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Reserve Funding Lessons Learned from the Collapse of Champlain Towers South

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Miss the webinar? Watch it here.

Every day, every week, every year, deterioration is ongoing. That hasn't changed, and will not change, as long we live on this green earth. To offset this ongoing menace of deterioration, associations need to responsibly collect Reserves in order to have sufficient funds, at the right time, to perform major repair and replacement projects. It's all about sustainability and responsibility. A Reserve Study is the guide boards use to see the future and prepare for it. Reserve Studies are guided by national Reserve Study Standards, helping Reserve Study professionals across the country provide consistent processes, calculations, and words to describe their work.

A key change was the updating of these Reserve Study Standards in 2023 to encourage boards to care for their properties in a more holistic way – seeing Reserve Studies work in conjunction with ongoing preventive maintenance and periodic infrastructure inspections. In addition, the updated standards also reinforced the need to fund for "long life" components (occurring less frequently than every 30 years), fund for major maintenance, corrective maintenance projects, and subject matter expert reports (infrastructure inspections, HVAC inspections, elevator inspections, etc.). So expect your Reserve Study to contain more components than before, driving up the size of your recommended Reserve funding. In addition, "Best Practice" was tightened to recommend a Reserve Study update based on a diligent visual site inspection at least every third year. For those associations only updating their Reserve Study every fifth year, this will increase their Reserve Study costs. But the silver lining is that by basing Reserve budgets on more current guidance, special assessments will drop dramatically.

So what has this done to Reserve Study results? Funding requirements have increased, and the average Reserve Fund strength of our client properties has dropped. This is due to so many associations coming out of the woodwork to have their first Reserve Study (or first in a very long time) and finding (to no one's surprise) that "drifting along" was not a strong Reserve strategy! The second reason is the longer Reserve Component list that raises the anticipated Reserve needs of the building. But does this make life at an association "more expensive"? No. It again just prevents special assessments by capturing anticipated projects and funding them through the Reserve budget. That's always a good tradeoff… paying a little bit more each month in order to avoid a fundamentally unfair special assessment every few years for an expense that could have been readily anticipated.

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™

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More questions?. Find more information on the Resources tab of our website here. Or download Chapter 1 of our book "Understanding Reserves" here to see if it is the kind of book you'd like to have on your desktop or bookcase to help you with ongoing Reserve component, Reserve fund, and Reserve funding decisions.

Want our 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 Questions

Q: How often should an infrastructure inspection and report be done?

A: National Best Practice for an on-site visit Reserve Study is now "at least every three years", and infrastructure inspections are recommended less frequently. Depending on the building's age and type of construction (and state, as some laws exist guiding this decision), the recommended range extends from 5 yrs to 20 yrs. Regular Reserve Study and infrastructure inspections catch issues early, minimizing costs and surprises.

Q: Does your company do studies in Georgia?

A: Yes, Association Reserves conducts reserve studies across the entire United States, including Georgia.

Q: A reserve study shows the maintenance and repair over useful life of an HOA and the exterior buildings. How do we use the study to keep the reserve funding for the OVERALL repair of items versus "work orders" for each little issue such as wear and tear of a patio railing paint touch up?

A: Reserve projects are scheduled major projects (above a minimum cost that is significant to the association). Reserve projects do not extend down to "maintenance and repairs", which should be handled through its own ongoing Operational budget line item.

Q: Do you see a Reserve Study becoming a requirement by banks or insurance companies? I'm in AL and it's not a requirement by condo statue.

A: Yes, we see that future. A Reserve Study is a key indicator of the combined physical and financial condition of the community. If I was a decision-maker at a bank or insurance company, I'd require the application package to include a Reserve Study based on a site inspection, within the last three years, prepared by a credentialed provider. If I'm to take a financial interest in an association, I would want to know how its doing. More and more lenders and insurance companies are asking for Reserve Studies.

Q: You mention that loss of life was something that has been factored into your reserve study. How does that happen exactly?

A: National Reserve Study Standards, which guide our component and funding decisions, were updated in 2023 (post-collapse of Champlain Towers South) to more tightly guide component selection and clarify funding terminology. This helps all Reserve Study providers have a clearer understanding of their professional standard of care, and it helps clients comprehend what is being recommended, so (hopefully) they will fund their Reserves responsibly. This means your Reserve component list may be a bit longer, and will more commonly include a line item for an infrastructure inspection.

Q: If an HOA removes a component, and their next study is not due until 2026, what type of study should I have done at this time?

A: That updated information can be accommodated with a No-Site-Visit Update. For instance, if you convert one pool bathroom into a storage rm (making the other one "all-gender"), just let us know. It will be easy to remove that second bathroom, along with the news that you sealed your asphalt, replaced both of your gate openers, etc.

Q: We're own a home in a subdivision (HOA). A 30-year replacement of perimeter fence and asphalt repaving (for the first time) streets are now about 5-7 years away. Total Reserve cash assets have grown from $150K to just $245K in the last 14 years! Our reserve study, just updated, shows we're on track to have a shortfall of about $500K at that time because of those two large projects. But our boards always say everything's fine "today". What to do?

A: I think the average turkey thinks life is great in October, nor appreciating It's life will take a drastic turn come November. So yes, your association may be "fine" now. But you can see the future (courtesy of your Reserve Study). Reserve projects are predictable. The board's job is to provide for the needs of the association, and that means increasing Reserve funding over the next 5-7 years. Make sure everyone knows Reserve funding pays the cost of living in the association, just like you have municipal taxes to pay for parks, paving, City Hall, etc.

Q: What were the two new webinar programs that you created in 2024?

A: This one, and "Breaking the Barrier" (to getting your first Reserve Study done) back in May. Both are, or shortly will be, available on our website here. In addition, material from a presentation at CAI National in Las Vegas in May appeared in two other webinars and will be featured in an upcoming Podcast episode here (Episode #76).

Q: Approximately what percentage of all U.S HOAs are subdivision (not condominium) HOAs?

A: Sorry, I don't have the national breakdown at my fingertips. Out of approximately 50,000 Association Reserves clients, the following is how our clients are divided:

- 67% Condo
- 30% HOA/Subdivision
- 2% Misc (commercial or industrial shared facilities)
- .5% Co-Op
- .5% Mobile Home Park or Manufactured Home Community

Q: How do you calculate the cost of your services? Can you provide an example?

A: It's all a matter of the time it takes to handle the project. Factors are # of homes/units, type of association (condo vs HOA vs …), extent of common area amenities, age, Fiscal Year End (our busy season is in the summer/fall serving the approx. 72% of associations with a 12/31 Fiscal Year End), and physical distance from one of our regional offices.

Q: You mentioned 25% is a good figure of merit for how much of total budget should go towards funding Reserves. What is the statutory requirement for HOAs (if any)?

A: The 25% figure is a guideline, not a statutory requirement, and it is what we find is typically needed to fund Reserves at an association. While every association is different, most associations fit into the 15-40% band. That range, and the common 25% of total budget recommendation, is amazingly consistent for all types of associations: condo-townhomes, condo-apartment-style, condo-high-rise, HOAs, Co-Ops, etc.

Q: HOA's in Texas must have a consensus of 67% of the members to pass a Special Assessment. What happens to an Association that cannot get the votes to continue maintenance of the property?

A: Deterioration accumulates dropping home values, small projects become more expensive projects due to problems becoming larger with every day delayed, and lawsuits begin to fly (because the board is not fulfilling its responsibility to provide for the care of the association). In some cases, we've seen building department condemnation or the local municipality installing a trustee (conservator) to run the place (with an iron fist, I might add). So set your budget to provide sufficient funds to care for the property, or create workable annual increases to get there in just a few years.

Reserve Component Questions

Q: Shouldn't reserves include funds to replace landscaping?

A: Yes, reserves can and often should include funds for the replacement of major landscaping elements. Check the project against the national standard three-part test (major replanting, tree trimming, irrigation system replacements, etc.). Routine landscaping maintenance (like mowing or minor trimming) should be funded through the operating budget.

Q: How do we determine what components should have reserve funding?

A: Your Reserve Study provider will apply the national standard "Three-Part Test". To be funded through Reserves it must pass all three tests:

- Is the component a common area maintenance responsibility?
- Can the project be reasonably anticipated?
- Is its cost above a level of significance (materiality) to the association? f significance?

If the answer is yes to all three, your Reserve Study provider will likely include the component in the Reserve Study.

Q: In the 3-part test, how "certain" does RUL and repair/replacement cost have to be?

A: The test is "reasonably anticipated". So somewhere between a guess and a written proposal. Trust the judgment of your local, credentialed Reserve Study provider to be a good guide in this matter. It is better to be prepared to be surprised.

Q: What is the useful life of common area plumbing and gas fitting in general? Do most HOA's fund this as a component in the reserve fund?

A: Check with your local credentialed Reserve Study provider. This varies with construction materials, age, construction style, and maintenance style (partial repairs on an ongoing basis, or anticipation of a major replumbing project after 25-40 years). Generally these two are long life components. If the project passes the above three-part test, it should be included in Reserve Funding. Because many of these types of projects fail test #2, they often do not appear in a Reserve Study.

Q: Can the cost of periodic architectural inspections be included as a Reserve component?

A: Yes, they can and they should. These inspections help to anticipate and plan for major repairs, thereby supporting a proactive maintenance strategy.

Q: Is it appropriate to fund a Reserve Study update from reserves?

A: Usually not. Commonly Reserve Study updates fall below the "significant cost" threshold for inclusion in the Reserve Component List. This is also a state-dependent issue, as some states have started requiring the funding of periodic Reserve Study updates.

Q: If a 57 year old high-cost asset has an estimated 75-100 useful life with no major expenses to date, would you recommend starting to reserve sooner than 30 years out?

A: Yes. If this project can be reasonably anticipated, you should start preparing. It is better to be close (and a bit wrong), than to have ignored a reasonably expected project because it wasn't yet "certain". You can continue to refine your estimate as the asset continues to age and approach the time it will need to be repaired or replaced.

Q: If cost are uncertain, but cost for full rehab are in the $8-to-20 million ranges, what would your recommend as a reserves target?

A: Check with your local, credentialed Reserve Study provider. They will provide a background of experience and expertise that you likely lack, and will be able to guide you forward. As above, it is better to make a good assumption and get close, than throw your hands up in the air (claiming "uncertainty") and be absolutely unprepared when the project inevitably occurs. Remember, you can continue to refine your estimates as the years go by, making more and more accurate estimates about the upcoming project.

Q: An asphalt company looked at our roads and said they are in good condition. The company said if we continue with a good maintenance plan, we may never need to repave. Therefore, should we then remove paving as a component since roads have an indefinite life?

A: Best practice in our experience is a combination of regular maintenance (crack repairs and seal coating) with the expectation for eventual resurfacing. Feel free to trust the judgment of your local, credentialed Reserve Study provider to guide you forward in this matter. You don't want to be caught unprepared for an upcoming (major) asphalt resurface project!

Q: Is there a rule-of-thumb for deciding the capitalization threshold?

A: A common rule-of-thumb for deciding if a Reserve project is "significant in cost" to the association is when they cross above roughly .5% to 1% of the association's annual budget. Regarding the Reserve Fund, our recommendation continues to be to aim for the Fully Funded (100% Funded) target, beginning to relax once you are above 70% Funded.

Q: You mentioned a couple of items that are now listed as components of a study and I'm wondering if there is guidance from the industry on specifics, or if we need to look to our state's laws. Two in particular: major maintenance (above what $ amount?) and corrective maintenance/repairs (what qualifies?).

A: Yes, major maintenance (such as an overhaul of a chiller or cooling tower) or corrective maintenance (balcony railings that are no longer to code, or replacing wood stairways with metal stairways). There are no authoritative reference books on the matter. Trust the judgment of your local, credentialed Reserve Study provider. As stated above, projects begin to become candidates for Reserve funding when they are more than about half a percent or one percent of the association's annual budget.

RESERVE FUNDING QUESTIONS

Q: Will the required reserve amount for the first year be the same for pooled and component methods? If not, why not? Isn't the calculation the same?

A: No, the required reserve amount for the first year is typically not the same for pooled and component methods. See our Reserve Studies 103 webinar [here](). Both methods fund exactly the same Reserve projects. But the math works out such that Component Method funding calculations rapidly strengthen the Reserve Fund in the initial few years, while that approach to a stronger Percent Funded can be spread out more evenly in the Cash Flow (pooled) method.

Q: Please comment on the difference between being "fully funded" and funded percentage.

A: Being "fully funded" means that your reserve fund is at or in the close proximity of being 100% Funded. That is where the cash in Reserves is equivalent to the cash value of deterioration at the association. Funding Percentages are related to that Fully Funded value. A property that is 50% Funded has half as much cash in Reserves as it has cash value of Reserve component deterioration. A Reserve Fund that has 70% of its cash value of deterioration in Reserves is 70% Funded.

Q: Are increasing costs also a major reason for more groups falling behind in reserve funding?

A: Yes, that is also a factor. With costs rising, funding obligations rise, and associations that have not increased their Reserve funding have fallen behind. That's a good argument for regular Reserve Study updates.

Q: You recommend 25% of annual budget going towards reserves. What do you recommend for a total Reserve Fund balance?

A: The total reserve fund amount should be based on the needs identified in your reserve study. We recommend all our clients pursue being 100% Funded, meaning having Reserves on hand equivalent to the amount of Reserve component deterioration at the property. That is a moving target, as prices tend to increase with inflation, yet when projects are accomplished that drops the amount of deterioration at the property. See more in your Reserve Study.

Q: If the HOA collects $40,000 per month in regular assessments should $10,000 be added the reserve account each month?

A: We recommend setting aside what is recommended in your Reserve Study, but a good figure of merit for an association collecting $40k/mo is 25%, or $10k/mo of that going to Reserves. But remember the math… if your current monthly budget is $40k and you aren't making any Reserve transfers, without a Reserve Study a good guess would be to start funding Reserves at $13,333/mo, would then be 25% of the new $53,333/mo budgeted income.

Q: What is the difference between cash flow v component method?

A: Please see our Reserve Studies 103 webinar here, where we spend the entire webinar explaining what they are, how they are similar (they fund exactly the same component expenses), and how they differ.

Q: One of my associations has only 6% funding of its reserves. What do you recommend to bring it up to at least 70%? Would you recommend a series of special assessments over a few years, or an immediate huge spike in HOA dues?

A: Actually, neither. I'd recommend getting a fresh Reserve Study and doing what is recommended in that document. Often it will mean a higher Reserve Funding rate, perhaps increasing x% per year until it reaches a level where it provides sustainability to the association, with special assessments only as needed. The specific strategy depends on the financial situation of the property and the timeline of upcoming expenses as identified in the reserve study.

Q: Can we switch from component funding to cash flow reserve funding?

A: Yes, you can switch from component funding to cash flow reserve funding (pooled method). The Cash Flow (pooled) method is advantageous to the association. We recommend making that change at your earliest opportunity.

Q: How to add funds to our reserve study when we underestimated elevator cost?

A: If the elevator cost was underestimated in your reserve study, you should perform an update to the study that reflects the true cost of the elevator replacement. The result will be adjusted Reserve Funding in future years to compensate for the "overspending" on the current elevator modernization, while also beginning to prepare the association for the next elevator modernization project (in 25 years or so).

Q: What are your thoughts regarding choosing between a special assessment and obtaining a loan?

A: A special assessment is painful, and a loan is expensive. Your board, will have to choose the lesser of two evils. We always counsel our clients to provide a choice… perhaps offering owners a "pay in advance" price break over paying spread over x months, or allowing them to prep-pay their portion of the loan (again, with a slight financial incentive) to minimize the association's loan requirement. We lean towards a special assessment in a cash-flow crisis situation, fundamentally because it is less expensive than a loan. Perhaps seek counsel from your local, credentialed Reserve study provider to run a couple scenarios for you to make the decision clearer.

Q: **What is your point of view on factoring of inflation into the reserve studies? Apparently it's optional to fund inflation adjusted reserves in FL.**

A: Factoring inflation into reserve studies is wise, and essential for modeling the reality of our current economic environment. Thus factoring in inflationary estimates is highly recommended. Including estimates for interest and inflation is the default recommendation of every Reserve Study provider I know.

Q: **Is there a percentage you can recommend to set aside for unexpected emergencies?**

A: A well-funded Reserves (above 70% Funded, approaching 100% Funded) sets an association up for success. When something unfortunate and unexpected happens, it provides a financial cushion so the project can be accomplished in a timely manner, and the Reserves either replaced or "built back up" over time. A strong Reserve Fund providers sufficient margin so that special assessments are rare.

Q: **Is it better to borrow from your reserves vs a special assessment?**

A: That depends on your overall Reserve cash situation and the timing and size of upcoming anticipated Reserve projects. A Reserve Fund weakened by an unexpected expense, or one occurring earlier or larger than expected, may be able to strengthened over time. But sometimes there are cash flow situations necessitating a special assessment. Check with your local, credentialed Reserve Study provider to get their wise counsel.

Q: **If we manage to achieve 100% funding, would we then drastically reduce the percent of our total funding that we set aside to reserve funding?**

A: No. Reserve Funding offsets ongoing deterioration. Reserve Funding does not stop when your Reserve Fund is strong, although it is at its minimum because the association is no longer in "catch-up" mode and its interest earnings are maximized.

Q: **As president of my board, I am concerned with our 17% funding level. Would a plan of achieving 100% funding over 30 years be a reasonable target (about 3% growth per year), meanwhile having to fund projects using Special Assessments? Essentially a 50/50 split between Reserve transfers and Special Assessments over that time?**

A: No. Special Assessments are to be avoided if possible. I would expect increased Reserve transfers, perhaps increasing an achievable % each year, would likely strengthen your Reserves in the 15-20-yr timeframe. But it depends on when your major expense are expected to occur. Seek wise counsel you're your local, credentialed Reserve Study provider.

Q: In the reserve funding plan, do you include the investment income?

A: Yes, investment income can and should be included as part of your reserve funding plan.

FL SPECIFIC QUESTIONS

Q: Do you provide SIRS report? If yes, how does it relate to reserve Study recently completed?

A: Yes, we do provide SIRS (Structural Integrity Reserve Study) reports in Florida, where they are required. The SIRS report identifies the funding needed for the FL-specific "mandated" components, and all the other Reserve Components at the association. This is a specifically formatted report due to the now "mandatory" and "non-mandatory" components in FL. It may provide similar results to a prior Reserve Study, if it was prepared according to national Reserve Study Standards. While a SIRS needs to be updated at least every 10th year, Best Practice is to update your Reserve Study (SIRS or not, FL or not) at least every third year.

Q: What are the ramifications of not funding the non-mandatory components?

A: The FL "mandatory" components are a short list. Not funding for the non-mandatory items will lead to inevitable special assessments when the elevator needs to be modernized, when the hallways need renovation, when the boiler or cooling tower need to be replaced, when the asphalt needs to be resurfaced, etc. Funding all your Reserve Components is always a good idea. Avoiding special assessments by presenting the homeowners with a realistic budget that reflects the true cost of ownership in the property is truthful, respectful, and wise.