



THE PRACTICAL GUIDE TO HOMEOWNER ASSOCIATION MANAGEMENT

HOA Reserves and Other Funding Options: Tips for Everyday Smart Money Management

An HOAleader.com Webinar

Presented By

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Guiding Principles

- Associations are governed by...
 - Governing Documents
 - State Laws
 - Business Judgment Rule



Guiding Principles

- Associations are governed by...
 - Governing Documents
 - State Laws
 - Business Judgment Rule
- And are subject to...
 - The Laws of Nature (common area components will age and deteriorate)



Guiding Principles

- Taken all together, this means...
 - The board is **responsible to run the affairs of the association**, repairing and replacing the common areas
 - Failing to do so **creates liability exposure and invites safety concerns.**



Executive Session with Condo Attorney



**"Every time we come up with a great idea,
you have to bring up the law & prison."**

Reserve Budget

- It's really pretty simple...
 - Reserve expenses may appear random through the years, but they are very predictable
 - No “smoke and mirrors”. Components deteriorate in very repeatable ways (clockwork)
 - It's just “adding and subtracting” (income and expenses)



Reserve Budget

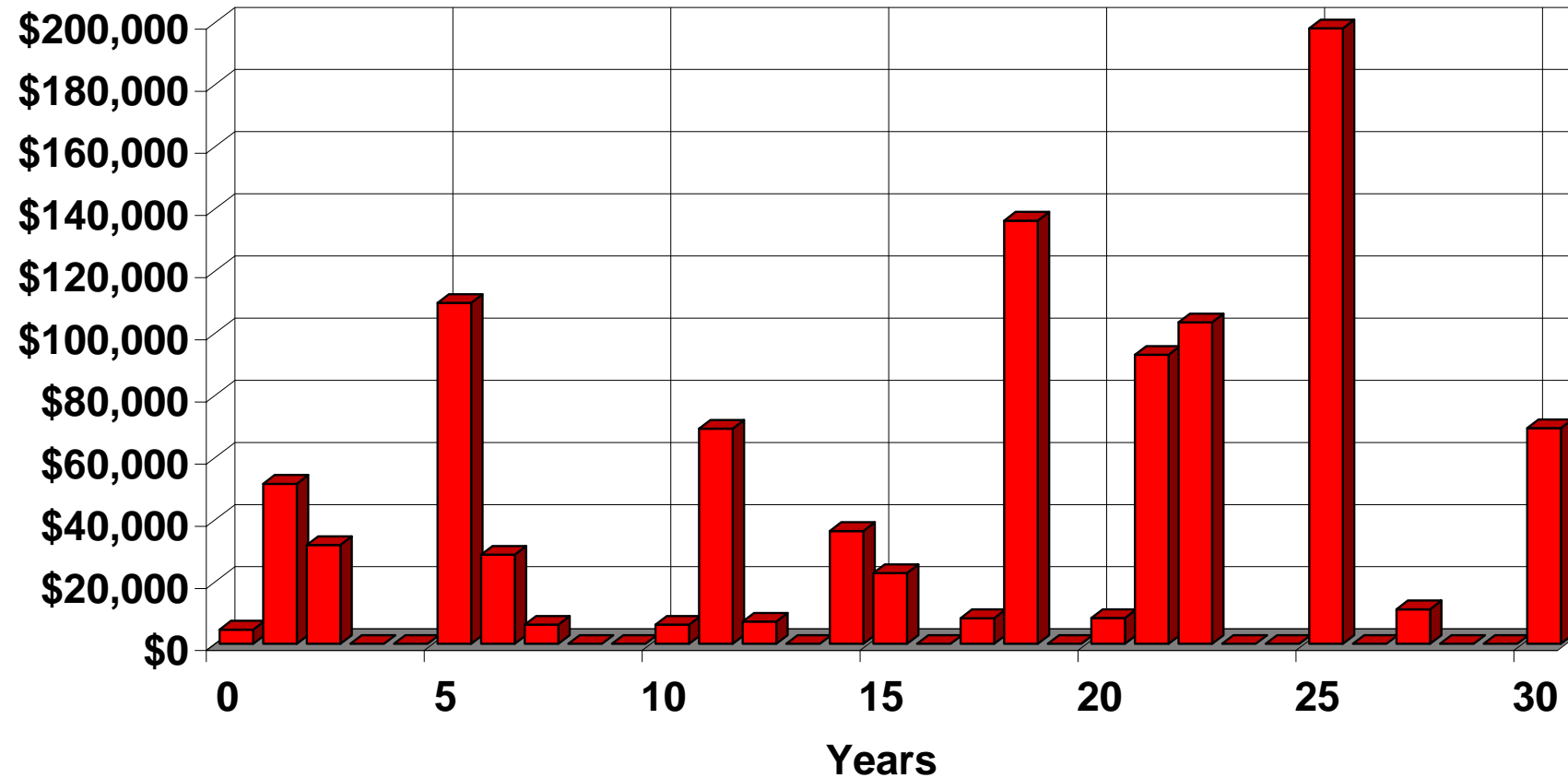
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 - Reserve expenses may appear random through the years, but they are very predictable
 - No “smoke and mirrors”. Components deteriorate in very repeatable ways (clockwork)
 - It's just “adding and subtracting” (income and expenses)
 - **So keep it simple!**



Four Reserve Rules:

- 1. Expenses always happen**
- 2. The board is responsible**
- 3. Delays usually get expensive**
- 4. Homeowners always get stuck
paying the bills**

Annual Reserve Expenses



Reserve Component List

Description	UL	RUL	Cost
Pool Furniture - Replace	5	0	\$4,600
Pool - Resurface	10	5	\$10,000
Roof - Replace	20	18	\$80,000
Asphalt - Seal	5	2	\$5,000
Asphalt - Resurface	20	2	\$25,000
Building - Repaint	10	1	\$50,000
Elevator - Modernize	20	5	\$80,000
Hallways - Refurbish	8	6	\$24,000

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Hallways - Refurb		6	\$24,000

Nothing "random" here!
Everything very predictable.

Operating/Management Responsibilities

- What to Accomplish?
 - Protect, maintain, & enhance the association's common area components
 - Community – belongs to all, but board makes the decisions on behalf of owners

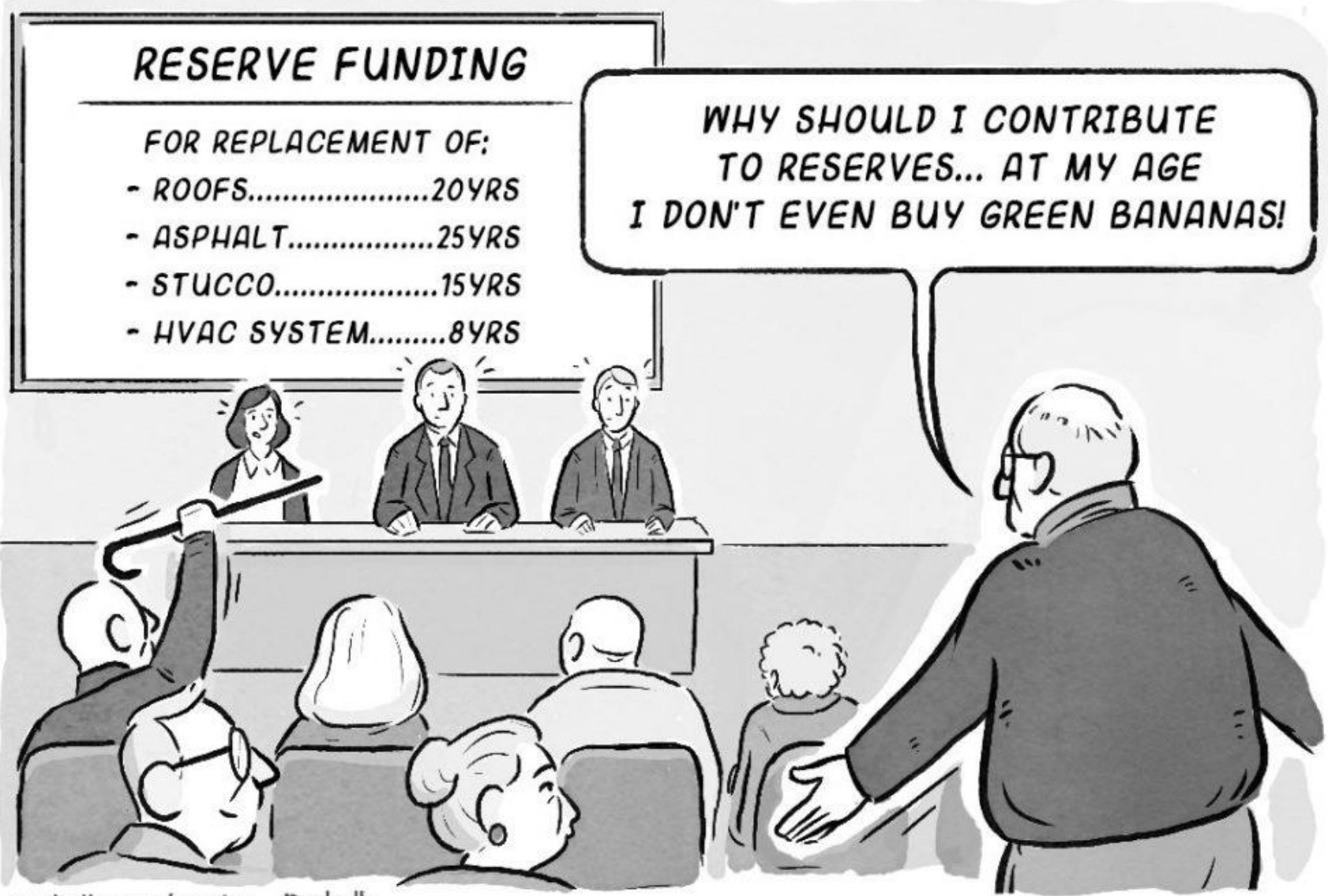


Reserve Contributions are for...



VS





gogladly.com/comics 



Operating/Management Responsibilities

- Boards have a **responsibility** to budget appropriately, providing for the current and future needs of the association
- Most boards are literally pursuing the wrong objective (minimized assessments)



The Business Judgment Rule: Three Elements

Duty of Care
(getting all the
right things done)



Duty of Loyalty
(making sure association
needs get met)

Duty of Inquiry
(prudently asking
questions)

Three Parts of every Reserve Study

How much needs to be set aside to offset deterioration & prepare for upcoming expenses

Do we have “enough”?

What the association is responsible to repair & replace (the foundation)



RESERVE STUDY RESULTS

Which **Components** should Appear in a Reserve Study?

National Reserve Study Standards, created in 1998, define a four-part test:



RESERVE COMPONENT "FOUR-PART TEST"

Which **Components** should Appear in a Reserve Study?

National Reserve Study Standards, created in 1998, define a four-part test:

Note: all costs related to property upkeep... inspections, permits, shipping, disposal...



RESERVE COMPONENT "FOUR-PART TEST"

How do you measure “enough” Reserves?

Compare the deteriorated value of the Reserve components (not total replacement value) against Reserve \$ on-hand (as of first day of the Fiscal Year), and express it as a percentage.

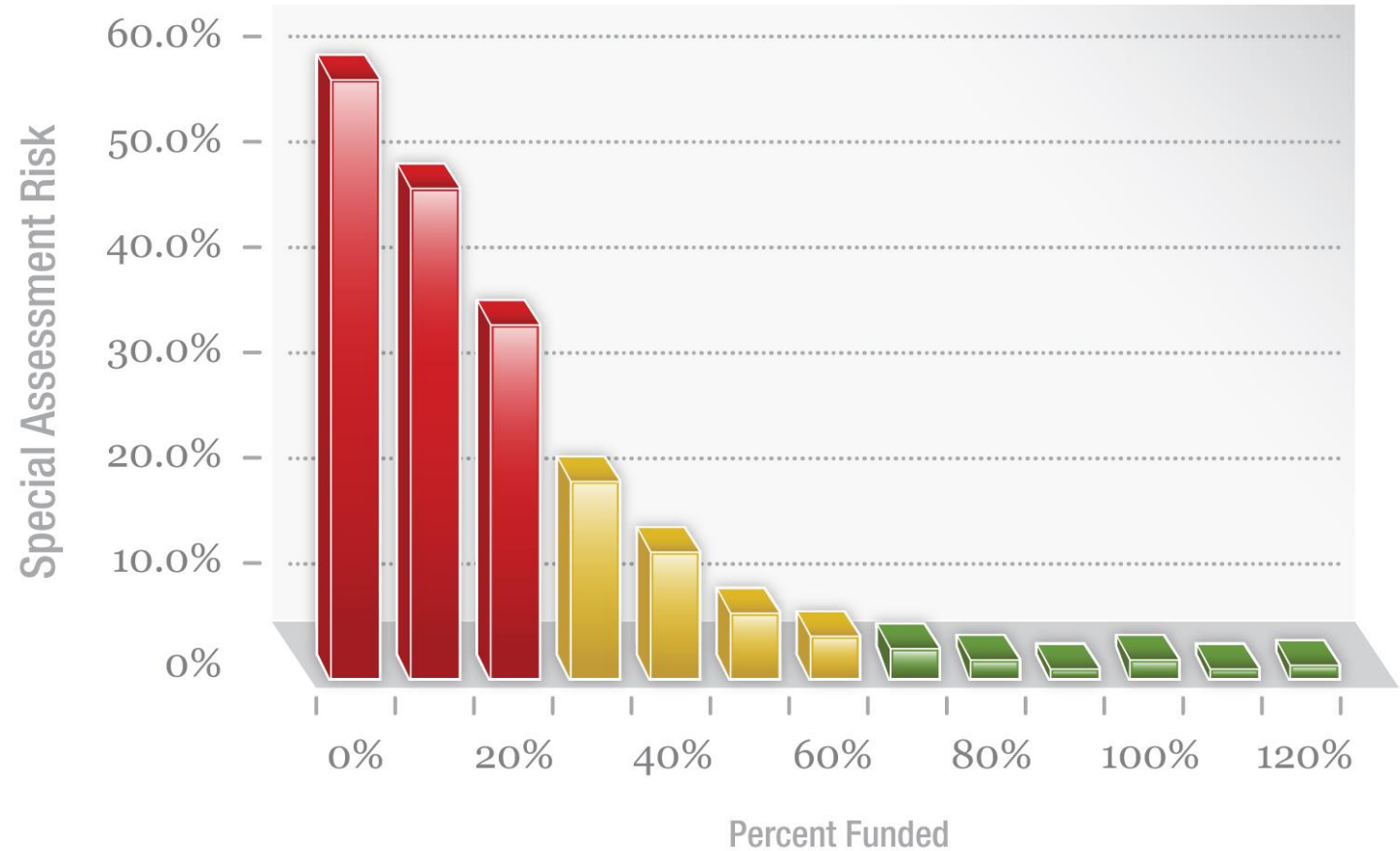


Are Special Assessments Predictable?

NATIONAL SPECIAL ASSESSMENT RISK

In most cases, based on the association's Percent Funded, you can anticipate special assessments **years in advance**.

It's important to have "enough"!



How much to Contribute to Reserves?

Different for each association
based on:

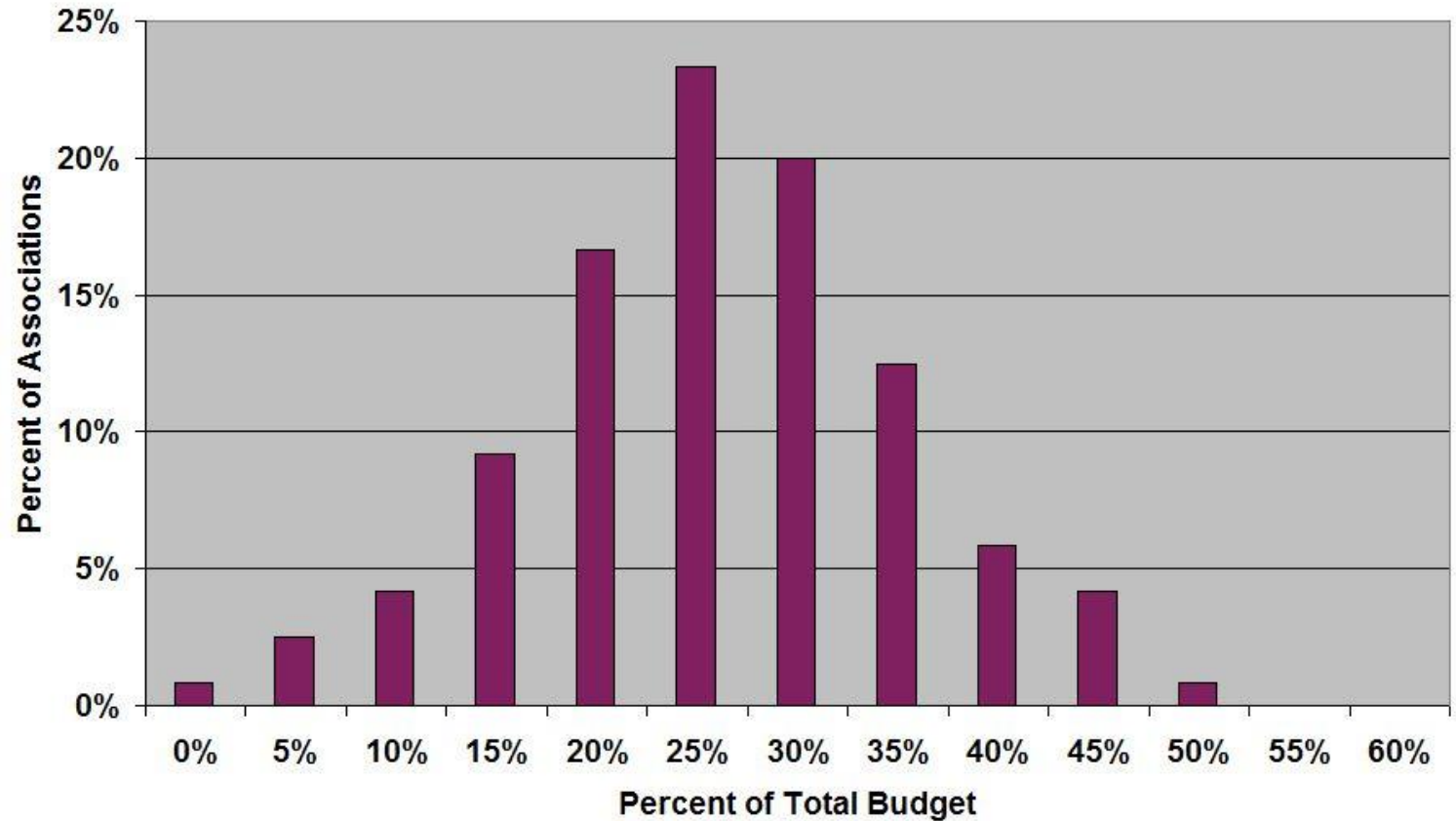
- Components
- Starting Percent Funded
- Timing of upcoming Reserve expenses



How much to Contribute to Reserves?

But there is a typical range:
15-40% of total budget

Adequate Reserve Contributions (Out of Total Budget)



How much to Contribute to Reserves?

Even so, **it's not a lot of money.**






- For the typical condo association, it's about the cost of a premium cup of coffee a day per unit



Do we need to Spend It?

Reserves exist to care for the needs of the property. *Be very cautious* about what you defer!

Reserve Project Types

-  Inconsequential
-  Re-Evaluate
-  Obsolescence
-  Protection
-  Catastrophic

Do we need to Spend It?








Reserve Project Types

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Reserve Project Types

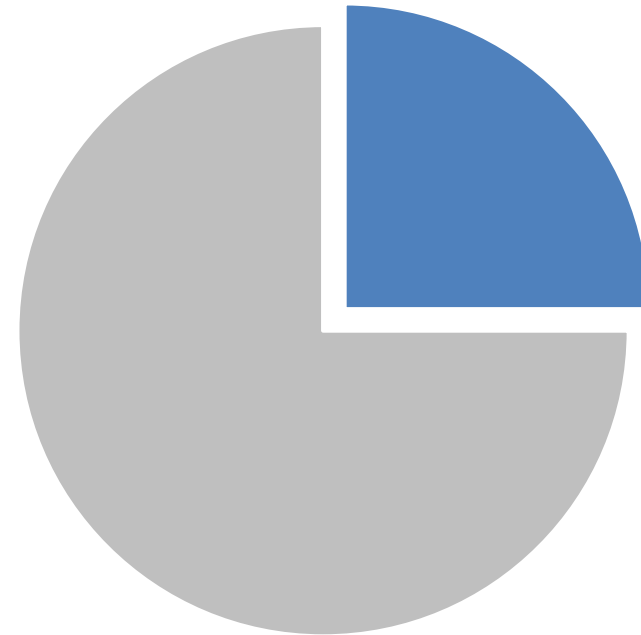
-  Inconsequential
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Do we need to Collect It?

Adequate contributions prevent...

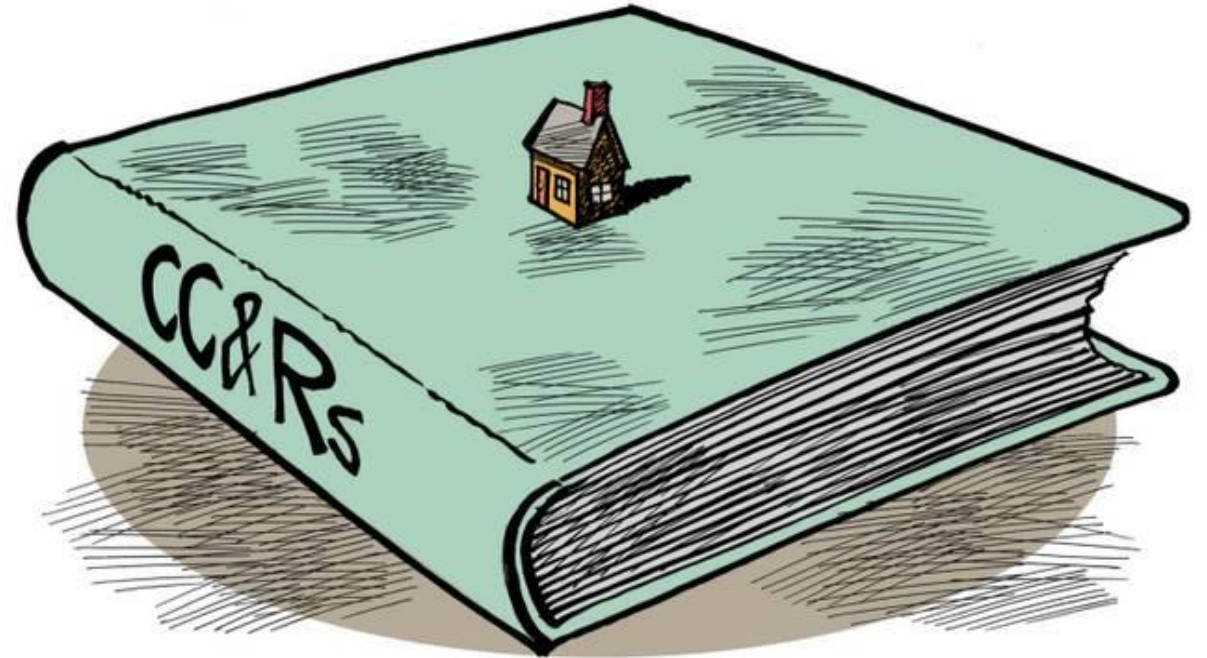
- Special Assessments
- Deferred Maintenance
- Sagging Property Values
- Building Safety Concerns

Reserve Contributions are often 25% of total Budget (not just an afterthought)!



Role of Reserves

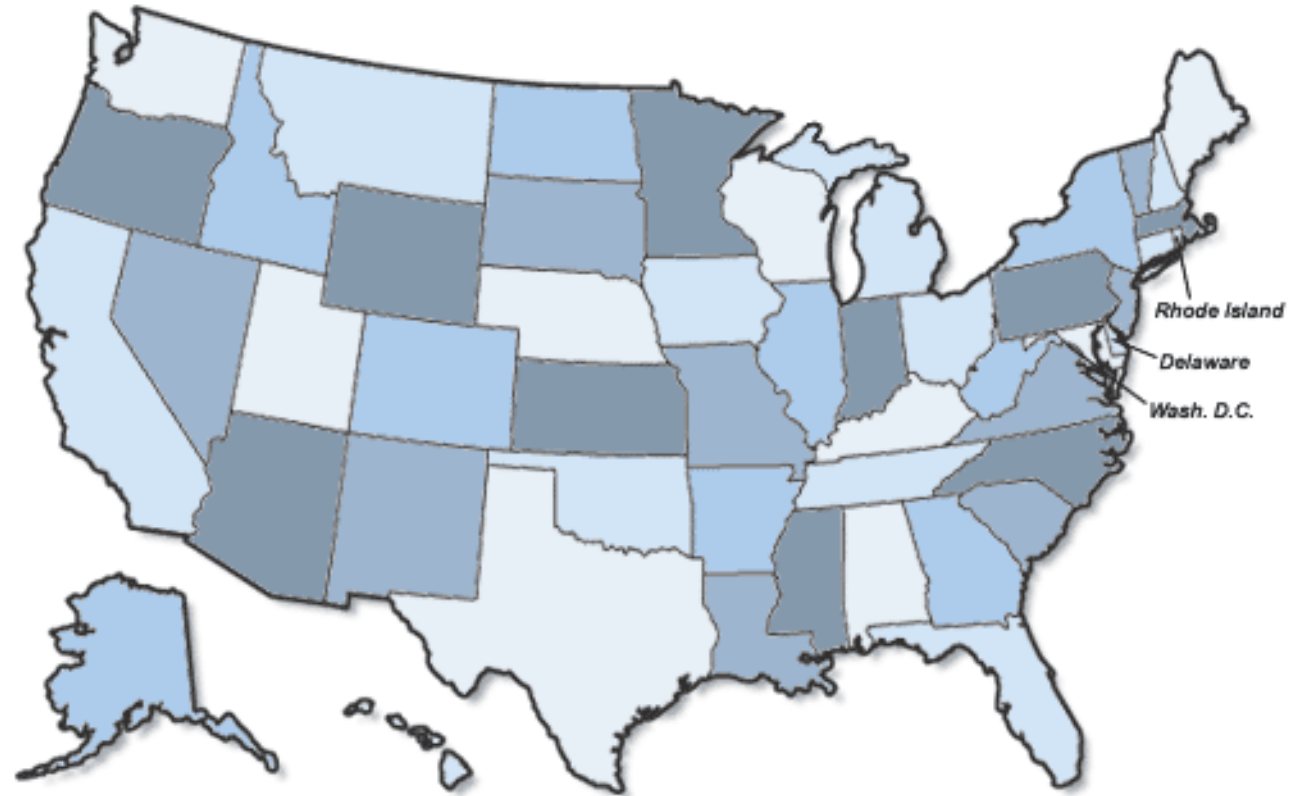
- Typically defined in Governing Documents or Statute/Law
- Board is typically required to fund adequately
- Everything deteriorates (first of the “Four Reserve Rules”), so you need to prepare!



Role of Reserves

State Laws Differ

- Some are silent
- Some are budget based
- Some are disclosure based
- Some have specific action and timing requirements



Role of Reserves

You don't need a law to tell you to pay your bills!

Boards already are required to provide for the needs of the association

Property and D&O Insurance is for accidents, not willful decisions!



Reserve Money Management

- Typically two accounts
- Make scheduled transfers
- Spend only for Reserve projects (all else is borrowing & should be repaid)

*You'll have enough in the future
if you make your scheduled
contributions today!*



Reserve Study Management

How often to update?

- Components deteriorate each year
- Reserve balance changes each year
- Economic environment changes each year
- Associations who update annually enjoy approx 30% fewer special assessments



Reserve Study Management

When to update?

- In advance of the Fiscal Yr End
- As part of the budget process
- Know which type of Reserve Study to obtain



Reserve Study Management

Three types of Reserve Studies

- Most associations only need a “Full” Reserve Study once
- Most Reserve Studies performed in the USA are one of the two less expensive “update” Reserve Studies

1

Full

2

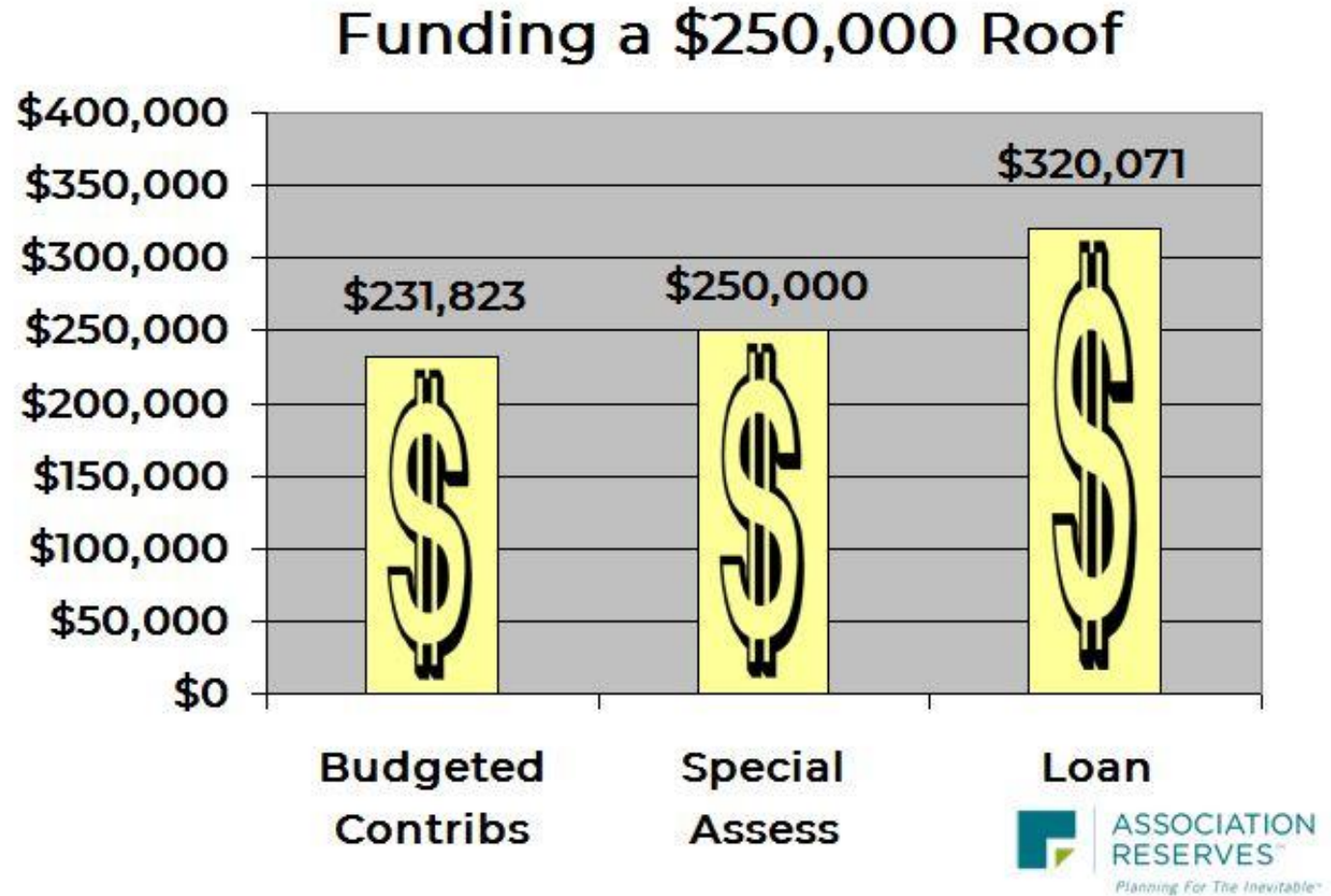
Update With-Site Visit

3

Update No-Site Visit

How to Fund?

Expenses will happen –
but you get to choose how
you'll pay for them!



What about Underfunding?

Can you really?

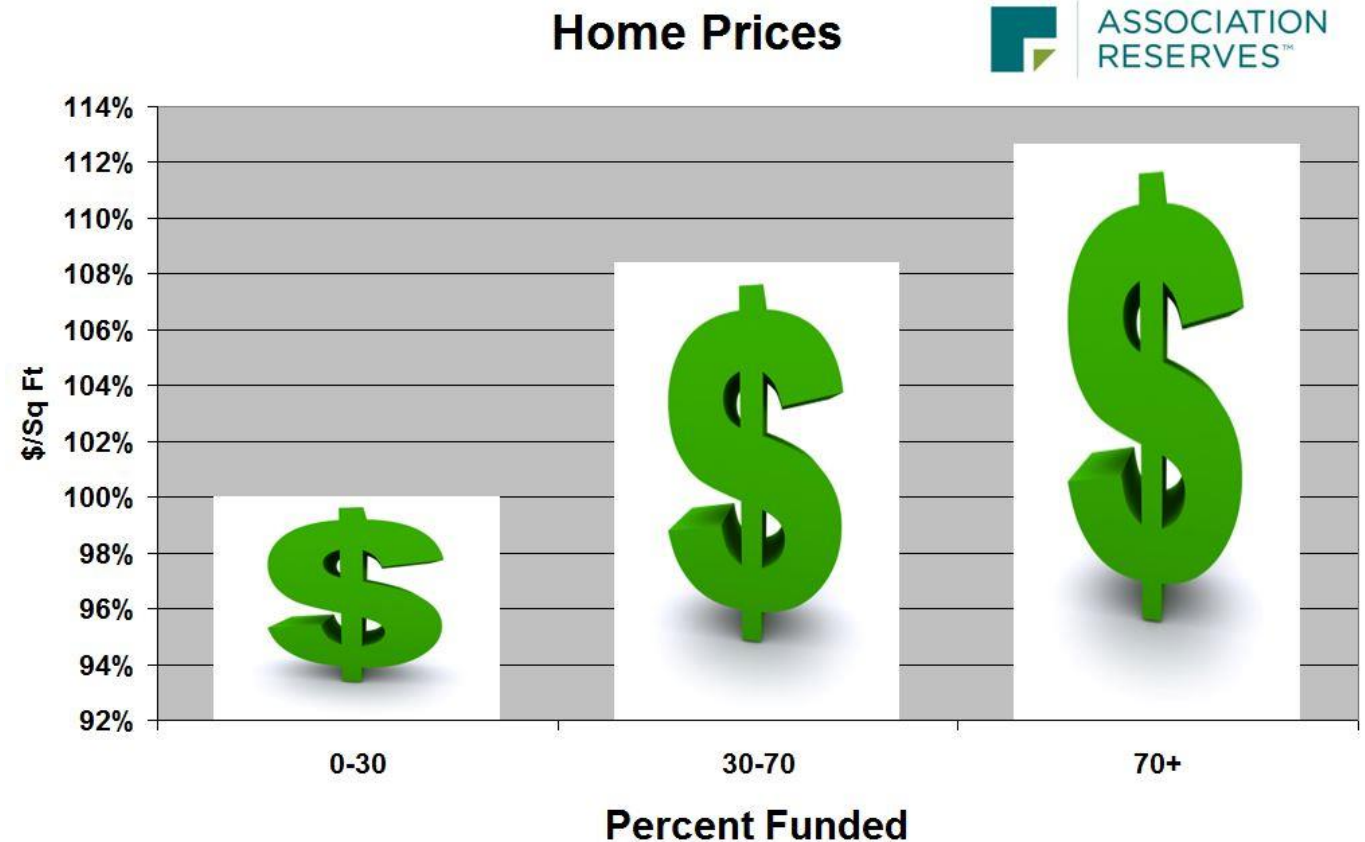
- The expenses will happen*
- Deferred maintenance is typically expensive*
- Special Assessments are painful
- Loans are expensive
- (Lack of) Curb appeal is real



What about Underfunding?

- Deferred maintenance drags down home values
- Special assessments drag down home values
- Condos in associations with strong Reserves average 12.6% higher \$/Sq Ft value

Underfunding is a foolish financial decision



What if you're Underfunded?

- Gather your facts
- Take steps of progress
 - It likely took years to get into this situation, it may take years to get out!
 - Consider the \$10 solution!



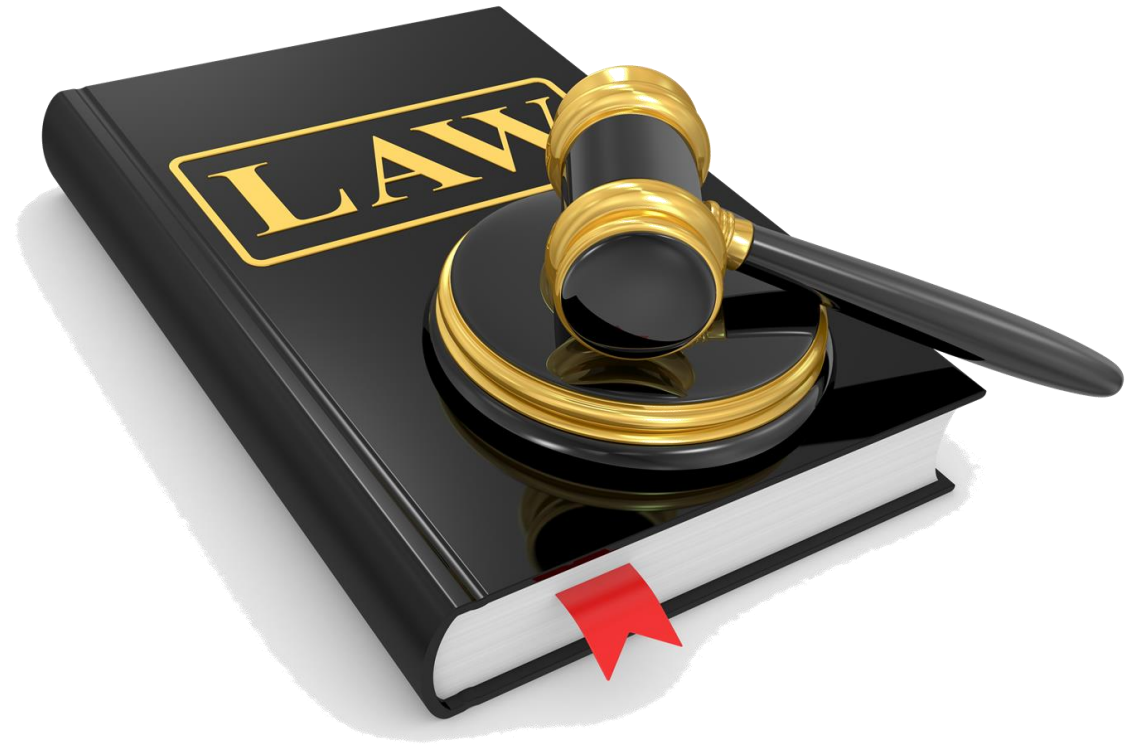
What are the most Common Mistakes?

- Fantasy budgeting (short term thinking)
- Skipping contributions
- Borrowing from Reserves (without a repayment plan)
- Spending Reserves on non-Reserve projects
- Thinking “we can’t afford it...”
- Not communicating budget needs to homeowners



Summary Thoughts

- Remember your role – homeowners are counting on you to run the association effectively
- Budget responsibly – not for popularity
- Be careful - all you do as a board member is documented (Business Judgment Rule)
- Insurance is for accidents, not willful decisions



Summary Thoughts

Appropriately Fund

- No special assessments
- Lower Expenses
- Lower Board Liability
- Higher Property Values



Underfund

- Special Assessments
- Higher Expenses
- Higher Board Liability
- Lower Property Values

Summary Thoughts

- Update your Reserve Study to get accurate guidance
- Make informed decisions – reach out for assistance
- Adequate Reserve contributions are not a lot of money
- Reserve contributions are great investments – they maximize property values!



Summary Thoughts

Best Practice to get Successfully to the Future

1. Update your Reserve Study regularly
2. Fund Reserves as recommended
3. Spend Reserves as recommended
4. Perform periodic Building Infrastructure inspections

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Best Practice to get Successfully to the Future

1. Update your Reserve Study regularly
2. Fund Reserves as recommended
3. Spend Reserves as recommended
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Communicate to the owners that Reserve contributions are part of the “cost of ownership” that cannot be ignored

Summary Thoughts

- Being a Board Member is a job. Take that responsibility seriously!
- Care for the association – give it what it needs
- Do what you can – consider the \$10 solution (you can do it!)
- Budget honestly - give the association the money it needs for sustainability!



Questions?



Your Presenters



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