

Reserve Study & Funding Policy

Planning for future repairs and replacements is one of the most critical things a homeowner association should do. A [Reserve Study](#) is a long range planning tool that identifies common area building and grounds components that have useful lives of 3-30 years, the current cost of repair or replacement and a fair Funding Plan to accumulate the money to accomplish the work. Having a written Reserve Planning and Funding Policy is equally important. It is a policy that *commits* the HOA and Board to the reserve planning process and holds future Boards to the standards. Without it, a future Board might decide on its own to set the plan aside or worse, spend reserve funds on something they were never intended for.

Pinewood, A Condominium Sample Policy Resolution # _____ Reserve Study & Funding

WHEREAS, Section ____ of the Association Bylaws grants the general power to conduct the business and affairs of the Association to the Board of Directors, whose members shall be members of the Association; and

WHEREAS, the Board of Directors has the responsibility to plan for the proper maintenance, repair and replacement of the Association common area; and

WHEREAS, the members have the responsibility to fund the proper care of common area; and,

WHEREAS, proper care of the common area directly impacts the value of members' homes,

NOW, THEREFORE, BE IT RESOLVED THAT in order to properly maintain the common area, protect market value of members' homes and livability in the community, the Board of Directors establishes a policy as follows:

Reserve Study Defined. The Board shall have a Reserve Study performed that includes this criteria:

1. Identifies all components that are the homeowner association's responsibility to repair or replace that have a useful life of 3 to 30 years.
2. Assigns a reasonable cost of repair or replacement to each component based on current costs for the area.
3. Assigns a reasonable useful life to each component based on local conditions.
4. Lays out a 30 Year Repair & Replacement Schedule which identifies the years when each component work will be performed including the inflation adjusted cost.
5. Establishes a 30 Year Funding Plan which takes into consideration the costs of repairs and replacements, contributions from members, impact of inflation, revenue generated from invested reserve funds and taxes owing on interest earned. The Funding Plan shall include monthly contributions from members adequate to meet projected costs without the need for special assessments.
6. The Funding Plan shall include a "Percent Funded" factor (percent of actual reserve funds on hand versus the ideal of 100%). If Percent Funded balance is below 100%, the Funding Plan shall provide regular contribution increases over coming years to attain the 100% level without special assessments, if possible.

Permitted Uses of Reserve Funds. Reserve funds are to be used only for the repair and replacement of the specific components identified in the Reserve Study, except as allowed under **Borrowing Reserve Funds.** Components that fit the Reserve Study definition may be added in any given year in the **Annual Review & Revision.**

Annual Review & Revision. The Board shall review and revise the Reserve Study annually to reflect changes in costs, inflation, interest yield on invested funds plus modification, addition or deletion of components. With this revised information, a new 30 Year Reserve Study projection shall be used in conjunction to assist in the Annual Operating and Reserve Budget process.

Borrowing Reserve Funds. Under special circumstances, like an unanticipated Operating Budget shortfall or for an emergency, and if allowed by state statute, the Board may borrow from reserve funds. In such cases, the Board shall adhere to a strict repayment plan that will replace borrowed reserve funds within 12 months.

Investing Reserve Funds. In order to reduce the amount of member contributions, the Board shall invest reserve funds to generate interest revenue that will accrue to the reserve funds balance. Unless otherwise approved by the membership, all investments will be FDIC (Federal Deposit Insurance Corporation) Insured or guaranteed by the United States Government. Investments should take into consideration the repair and replacement schedule so that there is no interest penalty for early withdrawal. The Board may hire an investment counselor to assist in formulating an investment plan. The Board shall review the reserve fund investment plan at least annually to ensure that the funds are receiving competitive yields and make prudent adjustments as needed.

Who Performs the Reserve Study, Annual Review & Revision. To ensure objectivity and competence, the Board shall hire only a third party professional with experience, references and credentials to do reserve planning analysis.

Recorded in the Book of Minutes on _____, 200____

Signed: _____, 200____

President - Board of Directors

Reserve Study Tutorial

Every association should develop a long range plan to properly maintain common area components like roofs, siding and decks. Healthy reserve funds are critical because:

- Buyers finding lack of Reserves back out of real estate purchases.
- Lenders finding lack of Reserves may not lend money.
- The board has a fiduciary responsibility to plan for predictable expenses.
- The costs of maintaining the property will be fairly shared by all owners.
- The Reserve Study provides a predictable maintenance plan.
- A healthy Reserve Fund helps maintain the highest market value of the homes.
- Adequate reserves help avoid special assessments which are both unfair and difficult to collect.

To conduct a Reserve Study, you need the following information:

- Component Description
- Number of Units per Component
- Replacement Cost per Unit/Component
- Year Built or Placed in Service
- Life Expectancy in Years

Step 1 - Make a List of all Common & Limited Common Elements These are defined in your association's governing documents. Some examples include: Decks/Patios, Gutter & Downspouts, Roofing, Siding Repair, Elevator Renovation, Fire Protection Equipment, Pavement Overlayment & Sealcoating, Restriping, Pool Equipment, Furniture, Pool Replastering, Fences and Signage. See [Reserve Study Component List](#)

To ensure a thorough list, consider all structures on the property, not just the most obvious ones. For example, unit roofs are obvious but don't overlook garages, clubhouse and shed roofs. If similar items are built or placed in service in the same year, lump them together as a single line item and note the total number of items; if not, list them as separate line items. This will be the case in associations built in phases. Avoid combining dissimilar items together, like clubhouse roof and unit roofs. Separating these gives a more accurate picture of your Reserve needs and reduces confusion should questions arise in the future. If you feel you must combine items, document the rationale behind it. Document any assumptions made to eliminate confusion. By doing so, anyone unfamiliar with the association will be able to understand the report. Note, for example: "The boat dock is not being reserved. Although a common element, it was decided by an association vote to remove it at the end of its useful life. Refer to the May 2001 Board minutes."

Step 2 - Determine Life Expectancy & Replacement Cost These items go together. Check association records for work that has been done to determine an item's Life Expectancy and Replacement Cost. If the developer is still available, request construction detail and cost information. If you are in an older development, ask qualified contractors. Some contractors may require a nominal fee for a detailed estimate. However, most will credit payment for an estimate toward any work done within a reasonable time frame. You can also obtain costs for labor, material, and useful lives through cost estimating resources like [RS Means](#) or [Craftsman Books](#) that provide national averages indexed to your local area. This is generally sufficient for long range general planning. If you use national averages, always get a detailed estimate near the end of the useful life of a component for a more accurate picture.

Step 3 - Establishing a Funding Plan You now have all the required information to complete a Reserve Study. Next, you must select a funding strategy. This decision is very important and has serious financial implications for your association. The preferred funding strategy combines reserve contributions, expenditures, inflation, interest earned on invested reserves and taxes

payable on interest earned over a 30 year period in order to determine a reasonable and regular reserves contribution (usually monthly) to avoid the need to ever have a special assessments. A Reserve Funding Plan requires:

- **Current Reserve Balance.**
- **Interest Rate on Invested Reserve.** Reserve funds should be placed in insured investment like CDs-Certificates of Deposit and Treasury Notes. The longer the money is committed the higher the return. For example, two year CDs return higher interest than one year CDs which return higher interest than six month CDs. Investing in stocks, Bonds, mutual etc. is an option but due to higher risks, the board should never use do so unless the owners agree in a Reserves Investment Resolution which authorizes them to do so. For current insured and guaranteed investment options, [click here](#).
- **Taxes.** There are two ways to report financial activities to the IRS:
Form 1120H is the tax form specifically made for homeowner associations and is likened to the 1040EZ for its relative simplicity. The tax rate for 1120H filers is 30%.
Form 1120 is an option for all incorporated HOAs (and all should be). While it is more complex, it carries a tax rate of 15%. Since healthy reserve funds can often rise to hundreds of thousands and even millions of dollars, it is usually prudent to use the Form 1120 and cut the tax rate in half. Check with a knowledgeable CPA.
- **Inflation Factor.** Incorporating the current area inflation rate is important because over a 30 year period, it will dramatically affect costs and the reserves needed.

Annual Review & Revision. Extremely important. In conjunction with your annual budget review, review your Reserve Study in the areas listed below. A change in any will often have a profound effect on your plan.

1. **Life Expectancy** Can vary due to use, weather, workmanship, etc. As items get close to the projected end of their useful life, closer monitoring is warranted.
2. **Replacement Cost** As items get close to the projected end of their useful life, you will need to get a minimum of three bids for their replacement from qualified contractors.
3. **Addition/Removal of Items** As time passes, items may be added or deleted from list of Common and Limited Common elements, like removing a boat dock or adding a gazebo.
4. **Inflation** Adjust your inflation factor if it has changed (and it usually has).
5. **Interest Earned.** Adjust the interest yield on invested reserves.

Who Performs the Reserve Study? There are a number of Reserve Study Specialists/Analysts that are available to perform this work. Check out the Service Directory-National for options or inquire with local HOA management companies for referrals. Unless you have a knowledgeable construction cost estimator in your group or your Reserve Study is very simple (few components), it's prudent to have a professional do the work. There are a number of advantage.

- **Objectivity.** An insider will always have a conflict of interest and usually want to minimize costs. An independent Reserve Analyst looks at the reality of your components, materials and their useful lives.
- **Expertise.** Reserve Analysts are trained in construction and cost estimating.
- **Connected.** Reserve Analysts have connections with professional contractors that helps develop reliable cost data.

While a Reserve Study can be compiled using software like [Microsoft Excel](#), there is also specialized Reserve Study Software in our Software section. Healthy reserves are critical to the well being of every association. Investing in a comprehensive Reserve Study and following a carefully charted funding plan will reap huge dividends in the coming years. If your association hasn't already done so, get the ball rolling today! [For more on Reserves](#)

Reserve Planning

Reserve Planning is accomplished via a "Reserve Study" which identifies association maintained components, their useful lives, their costs of repair or replacement and a 30 year funding plan. The Reserve Study ensures that all owners pay a fair share, that money is there when needed and ***no more special assessments!*** For more information:

1. [Reserve Study Tutorial](#) Discusses the process in detail.
2. [Reserve Study Terminology](#) Defines commonly used terms
3. [Reserve Study Component Checklist](#) Lists almost 100 possible reserve components.
4. [Reserve Planning & Funding Policy](#) Make reserving a requirement, not an options
5. [List of Reserve Study Providers](#)

Reserve Study Q&A

One of the most important and valuable planning processes a homeowner association can use is the Reserve Study, yet very few HOA Boards even know what one is much less use it. A Reserve Study charts a long range course for the Board to follow to best manage the assets in its care. Since the HOA's assets drive the value of the members' homes, this is no small matter. If the Board fails to adequately plan for maintenance of the HOA's assets, members will suffer both financially and lifestyle-wise. Here's a Q&A to explain the concept, process and benefits:

What is a Reserve Study and how can it help a homeowner association better manage its funds and maintenance? The Reserve Study analyzes repair and replacement needs like roofing and painting that happen every year and provides a funding plan for accumulating money to perform this work when its needed. It is more a budgeting function than a construction or building analysis, although there is an element of that. The study is usually based on *visual observations* as opposed to forensic testing (tearing walls and roofs apart to see what's underneath). The Reserve Study assumes that regular and adequate maintenance is being done to prevent premature repairs or replacements.

There are several parts to the Reserve Study process:

1. All HOA maintained building and grounds components are identified that have useful lives of 3 to 30 years, the recommended projection period for a Reserve Study.
2. The condition of each component is carefully evaluated and an estimated **remaining useful life** applied to each plus the **useful life** when the asset is new.
3. The repair or replacement cost of each component is estimated based on current

bids or reliable construction cost estimating sources (available from RS Means, Craftsman Book Company and other similar sources). The information for each component is applied to the formula: **Cost ÷ Remaining Useful Life = Money Needed Yearly for Reserve Fund** Totaling the results for each component will produce how much money should be reserved yearly. For example, if roof replacement costs \$100,000 and the remaining useful life is 25 years, then \$4,000 is required yearly to pay for the work when it's needed. Doing this procedure for each component will show the total money needed yearly to fund reserves. Each year, the reserve fund needs to be adjusted by area inflation and the interest earned on the invested reserve funds.

4. Since the recommended projection is 30 years, the inflation rate and yield on invested funds at the time of the study need to be factored in to ensure the fund keeps pace with reality. Adding inflation will increase future year costs and interest yield on invested funds will reduce the amount of owner contributions.

How should the Reserve Study recommendations be funded? A Reserve Study with no funds is a car with no gas: It'll go no where. The Reserve Study should provide a recommended **Funding Plan** which calls for regular and adequate contributions to pay for future repairs without the need of special assessments. For common wall communities, this is accomplished monthly. For HOAs with few assets, reserve contributions can be quarterly or annual, whatever the regular assessment (fees, dues) schedule is. If each member contributes a portion monthly, all members that own there along the 30 year time line will only contribute an amount attributable to their time of ownership. And **all** members will pay. This is the fair approach to reserve funding.

How should these reserve funds be accounted for? Reserve funds should be kept separate from operating funds. If your reserve plan is complete (includes all components and a plan to fund them), establishing separate ledger accounts for each component is unnecessary. The Board should only spend more out of reserves for items that are included in the component list.

How should the reserve funds be invested? It's conceivable that reserves could grow to many thousands, or even millions, of dollars. Since the Reserve Study shows the Board when reserve funds will be needed, funds can be placed in higher yielding long term investments Every dollar earned in interest is a dollar less needed from the members. Increasing interest yield only one percent over 30 years amounts to tens of thousands of dollars for the average HOA. If an HOA is large and accumulating hundreds of thousands or millions of dollars in reserves, it makes sense to hire a professional investment advisor to manage the funds. Conservative investments like government securities or certificates of deposit (CDs) are recommended, however, there are other options that an advisor can recommend.

When should a Reserve Study be performed? All homeowner associations, regardless

of size, should have a Reserve Study done, the sooner, the better. The study will compare what reserve funds you currently have versus what you should have. The concept is called the **Percent Funded**. Along the 30 year Reserve Study timeline, there is an ideal amount of money the HOA should set aside known as **100% Funded**. The Percent Funded function shows how the HOA is doing relative to the ideal. For example, it is not uncommon for older HOAs that have not been properly funding to be 20% Funded or less. Knowing the Percent Funded is critical to chart a funding plan to catch up. You need to know where you are to know where you need to go. If your HOA is newer, the sooner you perform a Reserve Study and begin funding it, the sooner you will reach the 100% Funded ideal.

How often should the Reserve Study be updated? Once the initial Reserve Study is completed and the funding plan is in place, yearly updates need to be performed even though they are relatively simply to do. Even if no reserve projects are done, the rate of inflation and the yield on invested funds always change year to year. Even a 1% change in either of these factors causes a huge impact on the thirty year projection due to interest compounding.

What happens if reserves are under funded? It depends. If the association has inadequate reserve funds to begin with, the Reserve Study will show the need for "catch up". How fast the HOA catches up depends on how soon funds are needed. If there is an expensive and urgent repair like roofing, a special assessment may be needed to address it. If major repairs are some years off, the funding plan can usually accrue the money through regular assessments (fees, dues). Or, using a combination of both special and regular assessments may be the way to go. Whatever course of action taken, the goal should be to reach "100% Funding".

What sorts of financial problems can homeowner associations encounter with inadequate reserve funds? Without adequate reserves, associations rely on special assessments. Special assessments are unfair because owners that have bought and sold in the past fail to pay their fair share and current owners end up "holding the bag". Special assessments are a hardship on owners and some may be uncollectible if an owner's equity is small, he is foreclosed or declares bankruptcy. Also, since special assessments are unpopular, the tendency of the Board is to postpone major renovations. This deferral accelerates the deterioration process, detracts from curb appeal and erodes home market values. A reserve funding plan with regular monthly contributions from each owner is both fair and permits major work to be done when it's needed.

Can poorly managed reserve funds affect the sale of units? Absolutely. Smart buyers and lenders look closely at how reserve funds are handled. Lack of reserves is a red flag for inevitable and costly special assessments (a sign of poor planning). If given the choice between an well maintained HOA with healthy reserves and one with little or none, which would be the wiser investment?

Which types of repairs and replacements must be paid for by HOA funds? The governing documents define what are the association's responsibility. In common wall communities like condominiums, the association is usually responsible for items like roofing, landscaping, siding, painting, paving, sidewalks, pools, clubhouses, signage and fencing. But there are many more components. The average condominium has between 15 and 50 reserve components that should be considered. High rise co-ops and condos can have hundreds.

What kind of qualifications should a Reserve Study provider have? Besides considerable experience doing reserve studies and a list of satisfied HOA client references, a qualified Reserve Study provider should have credentials, good budgeting skills, extensive knowledge of construction and homeowner association operations. Several organizations offer credentials for Reserve Study providers and maintain a list of members. **APRA-Association of Professional Reserve Analysts** (www.apra-usa.com) credentials the PRA-Professional Reserve Analyst and **CAI-Community Association Institute** (www.caionline.org) credentials the RS-Reserve Specialist.

How much does a Reserve Study cost? If the HOA has a qualified volunteer experienced in construction cost estimating, the cost is nothing. **However**, there are clear advantages to having a knowledgeable Reserve Study professional perform the work. Aside from the expertise, knowledge of local contractors and current costs, there is no conflict of interest that HOA members have. Costs to perform a Reserve Study vary based on the size of the HOA, the number of components and the time needed for field work and report compilation. The initial Reserve Study costs the most since it involves time to gather the component data. Reserve Study costs range from \$1500 to \$4000 for HOAs up to 100 units (although extraordinary circumstances, number of components or high cost locations can drive cost higher). Large communities with many reserve assets can expect to pay tens of thousands of dollars. If there are particular problems like dryrot, structural, soil or drainage, an engineering study should be incorporated with the Reserve Study. Recommended annual updates are much less costly since they involve only tweaking the initial study.

A properly funded Reserve Study is an invaluable tool for maintaining value and promoting harmony. When HOA member assets are properly maintained, members profit from higher market values of their homes. Since major maintenance is done consistently and uniformly, no one is getting a better deal than anyone else. The community is more livable and improved curb appeal engenders community pride. When the members like living there, they stay longer and are more willing to volunteer. Oh, one other amazing benefit: No More Special Assessments! What more could you ask for?

Regenesis performs Reserve Studies in Oregon and SW Washington. For a no cost, no obligation proposal, call 503.977.7974 or [Email Us](#).

Reserve Study Component List

Here are items that should be considered in a reserve study.

Needed for Reserve Study Research

- Governing Documents (Declaration, Bylaws)
- Site Plan
- Blueprints (As Built)
- Current Year's Budget
- Most Recent Year End Financial Statement
- Current Reserve Balance \$ _____
- Interest Earned on Reserves?: ____%

Reserve Components Checklist

Bridge Reconstruction	Paint-Exterior
Building Security System	Paint-Interior
Building Fire Detection System	Path Reconstruction
Building Telephone System	Paving-Asphalt-Overlay
Chimneys & Chimney Caps	Paving-Asphalt-Sealcoat
Clubhouse-Appliances	Pond-Fountains & Pumps
Clubhouse-Flooring	Pond-Clean Up
Clubhouse-Furniture	Pond-Renovation
Clubhouse-Office Equipment	Pool-Deck
Clubhouse-Painting-Interior	Pool-Filter
Clubhouse-Window Treatments	Pool-Furniture
Concrete Safety Repair	Pool-Water Heater
Deck & Deck Rail Replacement	Pool-Pump
Doors-Building	Pool-Replaster
Doors-Entry	Roof-Composition Shingles
Doors-Garage	Roof-Cedar Shingles/Shakes
Doors-Parking Garage	Roof-Flat-Built Up
Elevator Cab Renovation	Roof-Gutters & Downspouts
Elevator Safety Inspection	Sidewalks/Driveways-Concrete
Elevator Technology Update	Siding & Trim Repair
Entry Access System	Signage-Building
Fence-Chain Link	Signage-Main Entry
Fence-Masonry or Brick	Signage-Street & Directional
Fence-Wood	Spa-Filter
Flooring-Carpet	Spa-Pump
Flooring-Vinyl	Spa-Replaster
Flooring-Wood	Spa-Water Heater
Flooring-Other: _____	Sprinkler System
Fire Sprinkler System	Storage Units
Garage Door Operator	Tennis Court Net

HVAC-Heating & Cooling Equipment

Landscape Renovation

Lighting-Exterior-(describe fixture)

Lighting-Interior-(describe fixture)

Mailboxes

Office Equipment

Tennis Court Fencing

Tennis Court Resurface

Treework

Window/Skylight Replacement

Other: _____

Other: _____

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Reserve Study Terminology

COMPONENT: The elements which form the foundation for the Reserve Study. Reserve Components consist of those that are maintained and repaired by the association.

COMPONENT INVENTORY: The task of identifying and measuring Reserve Components by visual observation, review of association files and blueprints and input from knowledgeable experts.

CONDITION ASSESSMENT: The task of evaluating the current condition of the component based on observed or reported characteristics.

DEFICIT: An actual (or projected) Reserve Balance less than the Fully Funded Balance. The opposite would be a Surplus.

FINANCIAL ANALYSIS: The portion of a Reserve Study where current status of the Reserves (measured as cash or Percent Funded) and a recommended Reserve contribution rate (Reserve Funding Plan) are derived, and the projected Reserve income and expense over time is presented.

FULLY FUNDED: When the actual or projected Reserve balance is 100% Funded.

FULLY FUNDED BALANCE: An indicator against which the actual or projected Reserve balance can be compared. This number is calculated for each component, then totaled.

FUNDING GOALS: There are several approaches to Reserve Fundings:

BASELINE FUNDING: Establishing a Reserve funding goal of keeping the Reserve cash balance above zero.

FULLY FUNDING: Setting a Reserve funding goal of attaining and maintaining Reserves at or near 100% funded.

STATUTORY FUNDING: Establishing a Reserve funding goal of setting aside the specific minimum amount of Reserves required by local statues.

THRESHOLD FUNDING: Establishing a Reserve funding goal of keeping the Reserve balance above a specified dollar or Percent Funded amount. Depending on the threshold, this may be more or less conservative than "Fully Funding".

FUNDING PLAN: The savings plan followed to funds adequate to pay for anticipated

reserve expenditures.

FUNDING PRINCIPLES: In the development of a Funding Plan, the following four principles are to be considered:

- Sufficient Funds when Required
- Evenly Distributed Contributions over the Years
- Fiscally Responsible

PERCENT FUNDED: The ratio at a particular point of time of the actual Reserve Balance to the Fully Funded Balance expressed as a percentage.

PHYSICAL ANALYSIS: The portion of the Reserve Study where the Component Inventory, Condition Assessment, and Life and Valuation Estimate tasks are performed.

REMAINING USEFUL LIFE: The estimated number of years that a reserve component will serve its intended function.

REPLACEMENT COST: The cost of replacing, repairing, or restoring a Reserve Component to its original functional condition. The Current Replacement Cost would be the cost to replace, repair, or restore the component during that particular year.

RESERVE BALANCE: Actual or projected funds as of a particular point in time that the association has identified for use to defray the future repair or replacement of those major components which the association is obligated to maintain. Also known as Reserves, Reserve Accounts, Cash Reserves.

RESERVE STUDY ANALYST: A professional that prepares Reserve Studies.

RESERVE STUDY: A Reserve Study identifies the major components for which the association has maintenance responsibility that have a useful life of 3 to 30 years. Each component is assessed for condition, useful life and cost of replacement. With this information, a 30 year maintenance schedule and funding plan is produced. This 30 year plan provides current and future Boards with a roadmap to responsibly maintain the community's assets. Following the plan insures that all members pay their fair share of these major expenses. Special assessments become a thing of the past!

SPECIAL ASSESSMENT: An assessment levied on the members of an association in addition to regular assessments. Special Assessments are often regulated by Governing Documents or local statutes.

SURPLUS: An actual or projected Reserve Balance greater than the **Fully Funded**

Balance. See **Deficit**.

USEFUL LIFE: The estimated time in years that a reserve component can be expected to serve its intended function when new if properly installed and maintained.

For more on Reserves

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