Selling Association Reserves...

Reserves provide practical benefits and are essential to preserving your property values.

Gregory Pettersen, PRA, RS

One of the most frequently asked questions I encounter is "What can we tell people to convince them that we need to adequately fund our reserves?" Good question. I hope the following information will help you formulate an equally good answer.

Quite often we hear owners object to making adequate reserve contributions because they think it costs them extra money from which they derive no benefit. To persuade them of the need for reserves, you must help them understand a reserve fund is not an added expense.

Your Share of Depreciation

Replacement Reserve funding is simply a fair and just means of equitably distributing long term Association obligations among all members-- present and future. Reserves distribute the burden of these inevitable common element replacement costs more evenly and equitably amongst all the owners who receive benefit from them. Owners should recognize that adequate reserve funding carries an intrinsic value that provides them with an immediate benefit, otherwise they will presume they are simply throwing their money away!

A short list of Adequate Reserve Funding Benefits:

- Reserve funding enhances resale values! How much more is a home in your community worth if it has, for example, $3,500.00 per home accrued in reserves for common element replacements? Conversely, lenders and Realtors know the ramifications for new buyers if reserves are inadequate. The resale value of the homes is a reflection of the association's financial condition.
- Reserve funding assures continued strong "curb appeal" by providing for planned replacement of major items that must be replaced at some point. The Gallop organization conducted a nationwide survey of homeowner satisfaction in 1999. The #1 factor affecting homeowner satisfaction in associations? *Overall appearance and condition of the community!* Any Realtor will confirm that "curb appeal" is a significant factor affecting property values in the marketplace. Adequate reserve funding does more than merely provide money to replace roofs & siding. It significantly impacts the overall rise or fall of property values relative to the marketplace.
- Adequate reserve funding helps the association meet owner expectations that the property will be maintained in a state of good repair. Simply put, without proper funding the expectations of the members will not be met.
- ***Your reserves provide protection against decertification. Insufficient reserves can result in decertification of the community by mortgage backers, dramatically affecting salability of your home.***
- Reserves can reduce or eliminate the need for special assessments. Owners on fixed incomes are especially hard hit and may be unable to afford even modest special assessments.
- A detailed & comprehensive reserve plan improves the quality and value of financial audits, reviews and reports. The American Institute of Certified Public Accountants (AICPA) has published standards that provide disclosure requirements for financial reporting. The current version of the *AICPA Audit and Accounting Guide: Common Interest Realty Associations (CIRA guide)* references the National Reserve Study Standards of the Community Association Institute.
- If your association is *required* to maintain adequate reserves, either by stipulation in its governing documents or by statutory mandate, there really should be no need of further discussion. For example, the Minnesota Common Interest Ownership Act, statute 515B.3-1141, requires that association boards budget adequate replacement reserve funds. Further, they are required to reevaluate the adequacy of

their reserve funding at three year intervals (minimum) and fairly detailed information must be provided in resale disclosures and annual reports to the membership. Other states have varying requirements.

That's a pretty good list of talking points you can use to discuss reserves in positive terms. They should enable you to counter most arguments opposing reserve funding. Many of us do not actually *enjoy* writing a larger monthly assessment check, at least initially. However, we do enjoy our well-manicured communities and the confidence that our association is responsibly securing the value of our housing investment.

Avoiding Tough Spots

Another frequent objection goes like this: "Some of our owners just cannot afford it; this plan is going to hurt them." This argument suggests that it is better to forgo regular monthly reserve funding in favor of periodic special assessments because "poor" owners cannot afford the monthly assessment increase. But consider this: Isn't it easier for most people to write a relatively small check each month, than to come up with $4,000.00 at one time for a new roof, or siding, or asphalt replacement? If someone cannot afford a relatively modest increase to their monthly assessment, how will they afford a large, lump-sum *special assessment?*

Special Assessments?

Special Assessments are often substantial and almost always unfairly apportioned, especially for those living on a fixed income!

Worse, an association operating on a special assessment basis cannot guarantee that an assessment, when needed, will pass. Consequently, it cannot guarantee its ability to perform the required repairs or replacements to those major components that the association is required to maintain when the need arises. Additionally, while relatively new communities require very little in the way of major "reserve" expenditures, older communities often find many components reaching the end of their effective useful lives simultaneously. The appearance, condition, and value of the properties decline when you defer necessary maintenance and replacement.

Ironically, the community that most needs a special assessment often faces the greatest resistance from its' members. Why? Simply because too many of the owners lack the means to underwrite the large one year special assessment.

Analyze Your Need

Reserve planning is as important to a common interest community as a retirement plan is to most adults**. In essence, your reserve funding plan is your association's business plan.** It is almost common knowledge throughout our industry that the single largest problem facing Common Interest Communities today is inadequate reserve funding. ***Nearly any veteran board member or property manager can share a financial horror story or two: Special assessments, foreclosures, declining property values, FHA Decertification -- not a pleasant situation.***

The good news is it is a situation you can avoid with a thorough reserve funding plan. A detailed component inventory and a comprehensive financial analysis allow you to chart a smooth path to success.

When provided with enough information to formulate an informed opinion, most owners (and prospective buyers as well) will recognize the value of owning a home in a well-maintained community that is financially prepared to avoid large special assessments and yield them a good return on their sizable housing investment.

I hope the information presented here will help you address homeowner concerns and direct your association toward a successful future free of financial pitfalls and crises.

Greg Pettersen holds credentials with both the Association of Professional Reserve Analysts and Community Associations Institute. He is president of Reserve Data Analysis, Inc. in Minneapolis, which is RDA's Midwest Regional Headquarters.
He may be reached at (612)616-4817 or (866)780-7943. www.RDAmidwest.com