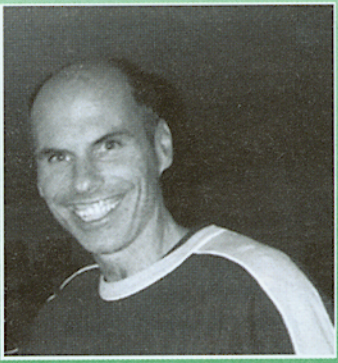

Percent funded: A management information tool

BY ROBERT J. PETRISIN, RS

CEOs and the elite upper level management of major corporations utilize various management information tools (MITs) in order to boost profits that result in shareholder satisfaction. In non-profit corporations, such as community associations, profitability may be thought of as reserves and the shareholders as members of the association. The board of directors is upper level management. Various MITs that must be utilized to provide financial stability (and member satisfaction) are often found within a professionally prepared reserve study.

One such effective reserve MIT is commonly referred to as percent funded (or reserve funding level) and may be defined as: "The ratio, at the end of the current fiscal year, of the reserve balance (or projected funds available at fiscal year end) to the ideal reserve balance (or the balance that is in the direct proportion to the fraction of life 'used-up' of the reserve items current cost)."

The percent funded parameter is of particular importance, for it provides a general indication of reserve strength measured at a particular point in time. This strength indicator may be interpreted in terms of risk associated with the availability of reserves to fund future expenditures.

Levels of Risk

Percent Funded	Level of Risk
70% and above	LOW
31% to 69%	MODERATE
30% and below	HIGH

Many successful long-term funding plans are a direct reflection of funding levels with a "low" level of risk. An additional reserve allocation is often suggested for funding levels below 70 percent. Many options exist to strengthen the reserve fund, however a viable plan designed to gradually achieve a 70 percent funding level is often the best.

Although the percent funded may fluctuate from year to year, experience has revealed that a reserve funding level of at least 70 percent indicates that reserves are strong and can be expected to fund future reserve item expenditures with low-risk of financial instabilities.

Association management needs to understand 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.

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you had $30,000 and higher than if you had $70,000. Given the above model, if you have an eight-year-old component with a replacement cost of $10,000 and a life expectancy of 10 years, one would expect that at year eight the fund would have "ideally" accumulated approximately $8,000. If the fund had only $6,000, not only would you have to fund a "normal" contribution to reserves over the next two years, but you would have to make up the underfunding shortfall.

This author has always held the belief that the board of directors has a responsibility to uphold decisions that are in the best interest of the community. The community is not only comprised of present members, but also future members. Any decisions made should not benefit the present membership at the expense of future members. Unlike an individual determining their own course of action, the board is responsible to the community as a whole. Any decision by the board of directors to adopt a calculation method or funding plan which would disproportionately burden a future membership into making up for past reserve deficits would be a breach of their fiduciary responsibility to that future membership.

When a member buys into a community, that member buys into a promise. A promise that in exchange for their payment of the regularly assessed membership dues, the association will maintain the community in a good state of repair in accordance with the association's governing documents. The only way that the board of directors can assure their ability to maintain the assets it is obligated to maintain is by assessing an adequate level of reserves.

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