



Associated Property Management

RESERVE FUNDS FOR COMMUNITY ASSOCIATIONS

By Associated Property Management

Community Associations set aside reserves for specific future expenditures. These expenditures are for major repairs and or replacements of certain common Association components. Reserves are items of expense that will not occur on a regular basis. Typical reserves are roof replacement and repair, building painting, pavement repair and replacement, elevator modernization and repair, lobby redecorating, swimming pool, tennis court, air conditioning replacement and repair, seawall replacement and repair, balcony restoration, etc. It is also possible for Associations to fund reserves for other types of expenditures such as anticipated increases in insurance premiums and other special projects.

The main reason that reserves are budgeted is for the membership to be able to fund for the extraordinary expense on an immediate or planned basis, without having to have a special assessment for the expense. These funds are accounted for in a special reserve section of the budget and the balance sheet. Because these funds are separately accounted for, their use is restricted to their intended use, unless the membership decides to allow the Board of Directors to change their use.

There are three commonly used reserves: Repair and Replacement Reserves, Capital Reserves and Contingency Reserves. The following defines and clarifies what each type of reserve is and how it is used:

Repair and Replacement Reserve:

Repair and replacement reserves are generally for common area components that will need to be repaired or eventually replaced over a long period of time. Also, deferred maintenance items are considered as repair and replacement reserves. Deferred maintenance is by definition something that is maintained and/or repaired less frequently than yearly and results in maintaining the useful life of the component. Some components would be roofing, painting, paving.

In a budget for reserves for repairs and replacements, the budget will be accompanied by a schedule showing when the components will need to be replaced, and the cost of replacement and amounts of funds that need to be set aside each year to fund the repair or replacement.

For condominiums and cooperatives, there are state statutes and administrative codes that must be followed for the budgeting, reporting and funding of these reserves. In several instances, the state statutes require that the Board of Directors budget and adopt a fully

funded budget. After that takes place, the membership can then reduce or waive the funding requirement.

This funding requirement cannot be waived by the Board of Directors and the reduction and or waiving of the reserves is for that year only. Each year the Board must report and adopt a fully funded budget.

Homeowners' Associations are not required by statute to have reserve funds unless it is required by the Association Documents. However, many homeowner associations fund reserves in order to avoid potential special assessments, if the funds were not available.

Capital Reserve:

Capital reserves are generally used to fund special projects and improvements for Community Associations. In addition, a capital expenditure is usually for an expenditure of funds for the purchase or replacement of an asset whose useful life is more than one year or results in the increase of the useful life of an asset for more than one year. Examples of capital reserves would be saving for a new clubhouse, privacy walls, landscaping projects, additional street lighting, new entry features, etc.

These types of reserves come and go depending on the needs and desires of the Community Association.

Contingency Reserve:

Contingency reserves are undesignated funds that are set aside for unanticipated expenses. Examples for future expenses might be for future increases in insurance, legal expenses for litigation, increases in operating expenses, etc. Many Associations will try to budget 1 - 3% of their total budget for contingency expenses. A contingency reserve will not meet the state requirements for funding, in that the reserves are not designated for specific uses and are not restricted.

When defining the purpose of a Reserve Fund for deferred maintenance and capital expenditures, the Board should clarify how specific or general the use should be. For example, if the Association had a reserve fund for Tennis Court Resurfacing and the Board wanted to use the funds for the replacement of the Tennis Court Lighting. They should not use the funds in that manner, as they are restricted by their definition of use. However, if they titled the reserve fund as Tennis Court Reserve, then the funds could be used for resurfacing, lighting, fences, tennis court supplies and additions.

Reserve funds are an excellent way for Associations to help manage the deterioration and repair of common elements, meet unexpected expenses and help an Association to save for major improvements without incurring special assessments to their unit owners.

If your Association does not have reserves or annually waives their requirement, you may want to reconsider this practice, as an Association with fully funded reserves is a sign of good financial management and will help the value and marketability of your Association's units.

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