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What is a Reserve Study?

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The reserve study analyzes major repair and replacement needs like roofing and painting and provides a funding plan for accumulating money to perform this work when its needed. It is a fundamental planning tool that all homeowner associations need.

There are several parts to the reserve study: First, all major association maintained components are identified. Next, the cost to renovate each item is then determined by contractor bid or construction cost estimate. Then, the remaining useful life (in years) of each item is established. These items are plugged into a mathematical formula:

$$\text{COST} \div \text{REMAINING USEFUL LIFE} = \text{MONEY NEEDED YEARLY FOR RESERVE FUND}$$

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.

How should these reserve funds be accounted for? Reserve funds should be kept in a separate account from the normal operating funds. It's conceivable that reserves will grow to tens or hundreds of thousands of dollars. Prudent investing of these funds will reduce the amount of money needed from owners. Since the reserve study shows when money will be needed, long term investments can be purchased that will return more than savings accounts. Conservative investments like government securities or CDs (Certificates of Deposit) are recommended, however, there are other options so consult with a knowledgeable financial advisor.

When should a reserve study be performed? All homeowner

associations, regardless of size, should have a reserve study done. Once done, yearly updates are relatively simple and inexpensive. If the association has inadequate reserve funds to begin with, the reserve study will show the need for "catch up". To replenish the fund, several options are available:

1. Special Assessment (lump sum contribution from each owner)
2. A phase-in period of several years where fees increase each year
3. Combination of #1 and #2

Whatever course of action taken, the goal should be to reach "100% Funding" which means the association is accumulating money on schedule to meet future major maintenance needs.

What sorts of financial problems can homeowner associations encounter with inadequate reserve funds set aside? 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 and assets are small. Also, since special assessments are unpopular, the tendency is to postpone major renovations. This deferral accelerates the deterioration process, detracts from curb appeal and erodes home resale values. A reserve funding plan with regular monthly contributions from each owner is both fair and insures that major maintenance is done when it's needed. Rarely, if ever, will special assessments be necessary.

Can poorly managed reserve funds affect the sale of units? Absolutely. Buyers and lenders look closely at how reserve funds are handled by the association. Lack of reserves is a red

flag for an inevitable special assessment, a sign of poor planning. If given the choice between an association with healthy reserves or one with little or none, which would be the wiser investment?

Which types of major repairs must be paid for by association funds vs. individual property owners? The association documents define what repairs 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.

What kind of qualifications should a reserve study provider have? The reserve study provider should have good budgeting skills, knowledge of construction and an understanding of homeowner association operations.

How much does a reserve study cost? Nothing, *if* the association has a volunteer qualified to compile the data properly. The challenge is to *accurately* identify, measure and estimate the cost of the each component. There are self help publications and computer soft-ware available.

However, using an objective and knowledgeable **Professional Reserve Analyst (PRA)TM** has a number of advantages including objectivity, training and access to accurate information. See www.apra-usa.com for details.

Regensis publishes The Regensis Report, a monthly newsletter available to subscribers of www.Regensis.net

Regensis specializes in Reserve Study analysis in the Pacific Northwest. For a no obligation quote, phone 503.977.7974.