RESERVES - ADVANCED CONCEPTS FOR MANAGERS AND BOARDS

by Robert M. Nordlund, PE, RS www.ReserveStudy.com Oct 9, 2024
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Miss the webinar? Watch it here.

In this webinar, long-time manager and New Mexico Reserve Study expert, Chip Munday, joins Robert to share from his wealth of management and Reserve Study experience to address some of the more “advanced” questions asked by clients and attendees of other webinars. Go beyond the basics (Reserve funding offsets ongoing deterioration), and learn how to put more “checks in the good column” and make fewer of the regular mistakes we see by learning:

- Strategies and keywords for communicating the value of Reserve funds, and a Reserve Study, to boards and homeowners
- Does delaying a project save Reserves? Is delaying wise?
- Dealing with Rejection (why spend $ on a Reserve Study if we’re just going to ignore it?
- Avoiding problems of your own creation (misstatements, forgetting, overspending, being casual about your investments…)
- Winning the “game” – knowing the objective, and the rules!
- How are “Adequate Reserves” defined, and do you have “Adequate Reserves”?
- Is ongoing maintenance money well spent?
- How to (safely) minimize Reserve funding (Hint: maximize interest, and spend wisely)
- Reserve Funding “Best Practices”
- Including projects 30 or more years away?
- What is “Best Practice” for updating your Reserve Study?
- Do strong Reserves influence property values? (Hint: yes!)

- Do associations with a strong Reserve fund have higher or lower Reserve transfers than weakly funded associations? (Hint: no!)

Get a sneak read of Chapter 1 of our book "Understanding Reserves" here.

See more about our novel online Reserve calculator uPlanIt here.

Join and enjoy our weekly 30-minute podcast for board members "HOA Insights: Common Sense for Common Areas" (get encouraged and equipped!) here, or subscribe from all your major podcast platforms.

Looking for more related resources? See additional recorded webinars on our "webinars" page here.

Remember - you're never on your own. Association Reserves is here to guide your association toward an improved future with carefully prepared Reserve Studies and wise counsel throughout the year!

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Please find the Questions and Answers portion of the program beginning on the next page.

Webinar Questions Asked By Attendees

General Reserve Questions

Q: What is required in an HOA?

A: Generally, Governing Docs empower and require the board to provide for the care of the association's physical and financial assets. That requires planning when many of the large assets (roofing, painting, asphalt, elevators, etc.) have long life expectancies, and the cost is so huge that it requires years of financial preparation. So a Reserve Study guides the board responsibly and successfully to the future by letting the board know the cost of ongoing deterioration, which can and should be offset by regular Reserve funding. .

Q: What software is commonly used to report and record property and equipment maintenance schedule in accordance with Reserve Fund study to ensure maximum life span?

A: There is no short list of "common" maintenance and repair tracking software size and scaled for use by community associations. We look forward to the day when such software options are readily available.

Q: Thank you for reinforcing that condo living is not the inexpensive and carefree living that it's made out to be. I wonder how we can change this perception?

A: The future is built on decisions we make today. So we stressed it on this webinar. And we will address it in an upcoming podcast (HOA Insights: Common Sense for Common Areas) episode on that topic. See HOAInsights.com for more.

Q: One of the risks of going from one special assessment to another is pricing people out of their homes. Understandably, the duty of the board is fiscal responsibility, but if numerous homeowners end up defaulting, doesn't that mean that all of the other owners end up having to pick up the slack - or, where possible, just not doing all of the special assessed item(s) or delaying them?

A: You've articulated a problem. It is best to clearly communicate the true cost of living in the association, so as that cost creeps up year by year, owners in a financial squeeze can sell their homes on their own time schedule and move to more cost-effective housing. When people default, in the short term all association bills fall on the remaining owners (until those homes are sold to new, paying homeowners). Fear of defaults often causes boards to delay projects, only (unfortunately) making those projects even more expensive and disruptive. The key is to stay ahead of the problem with responsibly sized Reserve funding.

Q: What is the requirements for having a reserve study? Is it $75,000 of annual income?

A: There is no national mandate. Different states have different requirements for timing and who the requirements apply to. National Best Practice is to have a Reserve Study based on a diligent visual site inspection at least every third year. That's a good practice to keep if you have any Reserve assets that could not be readily accomplished through the ongoing Operational Maintenance budget.

Q: What have you found to be the most successful way to educate owners who are vocally resistant to funding Reserves appropriately?

A: The board has the responsibility to provide for the needs of the association, and every homeowner "signed on the dotted line" when joining the association that they would pay their fair share. Make it clear that all Reserve funding is doing is offsetting ongoing deterioration. Nobody can put up an effective argument against paying their small, fair share along the way, for the deterioration of the common areas while they were owners.

Q: How to respond to homeowners who say they don't want to fund a long term roof replacement now when they will not be here when the roof is to be replaced?

A: In most cases, homeowners don't control the budget. The board is responsible to set the budget, and homeowners are responsible to pay. If they don't want to pay, they can move out. You don't lead the association to make friends. You lead the association because someone needs to responsibly run this not-for-profit multi-million dollar Real Estate organization.

Q: The most difficult issue to convincing current owners that funding reserves is fair to them. Can you elaborate the reasoning and arguments.

A: Reserve funding only offsets ongoing deterioration, preparing the association to have sufficient funds to care for the association, maintaining and maximizing property values. It is an investment in your home's value. Properly funded reserves prevent special assessments and ensure the long-term sustainability of the community. Everyone benefits from a well-maintained property.

Q: **I am at the end of the third year of our reserve study plan. What do I do next? Do I begin again or do I add another off-site reserve?**

A: Commission another With-Site-Visit Update. Contact your local credentialed Reserve Study provider for an update, or click here for a no cost, no-obligation proposal from Association Reserves.

Q: **What is the best way/technique to communicate a HOA fee/dues increase?**

A: Transparency is key. Be upfront about the reasons for the increase, explain how it aligns with the reserve study, which is only providing for the ongoing care of the association. Costs have increased, and that needs to be reflected in higher homeowner assessments, part of which needs to go to higher Reserve funding requirements.

Q: **Any advice on convincing a board to do the right thing and increase assessments when it is necessary, to the level necessary? I have reminded them of their fiduciary obligations, but they refuse to do the right thing and properly fund reserves.**

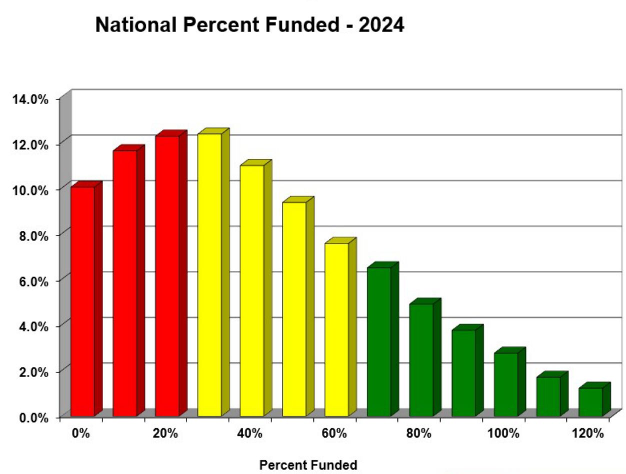
A: You can lead a horse to water, but you can't make it drink. Begin setting aside your own Reserve Fund for the inevitable special assessment(s) that will come. And campaign to run for the board (along with some other like-minded owners), to get on the board and begin to lead the association towards a future where maintenance is done on time, without special assessments, and home values are maximized.

Q: **I've been a board member for many years. I can't agree that all Special Assessments are bad. For example, I think it is fair that I pay into future elevator modernization, but not to fund it 100% 25 years from now. I believe big expenditures can be fairly funded through a blend of Reserves and Special assessments to make it more fair regarding who pays, how much, and when. Your thoughts?**

A: You are wrong on a key point. Nobody is being asked to fund anything in the future. Reserve funding offsets ongoing deterioration. Everyone is responsible to pay for the deterioration that occurred while they were an owner. That's how hotels set their rates, how rental car companies set their rate, etc. Everyone pays their fair share for the time they use the asset. Shifting costs onto future owners is irresponsible self-dealing, and any attorney will tell you that.

Q: **I'd be interested in knowing the average percent funded over ALL your associations.**

A: Please see below, for a national average.



Q: **If our reserves are not sufficient and our gov doc allows us to get a loan. Do we need a majority vote of the community to add the loan payment amount to each owners monthly assessment amount?**

A: Typically, yes. Please consult with your legal counsel to ensure what you are allowed to do under your Governing Documents. Sometimes there are limitations when the loan is necessary for an expense that was foreseeable.

Q: **Is there a webinar for newbies to reserve funding for association members to be introduced/ educated to the concept of Reserve Fund Studies and Funding and get off the Special Assessment train?**

A: Yes. Please see our "Reserve Study Basics" webinar outline and recording here.

Q: **Would you mind providing the information again on how to get the book?**

A: Absolutely. You can view more information here (including a link to a free download of chapter one).

Q: How do you move forward when you are faced with a community of owners who are middle to low cost and do not have money to pay and the potential of a community who ends up in total delinquency? 5% special is useless to large deferred projects and loans are groaned.

A: This is a challenging situation. Remember that all owners committed, upon becoming members of the association, to share in the cost of the association. This typically happens for two reasons – owners were attracted to the association by unsustainably low assessments, and those assessments were kept low for too long. Stress the profit possibility by investing in the association to reap higher home prices. A reserve specialist can help you develop a sustainable plan that attempts to build a feasible funding plan that stretches, but does not break, the homeowners.

Q: Confirming it is the Boards obligation/responsibility to set reserves. Some homeowners believe it is them.

A: Yes, in most cases the Board has the power to set the budget. Some Governing Documents and some states give veto power to homeowners. In those cases, it's up to the board to make a great case for paying the cost to care for the association. Otherwise, it's all downhill.

Q: What states require reserve studies?

A: Different states require different things – Reserve Studies, Disclosures, Funding, etc. Remember that state law has nothing to do with the cost of deterioration. So it is always best to budget to care for the association's common areas, no matter what state law says. View more information from CAI on this topic here.

Q: In our state, commercial associations, aren't required to have a Reserve Study, although as a manager we recommend it so the board knows how much to budget to offset ongoing deterioration. Many time business owners want to invest money on their own and decide the type of investment and then pay, if needed for a capital item. Any suggestions to encourage regular funding?

A: Reserve costs are eminently predictable. I'm a business owner. I don't like to be surprised by big bills. Appeal to the sensibility of the owners that a little bit set aside each month, collecting enough (just like a hotel or rental car company does) in order to have sufficient cash when needed, is wise and responsible.

Q: **We are a small single family home neighborhood with 144 homes. The only assets we're responsible for are two entry signs and nine mailbox clusters. The replacement cost for all today is $35,000. We have more than $50,000 in cash assets (invested). Do we really need to have a Reserve Study completed?**

A: At first glance, it seems like you have sufficient cash and don't need to worry. But a Reserve Study for a simple association like yours is inexpensive, and can inform the board if that $50,000 is "just right" or "far too much", which could result in gradually bleeding off that cash balance by subsidizing homeowner assessments for a year (or two or three). Guessing is rarely a prudent plan.

Q: **About how long does the average reserve study take?**

A: The duration of a reserve study can vary depending on the size and complexity of the association. However, a typical study takes approximately 8 weeks to complete.

Reserve Component Questions

Q: **How do we evaluate the estimates of components? We've had roof estimates from 3 years ago that are now costing 6 times that old reserve study estimate.**

A: I have yet to hear about roof estimates off by a factor of six just over the last three years. Update your Reserve Study by a credentialed professional, and find out what's right and wrong. Regular Reserve Study updates are crucial to ensure Reserve Funding stays on track to provide for upcoming projects.

Q: **I know that reserves components are projects related to existing assets. But what about costs that you know will take place for new, necessary components? How can those be worked in?**

A: Reserve Study replacements are not required to be "like for like". Please discuss with your local credentialed Reserve Study professional, who can separate "natural evolution" replacements from true "capital improvements" that need to be funded without an expenditure from Reserves.

Q: Is it appropriate to include "non-capital" (IRS definition) expenses into a reserve study such as large scale tree maintenance costs or termite treatment renewals that are performed every 5 or so years but are very expensive?

A: Yes. Do your Reserve planning based on Reserve Study standards (which recommend inclusion of such significant "non-capital" projects as these), and do your tax planning by IRS standards (which suggest these types of projects shouldn't be funded from Reserves).

Q: I had an association that wanted to increase homeowner assessments to flow more money into the Operating account to pay for a capital improvement rather than draw down Reserves. Your thoughts?

A: Great idea. Reserve funds should not be expended to add a new asset to the association. Capital Improvements are generally funded by a special assessment or a "war chest" created over time by higher Operating Income than Operating Expenses.

Q: What are the best practices for using reserve funds during a catastrophic event? Is it ok to borrow from reserve funds? Or should reserve funds not be used at all?

A: Reserve funds are intended for major repairs and replacements. But in the event of a catastrophic event, the board may need to use reserve funds to address urgent needs. However, it's important to have a clear plan for replenishing the reserves after the emergency back to the Reserve Fund. A written repayment plan is recommended.

Q: Can you repeat what Chip stated, that a capital improvement project should not be taken out of reserves?

A: That's it. Reserve funds are for the repair, replacement, or significant maintenance of major common area assets. You deplete Reserves, risking the inability to have sufficient funds to care for what you already have, when you spend Reserves to add new things to the association (which will likely require Reserve funding themselves!).

Q: Could reserves be allocated into plant/landscaping replacement? i.e. Allocate a $% amount every budget for this purpose, being $0 at the outset.

A: Yes. Discuss with your local credentialed Reserve Study professional to establish a Reserve component for landscaping refurbishment, tree trimming, etc. This will ensure the funds are available to accomplish those projects in a timely manner, maximizing home values.

Q: **In a Reserve Study, how do you come up with the dollar figures for various projects? My experience shows that the numbers that you use are on the higher side.**

A: Reserve specialists use various methods to estimate replacement costs, including historical data, vendor quotes, and industry standards. While the estimates may seem high, they are generally based on the actual cost experience of similar associations in your geographic area, including delivery, installation, cleanup (disposal), permits, change orders, etc.

Q: **When would you use reserves for an expenditure that is not in the reserve study?**

A: When it is a legitimate Reserve project (meeting the national standard three-part test), but for some reason (human error, passage of time, etc.) it had not been included in the prior Reserve Study. The higher authority is national standards, not your Reserve Study document. This type of event reinforces the concept that Reserve Studies need to be updated regularly… especially right after a new component has been added.

Q: **Normally, who is responsible for maintaining balconies within an individual unit - the homeowner or the HOA? I am asking because whether these balcony maintenance expenses need to be part of the Reserve fund.**

A: The responsibility for balcony maintenance typically depends on the governing documents. In many cases minor maintenance (sweeping, keeping drains clean) belongs to the homeowner. Generally when special tools, materials, or licenses, or insurance is required, then it indicates a significant project beyond "minor maintenance" that is best handled by the association.

Q: **Should a Assoc now make a projection to replace lead pipes from the new Federal decision last couple days?**

A: Please discuss with your local credentialed Reserve Study professional and your plumbing service provider to develop an appropriate plan for your association.

Q: **Can wages of personnel be included in a Reserve Project for the hours spent on the project?**

A: Reserve projects are to be "all inclusive", meaning labor, materials, permits, shipping, etc. are to be included. But don't get caught spending funds from Reserves for maintenance staff while working on projects that should be funded from the Operating Budget.

Q: **We received a reserve study and the vendor asked if we were comfortable with the useful life. I assumed it was a standard number. Should the useful life follow a certain guideline? Not sure why we were asked if we were okay with the Useful life.**

A: We often ask how often things have been replaced in the past, to get a gauge for how materials are standing up to the weather and usage in your association. There are ranges of Useful Life, affected by many factors, including ongoing maintenance. It sounds like your Reserve Study was "tuning" the Reserve Study to fit your particular association.

Reserve Funding Questions

Q: **How do you reserve for a new roof 20 years from now?**

A: Three steps: We establish the cost now, we add a stable multi-yr (multi-decade!) inflation adjustment factor, and we expect to update that Reserve Study based on a new "current cost" at least every three years going forward. That tends to get our associations well prepared for an "actual cost" many years into the future.

Q: **Are the number of dollars needed for full funding of reserves different for pooled funding vs. straight-line funding?**

A: Not in the long term, as Reserve Funding only offsets costs. Both the Cash Flow (pooled) method and Component (straight-line) method fund exactly the same projects. Cash Flow (pooled) method funding is regularly a smoother and gentler path towards Full Funding, so in the short term it greatly preferred. Component method (straight-line) method funding rapidly gets an association to the Fully Funded level. Being Fully Funded is a great goal, but it's generally not worth the pain of a Component method Funding Plan that penalizes the first few years of owners. Fairness trumps speed of getting to "Fully Funded".

Q: **What Percent Funded do you consider the safest to avoid special assessments?**

A: The "strong" level of Reserve Funding is generally considered at-or-above the 70% Funded point. Special assessments in this range are rare.

Q: **Is there a general % number for reserve funding as part of total budget that is a safe number?**

A: Most associations need 15-40% of their budget going towards Reserves to be adequately funded, providing for upcoming projects without reliance on special assessments or loans. A Reserve Study tells you where your association needs to be. But hint: it's generally pretty close to 25%.

Q: **We have a 2 large scale projects in the near future, a balcony inspection and repair project, and a seismic retrofit. Do we use the reserves vs. bank loan? How do we continue to fund the reserves during this time.**

A: Please consult with your local credentialed Reserve Study professional to design a good multi-yr plan that provides both short term funds and funds for other "normal" Reserve projects downstream after these two big projects are completed.

Q: **How does a deferred property ever catch up? I took reserves from 13% to 60% over the last few years, only to find out that due to some cost increases and "surprise" expenditures we'll soon deplete all our Reserves.**

A: Regular Reserve Study updates are key, providing regular course-corrections to spending and funding. Owning Real Estate is expensive. Generally higher assessments, and sometimes special assessments, are part of the solution. Establish a multi-yr relationship with your local credentialed Reserve Study professional to craft a plan that leads towards sustainability for your association.

Q: **We have a pool that is in the reserve study. The pool surface needs new plaster and the pool deck needs resurfacing. Each is about $ 50k each. Should we do it all at once or have two phases?**

A: Generally it is best to perform similar projects at the same time to minimize disruption to the owners. Check with your local credentialed Reserve Study professional to design a plan that is best based on the Useful Life and Remaining Useful Life of these two costly projects.

Q: **When streets are repaved, taking about half of the reserves balance, is it necessary to continue increasing assessments to replenish reserves?**

A: Increasing assessment to handle upcoming Reserve funding requirements is likely part of your multi-yr Funding Plan. Update your Reserve Study regularly to have a plan that works as you approach your big street repavement project, and provides sufficient cash for other projects after the street repavement project.

Q: **Our current maintenance payments are higher than we need for operating costs. We are planning to avoid a special assessment by funding capital improvements with a bank loan, using the "excess" maintenance to fund the amortization of the loan. Is this OK?**

A: First, check with your legal counsel to see if this is doable under your Governing Documents. Fundamentally, you'll need to repay any loan, and it sounds like you have excess Operating cash to do so. I'm generally not a fan of bank loans, as they're expensive. Perhaps work with your legal counsel and Reserve Study professional to see if you can borrow short-term from Reserves (<u>at zero interest</u>), repaying from Operating. Just an idea.

Q: **Can you overfund your reserves?**

A: Yes, you can overfund reserves. Associations at or above 130% Funded should begin a multi-yr plan of gradually bleeding off their surplus by intentionally "under-Reserving" for a few years. It's nice to be well prepared, but it's inappropriate to sit on hard-earned homeowner money that is not assigned to an upcoming Reserve need.

Q: **You mentioned a minimum of Reserve Funding (condo associations) to be 10% of budget. Is that of total Revenues of assessments and misc revenue (including late fees, amenity fees, etc.) or just 10% of assessments?**

A: Our understanding is that Fannie Mae, Freddie Mac, and FHA's "10% rule" is 10% of assessment income. Remember – this has <u>nothing to do with Reserve adequacy</u>. All it does is keep you in compliance with Fannie Mae, Freddie Mac, and FHA.

Q: **We have a severely underfunded Capital Reserve account in our COA...currently about 12% Funded. The Board approved a Special Assessment over the last 2 years, but has only brought our reserve account up slightly due to on-going Reserve expenses (the reason for the special assessment!). With monthly fees raising annually based in CPI and the "Special "Assessment" continuing for at least 2 more years, would it be better to raise the monthly fee by about 50% going forward and discontinuing the "Special Assessment"?**

A: That's a good question for your legal counsel. Once a special assessment is passed, it might be best to "leave it be". It seems apparent that your association needs more money. So increase assessments sufficient to pay your bills… both Operating and the cost of Deterioration. Look forward to getting a break in monthly assessments when the special assessment is over.

Q: If the reserves account is low, is it permissible to implement a special assessment to "catch up"?

A: Yes, it is possible, but not advised. Smoothness and fairness is always to be desired. Work with your Reserve Study professional to craft a multi-yr Reserve Funding Plan that provides for the upcoming needs of the association without an unsettling (and inherently unfair) special assessment if at all possible.

Q: We were happy to get a (projected) $70k Reserve project actually done for $50k. But now our Reserve Study shows it as incomplete. How do we handle this?

A: Get a new (local & credentialed) Reserve Study professional to update your Reserve Study, showing the project done, with an updated cost in the $50k range. A Reserve Study is not an accounting document, it is a budget and cash flow tool. When a Reserve project is done, it's done (whether under-budget, on-budget, or over-budget).

Q: There was mention of a limit on something to do with reserves, maybe $200 or $250K. I didn't quite catch it. I am not familiar with this regulation. More details please.

A: Deposits held in banks are insured up to $250,000 by the FDIC. It is reckless to hold more than that in a bank, as it is not protected & insured. So limit your exposure by working with an investment professional who can manage your Reserve cash, keeping it safe and maximizing your returns.

uPlanIt Questions

Q: Do you offer training for the uPlanIt system?

A: uPlanIt was designed to fundamentally be very simple. That said, once a year we do a uPlanIt webinar (see the last one here), and there are location-sensitive video tutorials through the uPlanIt system.

Q: I love U-Plan It. Is there a way to generate what your 30-year plan will look like? Does your Reserve Study professional have access to what you do (so that they can easily update your RS)?

A: Thank you for the kind words! Yes, on the "Tables and Charts" tab, there is both a 30-yr summary table (one page) and a 30-yr detail table (showing income and expenses for individual line items). And yes, Association Reserves staff can access uPlanIt to see what you've been doing. Make sure they know, so they don't accidentally overwrite it when the publish your updated Reserve Study!

Q: What are new and innovative processes and procedures for managing an Association's reserve study? Can you give more details about uPlanIt and are there any demos of uPlanIt?

A: See more information about uPlanIt here, and see a webinar introducing and demonstrating uPlanIt here. uPlanIt access through the association's budget season is free with a completed Reserve Study from Association Reserves, and $399 per budget season as a stand-alone service.

Q: Association interest is taxable. Is that accounted for in the online tools provided on the uPlanIt website?

A: Because tax rates are different for different associations in different situations, our recommendation is to reduce Interest earnings by the appropriate amount to only indicate "net" interest earnings. For example, in a 20% tax situation, if the association is getting 4% interest earnings, we recommend reducing that by 20% to have an effective yield of 3.2% net interest.

Interest/Inflation Questions

Q: What is a good planning inflation rate?

A: A reasonable planning inflation rate for a multi-decade timeframe is around 3%. That has been a good historical average, and with regular Reserve Study updates to re-anchor pricing, it should continue to provide responsible future guidance for budget planning purposes.

Q: I think the big question for planning for a roof 20 years out is trying to predict inflation and how much you will actually need in 20 years.

A: We actually don't predict costs 20 years out into the future. We identify current costs, and design a plan that incorporates interest and inflation, that points the association in the right direction of having sufficient funds in the future. That plan is updated either annually or every third year. We have no expectation to make an estimate of something 20 years from now, walk away, and expect that our 20-yr estimate will magically come true.

Q: Given the roof replacement question above, how do you accurately inflate the cost at present replacement value roof of $20K for a roof replacement 20 years in the future?

A: See above. It is a combination of using a stable inflation factor, and re-anchoring the "current cost" with regular Reserve Study updates annually or every third year.

Q: Is it appropriate to increase the monthly fee every year to keep up with inflation, say at the rate of the CPI, rather than large jumps every few or several years?

A: Gradual increases aligned with inflation are best practice. Costs increase gradually, so should your assessments.

Q: What is a good current interest rate on Reserve investments?

A: Check with a community-association investment counselor (at a bank supporting community associations, or a specific Reserve Fund investment company like HOAInvest.com) for current interest rates. We see many of our clients getting returns in the 4% range at this time.

Q: Rather than fuss about interest or inflation values, what do you think about only using the difference between the two for your Reserve planning… a number like 1.5%? Is that a fair way to address this situation?

A: No. It is better to use the individual reference points (interest and inflation), as they yield more realistic results. You can then see the roof realistically increasing in cost, and the Reserve Fund realistically increasing in size. The reader should be presented with the plan, so it can be compared to reality.

FL Specific Questions

Q: Many FL associations need a "Structural Integrity Reserve Study" (SIRS). Could these reserves be boosted through allocating the higher of 15-40% of the budget for reserves?

A: Yes, many of our FL associations are funding Reserves at the higher end of the "normal" range to make up for years of underfunding (all the years they were waiving Reserves entirely, or only funding Reserves at the 10% Fannie/Freddie/FHA minimum).