



Funding the Association's Reserves

Reserves provide the funding necessary to maintain, repair, replace or restore major common area components (such as asphalt pavement, exterior coat/paint/stain and roofs) in the future. These funds are normally collected over the life of the component from all members of the association and are held in segregated accounts as reserves.

The Reserve Study plays a vital role in establishing the annual reserve allocation to the fund and this long-term plan is usually developed and monitored by Reserve Specialists. The plan includes a funding method and funding goal based on the current physical and financial condition of the association.

Various methodologies have evolved to determine this allocation, however, the component and cash flow methods dominate most reserve study reports.

The **component method** determines reserve allocation by dividing cost by useful life for each component and then totaling. This method provides for "*independent funding*" of each component.

The **cash flow method**, on the other hand, determines reserve allocation by projecting reserve allocations and disbursements over a timeframe and testing different allocations until a minimum allocation is found that maintains a Percent Funded or Net Reserve Balance amount above a specified funding goal (perhaps a Net Reserve Balance of zero dollars for Baseline Funding). This method provides for "*collective funding*" for all components.

Independent of methodology utilized, the following represents the basic categories of funding plan goals:

- ***Baseline Funding***- Maintaining a Net Reserve Balance at or near zero.
- ***Full Funding***- Maintaining a Reserve Balance at or near Percent Funded of 100%.
- ***Statutory Funding***- Maintaining a specified minimum Reserve Balance per statutes.
- ***Threshold Funding***- Establishing and maintaining a set Net Reserve Balance or Percent Funded.

Association members must realize that certain levels of risk are inherent in any long term funding plan. The plan must therefore provide a strategy that minimizes risk, while maximizing success.

For potential buyers, understanding the reserve study is an important part of evaluating the value of the property being sold. For association members, proper reserve fund planning protects against declining property values due to financial instabilities that result in special assessments and/or deferred maintenance.

The reserve study conveys to owners and potential buyers a more accurate and complete picture of the association's financial strength and market value. The reserve study discloses to buyers, lenders, and others a long-term funding plan specifically designed to offset future reserve expenditures.

By Robert J. Petrisin, RS
President/CEO- Strategic Reserves
[www. ReserveStudySoftware.com](http://www.ReserveStudySoftware.com)