it is the board's responsibility to budget for the sustainability of the association. Frankly speaking, remember that you have no control over the expenses. Mother Nature and Father Time ensure that everything is in a constant state of deterioration. Your only choice is if you pay the cost of that deterioration evenly, on an ongoing basis, or in periodic unsettling special assessments.

Q: Can we use Reserves for preventive maintenance?

A: Yes—if it significantly extends the life of the component and passes the cost threshold. Routine care still belongs in the Operating budget. Discuss further with your local credentialed Reserve Study professional.

Q: What happens if our Reserve Fund is over 100% funded?

A: Do not pause contributions. Your provider may recommend a slightly reduced rate of Reserve funding in order to gradually deplete that surplus over time.

Q: Can Reserve funds be borrowed or used for emergencies (like insurance premiums)?

A: Sometimes. Check with your legal counsel to see if it is prohibited by your Governing Documents or State law. If borrowing is allowed, ensure all borrowed Reserves are restored in a timely manner. Some states (e.g., CA & WA) require any borrowed Reserves to be repaid within a specified (relatively short) period of time. It is inappropriate to extend Reserves for Operating expenses (like insurance premiums). Operating Fund shortfalls are an indication that your assessments need to be raised.

Q: Why are actual project costs sometimes higher than what's in the Reserve Study?

A: Often the culprit is an old Reserve Study (not for the current year). Reserve Study costs are estimates prepared to the best ability of the provider. If you find some costs in your Reserve Study were understated, challenge your Reserve Study provider with that news and request a revision or commission an update.

Q: What is Percent Funded and how is it calculated?

A: Percent Funded is a relative measure of Reserve Fund strength:

(Actual Reserve balance / Fully Funded Balance) × 100

Note that the Fully Funded Balance is the cash value of all the Reserve component deterioration at the association.

Q: Can we delay Reserve projects or substitute alternatives like patch repairs?

A: Yes—but proceed with caution. It may lower costs short-term but often leads to higher future expenses or safety concerns. It is best to discuss with your local credentialed Reserve Study provider to discuss phasing, delays, or interim repairs.

Q: Do different vendors produce different Reserve Study results?

A: Yes, even under national standards. Differences may arise due to assumptions about maintenance, cost sources, professional judgment about the amount of deterioration, and the selection of a Funding Goal (Full Funding is a conservative goal, Baseline Funding is an aggressive/risky goal, and Threshold Funding can be any level in-between). Please discuss differences and strategies with your local credentialed Reserve Study provider.

Q: How should boards handle underfunded Reserves without alienating homeowners?

A: Transparency and clear communication are key. Explain that prior underfunding has created a "legacy burden" that needs to be confronted. Explain that the ongoing cost of deterioration has exceeded Reserve Funding, and the association needs to increase Reserve Funding to prepare for upcoming projects. Homeowners may have enjoyed lower assessments for years, but that assessment structure was unsustainable.

Q: Can a homeowner or board member prepare a Reserve Study themselves?

A: In most states, they can. But it's never recommended. Lack of expertise and lack of independence are significant obstacles. Reserve Funding is commonly 15-40% of an association's total budget. For a budget line item that large, an understated funding recommendation can result in deferred maintenance or special assessments that cause home values to drop <u>far in excess</u> of the cost of a Reserve Study. Boards should rely on credentialed professionals.

"Funding Reserves...and What Happens When You Don't!" Attendee Questions

General Reserve Questions

Q: Is there a legal minimum balance required for the reserves?

A: No. There is no universal legal minimum reserve balance across all states. Different states (or Governing Documents) may have different minimum requirements, or no requirements. But I challenge your question. Your job as a board member or manager is to provide for the needs of the property, not be pursuing minimums. Get a Reserve Study from your local credentialed provider and put up a good fight against the unrelenting (and expensive!) forces of deterioration that Mother Nature and Father Time throw at you. If you are pursuing minimums, you're on your way to either "special assessment" land, declining property values, or both.

Q: How does it work when the Developer is the HOA and there will be an extended # of years before turnover to residents? Homeowners are asking for 24 hour security, speed bumps, replacement of trees and plants and much more, all which they are prepared to fund. Keep in mind the developer is subsidizing the community until it is built out.

A: The key word here is that the homeowners are "asking". They have no power under Developer control, when the developer has an incentive to minimize expenses (including funding reserves) to maximize their profits. Campaign for an independent Reserve Study and funding that offset ongoing deterioration, along with desired "upgrades", with the pitch that they will be good for home values. This approach may help the developer increase profitability by investing in improvements.

Q: You mentioned "spending reserves as recommended". But how can you be assured the recommendations are well founded?

A: Rely on a Reserve Study prepared by a independent, credentialed provider, and update it regularly. That by definition gives you a well-founded and credible professional projection. If you still have doubts, ask your provider to explain their assumptions. That regularly updated Reserve Study is designed to provide reliable guidance for funding and spending from Reserves over the years: sustaining the association, minimizing owner exposure to special assessments, and maximizing home values.

Q: Why are reserve studies strictly visual? Borescoping, etc. could help us to better fund our reserves & avoid surprises and special assessments.

A: Special tools are left in the hands of specialists. We rely on elevator inspectors (with their load tests), asphalt consultants (with their deflection testing), roofing consultants (with their moisture detectors), plumbing companies (with their borescopes), etc. Reserve Studies are budget and cash flow tools where the combined knowledge of all outside specialists relevant to the association are compiled.

Q: Is a management company needed for a small association for 12 units?

A: Not necessarily. Small associations may often run effectively as a self-managed entity. But it takes a significant amount of time. "Self-managed" associations have earned the stereotype as "unmanaged" associations for a reason. There are a number of companies out there specializing in cost-effectively serving small associations (HOA-Assist.com, HOASimplified.com, etc.). They are worth investigating, making the burden of leading an association a much easier responsibility (for a nominal cost).

Q: We have regular Reserve Studies, but the estimates of what we should save (for example, painting the basement) is only half of the actual costs. How do we explain that to the homeowners when we've been doing it correctly?

A: Real-world prices are moving targets—especially with inflation, labor shortages, and changes in project scope. Please discuss any under-estimate of repair or replacement costs with your Reserve Study provider, to get them "locked in" to actual costs at your association and request a revision.

Q: Where can we get a copy of the book?

A: You can order a copy of "Understanding Reserves" from Amazon here, and you can download Chapter 1 for free here.

Q: Can the board approve a budget that includes using reserves without the approval of the owners?

A: State Law and your Governing Documents articulate the budget process for your association. In most cases nationwide, the board sets the budget and does not need owner approval. Check with your legal counsel to learn the requirements for your association. The same is true for Reserve spending. Spend as recommended (remember that Reserve costs are only estimates… expect some to be higher or lower than stated), checking with your Reserve Study provider if some costs are significantly higher or lower than expected.

Q: **If we do not have a reserve fund, how should we get started with one?**

A: Step one: open a savings account. Then get a Reserve Study from an independent, local, credentialed (RS or PRA) provider. That Reserve Study will give you a roadmap about how much $ you should have in Reserves, how much to be collecting on an ongoing basis, and how much to be spending (and when, and on what). Expect a few transition years, but the sooner you start, the more manageable it becomes. Waiting guarantees pain later.

Q: **We are a new board and trying to "right the ship" of our association. We have 3 reserve study bids. How can we best evaluate the three bids to determine who is the best fit for our HOA?**

A: Look beyond price. Review each provider's credentials (like RS or PRA, toss any proposals not led by such a credentialed Reserve Study professional), ask if their reports are compliant with national Reserve Study Standards (toss any proposal where they answer "What standards?"). Ask for a sample report and see how easy it is to read, ask about their methodology, and ask whether they offer ongoing support after the Reserve Study is delivered (counsel, software, etc.). Note how long it takes for them to respond to your call or email. That says more about "customer support" than whatever they answer! Ask for references. Ask what fraction of their work is Update reports. A high fraction of Update clients suggests their clients are satisfied and return regularly. Generally, it's the same type of selection process you would go through for evaluating any professional serving your association.

Reserve Component Questions

Q: **Our Building is about 38 years old. For most of that time the dues were low, so prior boards chose not to repair or paint our buildings. The new Board is (no surprise) being aggressive in repairing and painting our buildings, meaning they've raised our monthly dues. We currently put aside 40% of our budget to Reserves. As a Senior Complex there is concern about this. Our Reserves are 15% Funded even after spending almost $450 K over the last 4 years. What do you recommend?**

A: Stay the course. You've got 38 yrs of catch-up to face (a classic "legacy underfunding" situation). It will take time to continue to strengthen your Reserves. But the bottom line – this "stepped up" Reserve Funding is <u>not</u> making the building more expensive. All the "new board" is doing is funding the cost of deterioration on an ongoing basis, rather than in a huge special assessment (or two or three). I understand it is shocking or eye-opening to residents. The building may truly be too expensive to live in (they just didn't know it for years because the board wasn't passing along the cost of deterioration), and some may need to move to less expensive housing.

Q: **Would a crawlspace cleanup be part of reserve funding or operations budget?**

A: It depends. Discuss particular issues like this with your local credentialed Reserve Study provider. If it's a one-time or infrequent cleanup as part of restoring an asset's function, it might qualify as a reserve expense. But if it's routine maintenance, it likely belongs in the operating budget. Remember the three-part test: common area, predictable life, and significant cost.

Q: We are a simple association with a community water system and private roads in a rural area. Some owners want to let the roads go back to gravel rather than reserve for asphalt repair. If the majority vote for this, can we "go back in time to gravel?"

A: Possibly - but remember that the job of the board is to maintain and protect the physical and financial assets of the association, not let them deteriorate back to lower or previous states. And also – remember that it is the board that has this responsibility (not the homeowners). Don't be surprised they are only focusing on "cost". Remind them that it is your job to provide for sustainability of the association and maximized home values, which is what well maintained roads will do. It's worth the investment.

RESERVE FUNDING QUESTIONS

Q: Should a reserve study precede a Special Assessment to fund a deficient Reserve Account?

A: Only when absolutely necessary, to provide sufficient funds for a very near-term project. A special assessment is not warranted to simply "build up the strength of the Reserve Fund". That is what ongoing funding is for. Consider a special assessment to be like surgery – only do when absolutely necessary. A Reserve Study prepared according to national Reserve Study Standards (and the four-part Funding Principles) provides the objective justification for how much Reserves you need, when, why, and how.

Q: We have a budget to fund our reserves every month, but we never have the money to actually transfer the money into our reserve account. Other than a Special Assessment, how can we get the money to transfer the money?

A: Raise your monthly assessments. It is very clear that the association needs additional income to offset its expenses.

Q: We are already in serious deferred maintenance. Continual special assessments will not properly address this. In this case, do you recommend a large loan?

A: No. I recommend what you already know… that you need to raise your monthly assessments. You may not qualify for a loan and be forced to (in the interim) pass another special assessment to buy you a few years to build your Reserves. Remember that a lender will require higher assessments to repay the loan. Get ahead of that…

raise your assessments now and start collecting the necessary cash your association needs.

Q: **As a homeowner how do we address underfunding or our reserves?**

A: Speak up. Attend board meetings. Ask if the board is "on track" for being ready for upcoming (painting, roofing, elevator, asphalt, etc.) projects. Make it clear that you are willing to face higher assessments in order to avoid an inevitable future special assessment. Propose a meeting or presentation with a Reserve Specialist. If the board doesn't respond, begin setting aside funds to prepare for the inevitable future special assessment, or consider selling your home so some other poor sap can pay the inevitable upcoming special assessment.

Q: **We have a lot of huge emergency projects. Should we set aside additional monies, outside of reserves, to fund for non-reserves emergencies?**

A: Discuss with your Reserve Study professional. There may be a pattern in these "emergencies" that should be funded through a more robust Reserve fund. But yes, expect to raise your assessments to fund these additional costs one way or another. If these costs are not Reserve projects, then consider opening another savings account for these "contingency/unknown" projects. Reserve funds are designated towards known Reserve projects. Don't deplete your Reserves for "emergencies" (broken water mains or lawsuits). You'll still have those Reserve projects to fund!

Q: **Is it necessary to do a special assessment if we have double the amount of the project currently in Reserves?**

A: Discuss with your Reserve Study professional. Your current project may deplete your Reserves, so it doesn't have sufficient cash for another project shortly to follow. Hopefully there's a good explanation… you shouldn't have a special assessment unless absolutely necessary.

Q: **Should you ever use a Special Assessment to refund "missing funding" from a reserve account? (No audit has been completed on the account)**

A: Usually "no". Typically, this is the case of optimistic budgeting, where Reserve funding was stated in the budget, but it was not a realistic budget and Operating Expenses are using all the association's income. Raise your assessment structure so you have additional income to the association to restore the missing funds. If truly "missing", it may be time for an audit to find where actually collected funds went. Missing money could mean mismanagement or worse. First, have an accurate understanding of the problem.

Q: **What do you say to a board who refuses to increase dues to add more to reserves than the 10% FHA (and Freddie Mac and Fannie Mae) minimum? They don't want to save the future. They get upset when a unit sells too high that it will make their property taxes increase.**

A: State clearly that it's not "saving for the future". It's offsetting ongoing deterioration, a bill as real as any other bill that doesn't go away if unpaid. Yes, homeowner assessments will go up, and home values will go up, and Real Estate taxes will go up. But I'll take higher Real Estate taxes from higher home values any day! Besides, boards face liability exposure when they are not providing for the financial needs of the association as required in the Governing Documents. And, of course, gather some like-minded individuals and run for the board at the next election, electing people who understand "fiduciary duty".

State Specific Questions

Q: Florida condo regulations (Statute 718) require full funding of reserves. Would this mandate a reserve study, or are there other ways to determine appropriate reserves?

A: First, FL <u>does not</u> require "Full Funding" of Reserves. All FL has done is eliminate the line-item veto homeowners used to have to waive all of Reserve Funding. Now FL associations (3 stories and higher) must fund a short list of structurally related components. Owners can still waive funding of Reserves for a host of Reserve projects like asphalt, elevators, pool resurfacing, HVAC, etc.), creating their own special assessment situations. Get the truth about your situation. Get a Reserve Study by an independent, credentialed (RS or PRA) professional who can provide wise counsel and guide your association forward… through mandated funding and voluntary funding.

Q: Due to CA SB326 requirements (law passed in 2019 requiring inspections of exterior wood elements like stairwells and balconies that support humans that could result in more than a 6 ft fall, with first set of inspections required before 1/1/2026) , several units have been red tagged. This looks to have opened up the opportunity for an emergency special assessment of greater than the state-limited 5%, though our association currently has the funds to pay for the work. Do you recommend doing this emergency special assessment as the special assessment recommended by our Reserve Study professional for other projects has not yet been approved by membership vote?

A: If the need is urgent (I'd consider resolving my red-tagged and uninhabitable unit an urgent situation!), those funds can and should be paid from Reserves. Now. Consult with your Reserve Study professional and ensure that all upcoming costs are identified and handled through Reserves and revise the upcoming special assessment amount as appropriate. So, get an accurate Reserve Study. Collect the funds necessary to sustain the association. Then get things done at your association.