

Adequate Reserves are a Good Operating Practice

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The purpose of a reserve fund for a homeowners association, townhome community, condominium or co-op is to plan for and set aside money for community property that will wear out or become obsolete over time. This spreads out the cost of upkeep and equitably shares those expenses across all members as they use the property.

No matter what type or size of community you live in, there are probably components of your common area that will eventually require major maintenance. These components may include perimeter walls or fences, roofs, siding, streets, pools, entry monuments, landscaping, irrigation, clubhouses, painting or other large scale items. Maintenance costs can generally be predicted and can be handled when properly budgeted for without a special assessment.

Capital items, such as those listed above, can run into the many thousands or sometimes hundreds of thousands of dollars. When planned for, the funds to replace may cost only a few dollars a month as part of the normal assessment. Reserve funds are not an extra expense - they simply spread out the expenses more evenly over a longer period of time, avoiding a large, unexpected expense to owners in the form of a special assessment or a large jump in assessments if the Association needs to obtain a loan when one of those components requires replacing. Every owner should share equally the cost of replacement during the time of their residence in the community. Everyone benefits from the common areas during their residency, even if they do not plan to live there forever.

The problem with a special assessment is that it can be difficult to collect the money when you suddenly have this large expense. If not everyone pays, then the project may not be able to be completed or those that did pay may be penalized by having to pay more to make up for the loss. It is better to collect funds gradually, so the money is there when needed.

There are other important reasons association funds should be put into the reserves every month:

- Reserve funds meet legal, fiduciary and professional requirements
- Reserves may be required by either documents, state statutes or court decisions
- Any secondary mortgage market in which the association participates (i.e. Fannie Mae, Freddie Mac, FHA, and VA) will take a hard look at the financial condition of the association before lending money to a prospective purchaser.

Reserve funds enhance resale values. Lenders and real estate agents are aware of the ramifications for new buyers. Many states require the disclosure of reserve funds to prospective purchasers.