





By John Ceragioli, PRA and Janis Lee, CCAM

Reserve Studies

for Common Interest Developments

Have you ever wondered what the monthly reserve contribution is and how it is calculated? Let's discuss reserve studies, their requirements and how your board of directors determines how much of your monthly assessment is going to be delegated to reserve fund contributions.

Each member of a homeowners association receives a document entitled "Annual Budget Disclosure Statement" annually. This document

includes, amongst other things, a statement as to what your monthly assessments will be for the coming year. Your monthly assessments are calculated to defray expenses such as insurance, landscaping, etc. and to fund your reserve account.

Reserve Study History

The State of California enacted the Davis-Stirling Act in 1986, as part of the California Civil Code. The Act describes the methodologies and

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practices required of all homeowners associations within the State of California. The Davis-Stirling Act was enacted to protect the owners (and potential homeowners) of these properties, requiring disclosure and openness in the financial and management processes and its practices.

Reserve Study Requirements

The main emphasis of the Act is for the homeowners association's board of directors to disclose how they intend to protect the fiduciary investment of the homeowners of the corporation. Section 1365 of the Davis-Stirling Act requires that "the association shall prepare and distribute to all of its members the following documents":

- A pro forma operating budget which shall include all of the following:

A summary of the association's reserves based upon the most recent review or study conducted pursuant to Section 1365.5 of the act. The required summary is a form as mandated by the Act.

Section 1365.5, Subsection (2)(e) states, "At least once every three years, the Board of Directors shall cause to be conducted a reasonably competent and diligent visual inspection of the accessible areas of the major components that the association is obligated to repair, replace, restore or maintain as part of a study of the reserve account requirements of the common interest development."

This reserve fund study must at a minimum accomplish the following:

1. Identify the major components that the association is obligated to repair, replace, restore or maintain that, as of the date of the study, have a remaining life of less than 30 years.
2. Identify the probable remaining useful life of the components.
3. Estimate the cost of the repair, replacement, restoration or maintenance of the component.
4. Estimate the total annual contribution necessary to defray the cost to repair, replace, restore or maintain these major components.

The description of a major component is "any component that the association is obligated to repair, replace, restore or maintain that has a remaining life of less than 30 years." What this doesn't describe is what components are required to be included in a reserve study.

Component Requirements

Here are the requirements that the components must meet in order for inclusion in study. These are:

The component must be a physical component that the association is responsible for repairing, replacing, restoring or maintaining. A "physical component" is understood to mean a component that is part of the association's common area.

The component must be visually inspectable. Reserve analysts are not expected to undertake destructive testing. Other vendors can undertake destructive testing and that information can (and should) be incorporated into the reserve study.

California does not mandate funding, only how the board intends maintain the property and fund these requirements.

The component must have a reasonably determinable statistical life expectancy. Analysts use various sources to determine life expectancy; among these are experience, various state documents such as Department of Real Estate guidelines, and contractor information.

The component must have a life expectancy of one year or greater. Components with expected lives (and that are paid for) more often than once a year must be included in your operating expenses and paid for out of operating funds. This may include routine maintenance expenses that are paid on an annual basis, such as backflow prevention testing and certification.

To fund for a components replacement it must have a life expectancy of 30 years or more. Components with life expectancies greater than 30 years may be included in the study, but their replacement cannot be funded until their expected life is less than 30 years.

Finally, the state mandates that all major components must be included in the study.

So What is a Reserve Study Really About?

Every association has three documents that provide guidance in the business decisions and help plan the future of the association. These documents are the Covenants, Conditions and Restrictions (CC&Rs), the association bylaws and the reserve study. The reserve study puts your association's history in context and provides valuable guidance in the long-term care and upkeep of the association.

Your CC&Rs describe the common components that the association is responsible for maintaining, repairing or replacing for the enjoyment of each homeowner. Simply put, reserve studies are nothing more than a complete inventory of, and the past history of the common component replacement. This information is then used to project a timeline for the long term care of the property and calculates a reasonable reserve-funding plan based on the timeline. This long-term funding plan will ultimately determine your association's monthly reserve fund contribution.

Monthly Reserve Funding Calculations

The State of California does not mandate funding, only the disclosure of how the board intends to maintain the property and what methodologies are going to be used to fund these requirements. Generally accepted practice is for the association to fund its reserve accounts from the regular monthly assessments it collects from the members. This mirrors the intention of the Davis-Stirling Act which suggests that members who enjoy the benefits of the common area components pay for its accumulated depreciation.

The Davis-Stirling Act states in part "the association shall levy regular and special assessments sufficient to perform its obligations under the governing documents." The operating budget process involves your board processing the information in the reserve study and determining what appropriate and sufficient reserve funding level is realistic and appropriate for your association. E

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