

Reserve Funds

One of the primary business duties of community associations is maintaining and preserving property values of homes and the common property. To do this properly, associations must develop funding plans for future repair or replacement of major common area components, such as roofs, boilers, elevators, swimming pools, balconies, asphalt surfaces and decks.

An association has several funding options, including periodic assessments over the life of assets, special assessments at the time of replacement, borrowing funds when needed, a combination of the above or the most common method—and in many states the only lawful alternative: setting aside funds in a special category commonly called reserve funds.

Knowing just how much to put aside in reserves requires a reserve study, which is comprised of two parts: the physical status and repair/replacement cost of the major common area components (physical analysis) and an evaluation and analysis of the association's reserve balance, income and expenses (financial analysis).

Associations must also plan for the ongoing maintenance of their physical assets, which in turn affects the reserve study. Without proper care, these assets will deteriorate more quickly and require funds from the reserves for replacement earlier than planned. If these needs are not anticipated, the reserves could become underfunded.

Reserve studies can be conducted at three levels of service: a full study, an update with an on-site review or an update without a site visit. Reserve studies are vital in determining future re-

serve funds and should be reviewed or updated every one to five years.

Associations typically choose one of four funding plans. Each can be used successfully, and each has its pros and cons. The goal of all of the funding plans is to establish adequate reserves—that is, to avoid a deficit due to underfunding.

Adequate reserve funding means more than just providing funds for roof replacements; in the long run it can contribute to the rise or fall of property values. For instance, if an association is in debt or has no reserve fund, educated homebuyers may not want to invest in the community.

Owners can be reluctant to contribute to reserve funds because they think the funds are costing them extra money. However, a reserve fund is not an extra expense—it just spreads out association expenses more evenly.

Reserve funds meet legal, fiduciary and professional requirements. They might be required by the governing documents, as well as state statutes, regulations, court decisions or a secondary mortgage market in which the association participates.

Reserve funds reduce the likelihood of the need for special assessments or borrowing. Owners may have limited resources and be unable to afford the large special assessments necessary for major replacements. Reserve funds can help with these costs, and in turn help enhance resale values. Lenders and real estate agents are aware of the ramifications for new buyers if the replacement reserves are inadequate. Many states require associations to disclose the amounts in their reserve funds to prospective buyers.