

Percent Funded Calculation...*Get it Right!*

It is vital for association management to understand how Percent Funded is calculated on a reserve study report, and then to question the reserve specialist as to why they calculate it this way. There are several firms that calculate it using the Fiscal Year (FY) Start Balance & there are several firms that calculate it using the FY End Balance. Why the difference? Why has the industry not adopted a 'standard' Percent Funded calculation that all must follow to provide this important 'general strength indicator'? Let's take a look at both calculation results, in an effort to understand how to calculate it correctly.

For this simple example we will use only 3 components. First, we must determine the total Reserve Allocation per year as shown in Table 1. The Reserve Allocation (component method) is calculated as follows: Cost / Useful Life. This component method of funding provides for a consistent & even funding amount every year for the respective component over the useful life (UL) so that 100% of the funds are available for disbursement.

Component	Current Cost	Useful Life	Remaining Life	Reserve Allocation
A	\$2,000	2	2	\$1,000
B	\$4,000	4	4	\$1,000
C	\$6,000	6	6	\$1,000
				\$3,000
				Total

Table 1.

Next, we must determine the Disbursement & Fully Funded Balance values for each component & then the sum for the respective FY as shown in Table 2. The Fully Funded Balance is calculated as follows: $FFB = Cost / UL \times (UL - RL)$. The component will disburse in the FY where the respective remaining life (RL) value is 0.

FY	Component A				Component B				Component C				Total Disburse	Total FFB
	Cost	UL	RL	FFB	Cost	UL	RL	FFB	Cost	UL	RL	FFB		
0	\$2,000	2	2	\$0	\$4,000	4	4	\$0	\$6,000	6	6	\$0	\$0	\$0
1	\$2,000	2	1	\$1,000	\$4,000	4	3	\$1,000	\$6,000	6	5	\$1,000	\$0	\$3,000
2	\$2,000	2	0	\$2,000	\$4,000	4	2	\$2,000	\$6,000	6	4	\$2,000	\$2,000	\$6,000
3	\$2,000	2	1	\$1,000	\$4,000	4	1	\$3,000	\$6,000	6	3	\$3,000	\$0	\$7,000
4	\$2,000	2	0	\$2,000	\$4,000	4	0	\$4,000	\$6,000	6	2	\$4,000	\$6,000	\$10,000
5	\$2,000	2	1	\$1,000	\$4,000	4	3	\$1,000	\$6,000	6	1	\$5,000	\$0	\$7,000
6	\$2,000	2	0	\$2,000	\$4,000	4	2	\$2,000	\$6,000	6	0	\$6,000	\$8,000	\$10,000

Inflation- 0.0%
FFB- Fully Funded Balance
FY- Fiscal Year
RL- Remaining Life
UL- Useful Life

Table 2.

Next, we'll run the Cash Flow using the Reserve Allocation from Table 1 & the Disbursement totals from Table 2 over a period of time. In this example all components begin in a 'new' condition, with the FY Start Balance beginning at \$0 in 'FY 0' & the initial Reserve Allocation funding of \$3,000 beginning in 'FY 0'. And finally, with the Cash Flow in place, the Percent Funded calculation is performed for each respective FY using the FY Start Balance (FY Start Balance / FFB) & also using the FY End Balance (FY End Balance / FFB). The FFB totals are from Table 2.

Cash Flow						FY Start Balance	FY End Balance
FY	FY Start Balance	Reserve Allocation	Disburse	FY End Balance	FFB	Percent Funded	Percent Funded
0	\$0	\$3,000	\$0	\$3,000	\$0	100%	100%
1	\$3,000	\$3,000	\$0	\$6,000	\$3,000	100%	200%
2	\$6,000	\$3,000	\$2,000	\$7,000	\$6,000	100%	117%
3	\$7,000	\$3,000	\$0	\$10,000	\$7,000	100%	143%
4	\$10,000	\$3,000	\$6,000	\$7,000	\$10,000	100%	70%
5	\$7,000	\$3,000	\$0	\$10,000	\$7,000	100%	143%
6	\$10,000	\$3,000	\$8,000	\$5,000	\$10,000	100%	50%

Table 3.

A review of the respective column above in Table 3 indicates that Percent Funded calculation using the FY Start Balance provides for a 'consistent' Percent Funded value of 100% in all years of the Cash Flow. This is expected since we are funding 100% of the Reserve Allocation amount (or \$3,000) for all components in every year. On the hand, a review of the respective column above in Table 3 indicates that Percent Funded calculation using the FY End Balance provides for an 'inconsistent' Percent Funded value that is 'high' (i.e. 200% in FY 1) or over exaggerated in most years & 'low' (i.e. 50% in FY 6) or under exaggerated in some years.

In summary, association management must understand how Percent Funded is calculated on a reserve study report & must question the reserve specialist as to why they use the FY End Balance in the Percent Funded calculation when it provides for an 'over exaggerated & inconsistent' Percent Funded value. An industry standard is required for Percent Funded (used in Financial Disclosures), and until other proof exists, the calculation must use 'FY Start Balance'.

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