

HOA Reserve Study Guidelines

Every homeowner association should exercise a plan to repair and replace major common area components like roofs, siding, and decks. Healthy reserves are critical to a healthy association because:

1. Buyers examine the Reserves before buying
2. Lenders examine the Reserves before approving a loan
3. The board has a fiduciary responsibility to protect the association from financial hardship
4. The costs of maintaining the property will be shared by all owners now and in the future
5. It provides a predictable, manageable, contribution plan
6. A healthy Reserve Fund will enhance the value of your home
7. Most importantly, avoids special assessments

To conduct a Reserve Study, you need the following information: Item/Component Description, Number of Units per Item/Component, Replacement Cost per Unit, 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 (Declaration of Condominium, Site Plan, and Floor Plans). Some examples include: Decks/Patios, Gutters, Roofs, Siding, Elevators, Fire Protection Equipment, Pavement (Resurfacing, Sealcoating, Restriping), Pool (Equipment, Furniture, Replastering, Deck Resurfacing), Fences, and Signage.

To ensure a thorough list, consider all structures on the property, not just the most obvious ones. For example, dwelling roofs are obvious. However, 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 which were built in phases.

Avoid combining dissimilar items together, like, a clubhouse roof and dwelling 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 located in the SW corner of property 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 94 Board minutes."

Step 2 -- Determine Life Expectancy & Replacement Cost

These items go together. A question about one leads directly to the other. Check association records for work that has been done in the past. This will provide an indication of an item's Life Expectancy and Replacement Cost. In a development where the developer is still selling units or has recently completed all sales, ask the developer to provide this information. If you are in an older development, ask qualified contractors or equipment manufacturers, getting a minimum of three estimates. The lowest estimate is not always the best indicator of the quality of work, so ask for, and check references.

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. If an item is nearing the end of its useful life, getting a detailed estimate (regardless of whether it is free or not) is a good idea. If the item in question has a long remaining useful life, pursue getting a conservative, general estimate. This is usually sufficient for planning purposes.

You can also obtain costs for labor, material, and useful lives through sources 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 accountants, and professional Reserve Study providers use, is a Cash Flow Analysis. In general, it examines and projects the Reserving needs (contributions and expenditures) over many years, combining funds from all components, in order to determine a stable annual contribution.

In order to establish your funding plan, you need to determine:

1. What is your current reserve balance?
 2. Do you currently invest the money in your Reserve Fund? If so, what is the investment rate?
 3. What tax rate applies to the interest or dividends earned on the invested Reserve Funds? (see past tax records, or the accountant)
 4. What is the current area inflation rate? This is important because in a cash flow analysis, you examine the contributions and expenditures over five or more years.
- Once you have determined these parameters, you are ready to put together your cash flow analysis.

Review your Reserve Analysis annually and make adjustments as needed to the areas listed below. A change in any will have an effect on your Reserves.

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. 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.

Addition/Removal of Items. As time passes, items may be added or deleted from the list of Common, and Limited Common elements, like removing a boat dock or adding a gazebo.

Approximately 20 percent to 25 percent of your HOA dues should go toward the reserve fund. There should also be a long-term schedule for the reserve fund in the annual budget, including an estimate of upcoming expenses for the community: swimming pool maintenance, lighting repairs, landscaping, etc. Reserve accountants recommend that the reserve fund should contain at least 70 percent of the projected reserve budget. If the fund is lacking, expect to be hit with big assessments when something in the community goes awry.

Healthy reserves are critical to the well being of every community association. Investing in a comprehensive reserve study and following a carefully charted funding plan will reap huge dividends in the coming years.