

THE COMMUNITY BUILDER

Reserves... What are they Really for?

As a community manager and a homeowner, I am completely committed to the idea of Reserves. As a Florida resident and longtime manager, I have grown up with the evolving requirements of Florida law as it relates to the condominium statutes and more recently, homeowners association statutes regarding the requirements for the formulas and the accumulation of Reserve funds. I've even gone so far as to apply this theory to my own home to ensure that for replacing the roof, painting and long-term maintenance, we have sufficient funds to make those improvements when they occur. It is so much easier to put away a few dollars per month in a savings account over a few years than it is to take a huge hit and have to pay it out all at once out of my operating budget. If you're not prepared, it could be a devastating cost or you will defer the replacement until it begins affecting other components, costing even more.

This same theory applies to all common interest realty properties. Condominiums have different shapes and types, but they all have the same components in common: roofs, painting, parking, plumbing, etc. Townhomes may sometimes have the responsibility for common maintenance. Single family homes have common areas and sometimes mega amenities such as private roads, gated entries, storm water systems, retention or detention ponds, clubhouses, pools, tennis courts, etc. Each of these components has an expected useful life the repair or replacement of which will at some time exceed a normal maintenance or operational budget. These are all reasons why a little preventive planning is necessary to ensure the continued viability of your community and home.

Borrowing heavily from an expert in the field, Robert M. Nordlund, PE, RS, CEO and founder of Association Reserves, Inc., the following offers some insight into what a reserve study is, how it is intended to be used and the basis for it. A reserve study component list is dependent on a four-part test defined in National Reserve Study Standards. To qualify for reserve budget funding, a component needs to pass all four tests:

Test #1: The component must be a common area maintenance responsibility.

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This means that your Reserve components should not be derived from a generic master checklist. Reserve line items should be established based on a thorough understanding of the Association's common area assets and maintenance responsibilities as defined in the association's governing documents or well-established Association precedent.

Test #2: The component must have a limited Useful Life (UL).

This excludes components with "very extended lives" (i.e. the life of the property) or components that can function indefinitely with only minor ongoing maintenance or repair.

Test #3: The component must have a predictable Remaining Useful Life (RUL)

This test rules out any unpredictable or random line items. A future expenditure needs to be reasonably anticipated in order to be defined and incorporated into a plan.

Test #4: The scope of work must be above a minimum threshold cost.

This test rules out projects below a minimum threshold cost. It is inappropriate to clutter the Reserve budget with insignificant expenses that are more appropriately handled in the ongoing operating budget. This threshold is sometimes determined by statutes, such as in Florida where it is required in a condominium that Paint, Roofs and Paving are required reserves no matter what the replacement cost, and then any component with a replacement cost of \$10,000 or more is also required to be included.

An example of a threshold cost would be \$250 to repair or replace a gutter or downspout; \$1500 to repair a boiler; \$1,000 to replace signs in the parking lot or at the pool. Each Board should determine a policy as to where this threshold is and use it as a basis for determining what their operating budget should be and provide a guideline for their manager to use.

A Reserve Component List forms the foundation of every Reserve Study, detailing the scope and schedule of all anticipated Reserve projects. Reserve fund strength (also known as % Funded) and the Reserve Funding Plan are both calculated based on the repair & replacement projects that appear on the Reserve Component List.

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There are different methods of determining how Reserve funds are to be accumulated, the Pooled Method or, my particular preference, Straight Line Depreciation. While both are acceptable, most of us do not truly understand the "pooled" method. The funds accumulated in this method are light at the beginning and back end loaded as the component ages. I find that it can be overly burdensome when it is time to do a major project. The Straight-Line method is stated in a formula that is easily understood and presents well as a schedule when included with the budget each year. There is clear indication of the age of the component, when it was last completed, how much it will cost to replace, how much specifically has been accumulated in that fund and what the required budget should be this year.

Whatever method is used, Reserves are a critical part of the well-being of your community. Well-funded reserves will avoid special assessments that can cause undue stress on owners and will count heavily in the Association's favor with lenders and new buyers.