

We've Received Our Reserve Study—Now What?

You paid good money for your reserve study. So why not make the best use of it?

Unfortunately, few board members take the time to thoroughly understand their reserve study. The consequences can be disastrous when making long-term fiscal decisions. It is imperative that your board designate one or more members to become familiar with the reserve study—to analyze it, study it, and fully comprehend it.

Here are three steps you should take as soon as you receive your reserve study:

STEP 1: Check for Omissions

The sooner you examine your reserve study, the better. Include the finance committee in the review process, and, if possible, the association accountant.

Make sure the information you conveyed to the reserve study preparer was correctly incorporated into the analysis. At a minimum, check the following:

- Are all reserve components—such as roofing and painting—incorporated in the reserve study?
- Does the estimated useful and remaining life of each reserve component meet the expectations of the board or its contractors? What about the estimated costs? Do the estimates seem reasonable?
- Does the reserve study accurately reflect the association's finances (starting reserve balance, interest rate on reserve investments, inflation rate on future reserve expenses, tax rate on re-

serve interest, member assessments)?

- Do you disagree with any of the assumptions? Does the reserve study clearly indicate your reserve funding requirements for the next year?
- If your association is significantly underfunded and requires a special assessment, does the study indicate the amount of the special assessment?

Some reserve study preparers give boards a draft study to review. Not only does this provide an opportunity to correct omissions, it also allows the board to fine-tune the final reserve recommendations. For example, suppose the draft study shows that your association is overfunded. If the board

had been postponing some noncritical expenses, such as building a playground, it could then accelerate the scheduling of such expenditures. The board can incorporate this into the final copy of the reserve study, thereby reducing surplus reserves.

Another reason for adjusting the draft is that replacement scheduling is often arbitrarily based on aesthetics. In many cases, reserve study preparers impose *their* notion of aesthetics on the board, when the board may have its own ideas. Suppose, for example, your reserve study preparer schedules stucco painting next year. Your board, however, may want to post-

UNDERSTANDING FUNDING METHODS

Make sure you understand how your reserve study results were derived. Some studies use a single-year projection. With this strategy, funds are set aside for the current year and recalculated annually. Most reserve studies use a multiple-year projection known as *cash-flow analysis*. Cash-flow analysis determines the amount of money the association must set aside in each of the next several years. There are two methods of determining cash-flow projections:

Component method. Each component has its own payment plan. This includes the item's remaining useful life, the cost to replace it, and the amount that must be set aside annually for replacement. For example, an association may have purchased \$11,000 worth of pavement seal coating in a year. The estimated useful life is five years. \$11,000 divided by five years is \$2,750. So for the next five years, \$2,750 would be set aside annually for pavement seal coating.

Pooling method. Like the component method, replacement costs and remaining lives are determined for each item. After projecting annual contributions and anticipated expenditures, a cumulative fund balance is determined for each year. By reviewing the fund balance, the board can annually adjust its contributions.

This information was taken from CAI's GAP Report 24—A Complete Guide to Reserve Funding & Reserve Investment Strategies, edited by Mitchell H. Frumkin, P.E., MBA, and Christopher J. Juall. For information, contact CAI Central at (703) 548-8600.

pone the job for one or two more years to save money. A reserve study should be an interactive process between the board and the reserve study professional.

If you determine that the reserve study incorrectly represents any information, contact your reserve study preparer before making your final payment for the study. Use that final payment as leverage to ensure that the corrections are incorporated into the final copy.

STEP 2: Use the Study as a Planning Tool

Once you receive the reserve study, evaluate the results. Remember: the reserve study is a planning tool. Use it to determine whether to increase or decrease assessments, to decide which repair or replacement tasks to address in the next year, and to calculate the cost and timing of major repairs. If funds are not available to meet pending reserve expenses, you may need to levy a special assessment. Your reserve

study should help you determine amount of that special assessment.

You should also use the reserve study to schedule investment cycles for reserve funds. Using cash-flow analysis (see the sidebar on page 47), determine which years the association will not spend its reserve funds. You can then make higher-yielding, long-term investments in the years the funds are not needed. Laddering investments is an excellent way to ensure that funds are available while still earning high rates of return (see "Laddering Investments," January/February 1996 *Common Ground*).

STEP 3: Distribute the Results

The board should distribute one or more of the following to its members before the beginning of each fiscal year:

- The estimated cash reserves needed to fund future reserve expenditures.
 - The amount of cash reserves actually set aside in the reserve fund.
 - A statement as to whether the board will levy special assessments to pay for repair or replacement expenditures.
 - A general statement outlining the procedures used for calculating and establishing reserves.
 - Graphs of the reserve analysis results (if your reserve study provides them).
- Graphs help convey the effect of your reserve analysis for association members who are more comfortable with visual displays than with numbers.

Distributing the results helps fulfill some state requirements and provides supporting evidence for assessment increases or special assessments. Consult your accountant to determine reserve reporting requirements in your state.

If you follow the steps discussed in this article, your reserve study will be a valuable planning tool. Remember to verify the results, evaluate the results, use the results, and distribute the results. And if you don't understand your reserve study, ask your reserve study provider for help. **CG**

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