



presents

RESERVES & RESERVE STUDIES

for

**MARLEY PARK
COMMUNITY ASSOCIATION, INC.**

July 26, 2018

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**“If you fail to plan,
you are planning to fail”**

Benjamin Franklin

Reserves

- What are reserves?
- Why are reserves maintained?
- What if reserves are inadequate?
- How are reserves calculated?
- How is the percent funded calculated?
- What economic factors affect reserves projections?
- What reserves funding strategies are available?
- What causes reserve fund failures?
- How much is enough?
- Marley Park's projected reserves funding status

What are reserves?

- Mostly based upon IRS guidelines
- Funds set aside in a separate account
- Used to replace commonly-owned "capital" components
- Not used for maintenance and operational expenses

Why are reserves maintained?

By having funds available for major repairs and replacements on a timely basis:

- Protect and enhance the physical assets and property value of the community
- Protect and enhance the financial interests of the Owners
- Comply with community association governing documents
- Satisfy the fiduciary duty of the Board of Directors

What if reserves are inadequate?

- Dues increase
- Special assessments
- Loss of curb appeal
- Decrease in property values
- Long-time and new owners foot the bill
- Possible breach of fiduciary duty

How are Reserves Calculated?

The “component method” formula is simple:

$$\frac{\text{Component Cost}}{\text{Remaining Useful Life}} = \text{Full Funding}$$

Example: Asset purchased in 2015 at cost of \$10,000 with replacement in 3 years

$$\frac{\$10,000}{3} = \$3,333.33 \text{ per year reserve allocation}$$

Component method example

- 8 year-old painting project
- 10 year useful life
- \$10,000 current cost
- \$8,000 ideal level of reserve
- $\$8,000 = 8/10 \times \$10,000$

How is the percent funded calculated?

- Computed by comparing the current reserve fund balance (actual) against projected reserve requirements (fully funded balance):

$$\text{Percent funded} = \frac{\text{Reserve Fund Balance (Actual)}}{\text{Fully Funded Balance (Projected)}}$$

- Percent funded = 100 (ideal) when actual reserve fund balance equals the fully funded balance

Economic factors

Economic factors affecting reserves projections:

- Inflation rate
- Interest rate
- Cost of goods and supplies
- Labor market

Economic factors example:

2003 Study	2010 Study	2013 Study
Beginning balance: \$10,000	Beginning balance: \$10,000	Beginning balance: \$10,000
Funding goal: Full funding	Funding goal: Full funding	Funding goal: Full funding
Interest rate: 5%	Interest rate: 1%	Interest rate: .050%
Inflation rate: 5%	Inflation rate: 2%	Inflation rate: 2.5%
Annual contribution: \$6,097	Annual contribution: \$4,718	Annual contribution: \$5,094
Monthly per unit: \$10.16	Monthly per unit: \$7.86	Monthly per unit: \$8.49
Percent funded: 49.0	Percent funded: 59.6	Percent funded: 55.8

Reserve funding strategies

- Full funding
 - Attains and maintains funding at or near 100%
- Baseline funding
 - Keeps reserve balance at or above \$0
- Threshold funding
 - The minimum reserve cash balance is set at a predetermined dollar amount
- Statutory funding
 - Specific minimum amount of reserves as required by local statutes

What causes reserve fund failures?

Most community association financial crises occur due to one or more replacement reserves failures:

- Lack of long-term reserves planning
- Failure to adjust reserves for deteriorating physical conditions
- Failure to adjust reserves for inflation over time
- Inappropriate use of reserve funds

How much is enough?

Percent Funded	Special Assessment Risk
0-10%	53.5%
10-20%	36.9%
20-30%	26.6%
30-40%	17.6%
40-50%	11.6%
50-60%	6.0%
60-70%	3.5%
70-80%	2.4%
80-90%	2.3%
90-100%	0.5%

Analysis prepared by Association Reserves

Marley Park's projected funding status

Marley Park Community Association:

1.1.19 Reserve account balance: \$445,116.27
1.1.19 Percent funded: 25.21%
12.31.19 Reserve account balance: \$494,270
12.31.19 Percent funded: 26.0%

Marley Park Special Service Area:

1.1.19 Reserve account balance: \$63,186.55
1.1.19 Percent funded: 12.45%
12.31.19 Reserve account balance: \$125,830
12.31.19 Percent funded: 23.4%

Reserve studies

- Why is a reserve study important?
- How is a reserve study useful?
- Arizona reserve studies requirements
- Timing of reserve study updates

Why is a reserve study important?

- Provides fair and equitable funding of reserves over time
- Helps to prevent future financial crises due to lack of long-term financial planning
- Provides independent, skilled assessment of future reserve funding needs
- Provides important periodic update and adjustment of replacement reserves funding

How is a reserve study useful?

- May be required by the Association's accountant during the annual audit
- Often requested by lending institutions during the loan due diligence process
- A management tool for scheduling, coordinating and planning future repairs and replacements
- Contains measurements and cost estimates that are useful in evaluating contractor bids
- An annual disclosure to members concerning the financial condition of the Association

Arizona reserves requirements

- Associations not required to have a reserve study
- If a reserve study exists:
 - Must be disclosed during escrow process
 - Amount in reserve fund must be disclosed during escrow process

Timing of reserve study updates

- Data is valid for 5 years at best
- Update with site visit should be performed every 2 to 3 years after full study
- Financial updates without site visit appropriate between updates with site visit when there have been significant changes made to common areas, or interest and/or inflation factors

What types of updates are available?

- Financial update with site visit
- Financial update without site visit

Thank you for your time



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