What is a Reserve Study?

The Reserve Study analyzes repair and replacement needs like roofing and painting and provides a funding plan for accumulating money to perform this work when its needed. The Reserve Study is based on *visual observations* as opposed to forensic or destructive testing (opening up structural systems to see what's inside). The Reserve Study assumes that regular and adequate maintenance is being done to prevent premature repairs or replacements.

There are several parts to the typical Reserve Study:

All HOA maintained building and grounds components are identified that have useful lives of, typically, two to thirty years.

The condition of each component is evaluated and an estimated Remaining Useful Life applied to each.

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 others). The information for each component is applied to the formula: **Cost ÷ Remaining Useful Life = Money Needed Yearly.** For example, if roof replacement costs $100,000 and the remaining useful life is 25 years, then $4,000 should be reserved yearly to pay for the roofing work when it’s needed. Doing this procedure for each component will determine the total money needed yearly to fund reserves.

Since the projection period is typically 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 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 nowhere. The Reserve Study should provide a 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 usually accomplished monthly. For HOAs with few assets, reserve contributions may be collected quarterly or annually.

If each member contributes a portion monthly, all members that own along the 30-year time line will contribute an amount for the assets they personally benefited from, no more and no less. 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. The board should only spend reserves for items that are included in the Reserve Study component list.

How should the reserve funds be invested? It’s conceivable that reserves could grow to many thousands, 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. If an HOA is large and accumulating hundreds of thousands 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.

When should a Reserve Study be performed? All homeowner associations, regardless of size, should have a Reserve Study done. The study will compare what reserve funds you currently have versus what you should have. This is called the Percent Funded, the ideal being 100% Funded. It is not uncommon for older HOAs that have not been adequately funding reserves to be 20% Funded or less. Knowing the Percent Funded is critical to chart a funding plan to catch up. If your HOA is newer, the sooner you perform a Reserve Study and begin funding it, the sooner you will reach the 100% ideal.

How often should the Reserve Study be updated? Reserve Studies need to be updated annually even if no reserve projects have been done. The rate of inflation and the yield on invested funds always change year to year. Even a 1% change causes a huge impact on the thirty year projection due to the compounding effect.

What happens if reserves are under funded? It depends. If the HOA has inadequate reserve funds to begin with, the Funding Plan will provide a plan to catch up. How fast the HOA needs to catch 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 is 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, HOAs rely on special assessments. Special assessments are unfair because owners that have bought and sold in the past failed to pay their fair share and current owners end up "holding the bag". Special assessments are a hardship on some and 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 and adequate contributions from each owner is both fair and permits projects to be done when they’re due.

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 special assessments and a sign of poor management. If given the choice between a 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 HOA’s responsibilities. In common wall

communities like condominiums, the homeowner association is usually responsible for items like roofing, landscaping, siding, painting, paving, sidewalks, pools, clubhouses, signage and fencing. But there are many more possible components. The average condominium has between 15 and 50 components that should be considered. High-rise condos can have hundreds.

What kind of qualifications should a Reserve Study provider have? Besides years of experience doing reserve studies and a long list of satisfied HOA client references, a qualified Reserve Study provider should have industry credentials, good budgeting skills, extensive knowledge of construction and homeowner association operations. The reserve providers with the best credentials belong to **Association of Professional Reserve Analysts.** For a member list and contact information, go to www.apra-usa.com

How much does a Reserve Study cost? 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 the time needed to gather the component data. The typical Reserve Study cost ranges from $2500 to $5000 for HOAs up to 100 units. Large communities with many reserve components can expect too pay much more. If there are particular problems like dry rot, structural, soil or drainage, an independent engineering study should be incorporated with the Reserve Study. 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 then anyone else. When the members like living there, they stay longer and are more willing to volunteer. Another amazing benefit: **No More Special Assessments!** What more could you ask for?