

# Reserve Funding 101:

## The Importance of Reserve Funds, Funding Methods, and Best Practices

A reserve study is a vital capital planning tool for community associations that provides directional guidance and an in-depth analysis of community assets in the form of a 30-year expenditure and funding plan. But exactly how important is it to fund reserves according to this plan?

### What Are Adequate Reserves?

The Community Association Institute defines adequate reserve as...

*"A replacement reserve fund and stable and equitable multiyear funding plan that together provide for the reliable and timely execution of the association's major repair and replacement projects without reliance on additional supplemental funding."*

### The Importance of Adequate Reserve Funds



#### Ensure Financial Stability

Adequate reserve funding helps maintain the financial health of the property, preventing unexpected financial crises



#### Protect Property Value

Adequately funded reserves ensure timely maintenance and repairs, preserving and increasing property value



#### Plan for the Future

Adequate reserves allow for strategic planning and long-term improvements, ensuring the property remains competitive and desirable



#### Minimize Financial Stress

Adequate reserves reduce the financial stress on property owners by spreading out costs over time



#### Support Sustainable Growth

Well-funded reserves support sustainable growth and development, ensuring the property can adapt to future needs.



#### Compliance with Regulations

Adequate reserve funding helps meet legal and regulatory requirements in states with applicable legislation





# Reserve Funding Strategies

## Baseline Funding

Calculates future reserve contributions such that the reserve balance will reach \$0 at its lowest point over the life of the study.

Baseline funding has the lowest cost, but the highest risk level.

## Threshold Funding

Calculated like baseline but factors in a minimum annual balance to avoid taking the reserve account balance down to \$0.

The threshold amount is determined by the board and/or Reserve Specialist.

Threshold funding offers the most flexibility for allocation of reserve funds.

## Full Funding

Fully Funded Balance =  $\text{Current Cost} \times \text{Effective Age} / \text{Useful Life}$

Full Funding: Reserve balance equal to the fully funded balance

Full Funding has the highest cost, but the lowest risk level.

## Baseline Funding

30 yr. Funding



1.46 M

Annual Funding

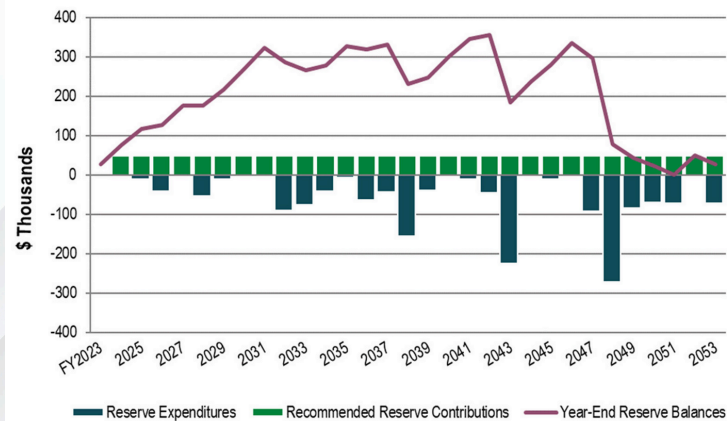


\$49K

Annual Owner Contribution



\$132



## Threshold Funding

30 yr. Funding



1.56 M

Annual Funding

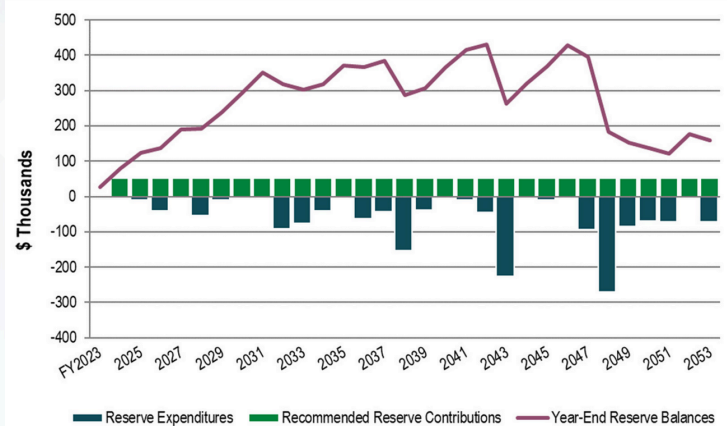


\$52K

Annual Owner Contribution



\$141



## Full Funding

30 yr. Funding



2.36 M

Annual Funding

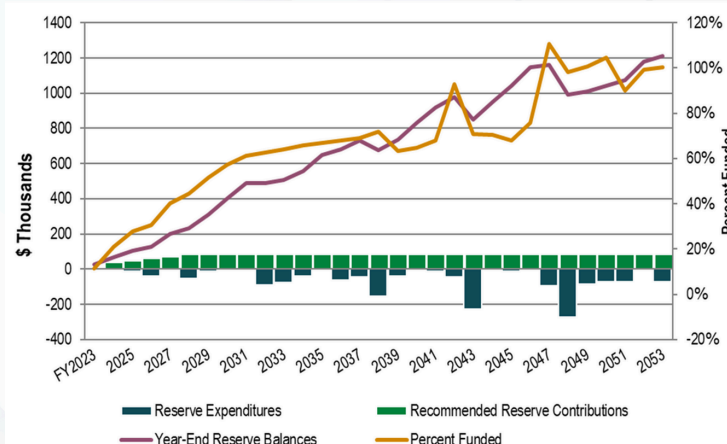


\$79K

Annual Owner Contribution



\$213



# Who Benefits From Maintaining Adequate Reserves?

## Homeowners

- Protects investment
- Maintains eligibility for mortgage financing
- Mitigates special assessments
- Preserves community appearance
- Reduces maintenance costs
- Safety and security
- Equity

## The Board

- Fulfills fiduciary duty
- Provides guidance on project costs, scope, and timing
- Consistency and alignment on priorities and funding
- Stewardship and a harmonious community
- Ability to maintain and enhance building aesthetics

## Management

- Fewer surprises and complaints from unit owners
- Saves time with decision-making and projects
- Compliance with laws and accounting requirements where applicable

# Establishing a Reserve Fund Policy: Best Practices

Develop an annual budget that includes funds for routine maintenance, utilities, insurance, administrative costs, and contributions to reserves



Implement clear financial policies and procedures for approving expenditures and managing funds

Priorities – Protection of principal (security), liquidity, then yield



Regularly review financial statements, budgets, and reserve fund status

# Communicating, Educating, & Engaging with Unit Owners

Fostering transparency between board members and unit owners in community associations is crucial for building trust and ensuring effective governance. When board members openly share information about decisions, financial matters, and upcoming projects, it helps unit owners feel informed and involved in the community's direction. Transparency reduces misunderstandings and conflicts, as everyone has access to the same information and can provide input or raise concerns. This open communication fosters a sense of collaboration and accountability, making it easier to address issues and work towards common goals. Ultimately, transparency strengthens the community by promoting a culture of trust, respect, and shared responsibility.



Provide clear and timely financial reports to homeowners, detailing income, expenses, reserve fund balances, and any planned expenditures



Foster open communication channels to address homeowner concerns and questions about finances, and seek input on priorities



Remind them of the importance of adequate reserves and legal obligations if applicable



Encourage continuing education as laws and attitudes change