

Reserve Study Tutorial

Introduction

- A reserve study is a tool used by Board of Directors and Property Managers of Community Associations to assist in the preparation process of their Association's Budget.
- A Reserve Study identifies those common area assets that require reserve funding and then projects their associated costs into the future.
- The Reserve Study will evaluate the current status of the Reserve fund, and provide a recommended contribution rate (the funding plan) that should be going into the Reserve fund on a periodic basis.

Reserve Study Basic Standards

- Complex Solutions subscribes to the CAI and APRA National Reserve Study Standards.
- By these standards, a Reserve Study is comprised of two parts: the **financial analysis** and the **physical analysis**.
- The **financial analysis** section includes information on the current status of the reserve fund and recommendations for the future life of the fund.
- The **physical analysis** section refers to the current conditions and estimated replacement cost for the individual common area components.

Physical Analysis

- The Physical Analysis is based around the “site inspection.”
- When inspecting the property, Complex Solutions, Ltd. will analyze all of the association’s “common area components” to determine which components warrant reserve funding.

Financial Analysis

- The Financial Analysis provides information on the current status of the reserve fund and recommendations for the future life of the fund.

Four Point Test

- Generally speaking, a reserve component must pass a four-point test (designated by the CAI National Standards) in order to qualify for reserve funding:
 - Must be a common area asset
 - Must have a limited life
 - Must have a predictable remaining useful life
 - Must be above a minimum threshold cost

Component Life and Cost Estimates

- Once a reserve component has been identified the following must be determined for each component:
 - Useful Life
 - Remaining Useful Life
 - Current Replacement Cost
- * After this information is recorded during the site inspection, it is verified or refined through research with the association's vendors or other experts.
- * Once all of an association's reserve components are identified and their life and cost estimates determined, a financial analysis can be performed.

Financial Analysis Basics

- The Financial Analysis section of a Reserve Study uses the cost and life estimate information gained from the physical analysis to come up with a funding plan that provides for each component's reserve funding needs.

What is Percent Funded?

- The present status of the Reserve Fund is generally expressed in terms of “Percent Funded.”
- The amount that an association should ideally have in its reserve fund (according to the most recent reserve study) is called the Fully Funded Balance.
- The percentage of the actual amount in the reserve fund versus the ideal is said to be the account's percent funded.
- For instance an association with an actual reserve fund balance of \$50,000 and a theoretical fully funded balance of \$100,000 is said to be 50% funded.

How is the Fully Funded Balance Calculated?

- The formula for the fully funded balance is:

$$\text{FFB} = (\text{Current Cost} \times \text{Effective Age} / \text{Useful Life})$$

- Current Cost = the current cost of any reserve component project
- Effective Age = the difference between Useful Life and Remaining Useful Life

Example

- If a reserve project has a useful life of 5 years and a current cost of \$5,000, then the association needs to put aside \$1,000 a year towards the future cost of that project
- (\$1,000/year for 5 years = \$5,000 total project cost)
- If that reserve component is 2 years old then the reserve fund should already have $\frac{2}{5}$ of the project cost or \$2,000 towards the future project cost.
- This calculation is repeated for each component.
- The sum of the individual reserve requirements is said to be the fully funded balance.

Funding Goals

- Once the present status of the reserve fund is determined a sound funding plan must be put together.
- When putting together a funding plan, there are four “Funding Principles” (CAI National Reserve Study Standards) that should be considered

Funding Principals

- Sufficient funds when required
 - A sound funding plan must provide enough cash when necessary to meet the needs of each reserve component.
- Stable contribution rate over the years
 - A funding plan should not require reserve contributions that vary greatly from year to year. Ideally a funding plan should recommend one monthly contribution (with increases to offset inflation) for the entire 30-year period.

Funding Principals

- Fiscally responsible
 - Any funding plan should be prudent and financially sound.
- Evenly distributed contributions over the years
 - Ideally the reserve contributions should not be weighted more to the present or the future. Doing so would put undue burden on either the present owners or the future owners.

Sound Funding Plan

- A sound funding plan from a reputable reserve study provider is an association's best bet to ensure their community will always look as good as the day it was built.