





By John Ceragioli, PRA and Janis Lee, CCAM, CMCA

Reserve Studies

How Should This Tool Be Used?

In the August 2012 Edition of the *ECHO Journal* we discussed the history and requirements of reserve studies.

We also looked at what reserve studies are about, and how the funding calculations are generated. This month we now explore how reserve studies must be used by your Board of Directors under the Davis-Stirling Act, and important alternate methodologies for using the component analysis and financial results within your reserve study.

California State Mandated Requirements

The Davis-Stirling Act Section 1365 requires that the Board of Directors of every Common Interest Development (CID) disclose to the members of their association the following information on an annual basis:

1. A summary of the association's reserves based upon the most recent reserve study, which includes the following:

- a. The current estimated replacement cost, estimated remaining life,

and estimated useful life of each major component.

- b. The current financial condition of the association.

- c. The long-term (30 year) financial plan that the association has adopted.

- d. The Section 1365.2.5 Assessment and Reserve Funding Disclosure Summary.

- e. Whether or not any future Special Assessments are anticipated.

- f. A statement whether the Board of Directors has determined to defer or not undertake repairs or replacement of any major component with a



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remaining life of 30 years or less, including a justification for the deferral.

Items *a-e* comprise the required Reserve Study Disclosure form and may be provided by your Reserve Analyst depending on the contract you have with your vendor. Item *f* must come from the Board of Directors.

2. These items are to be included in your annual pro forma operating budget package that must be distributed to the association members not less than 30 days, nor more than 90 days before the beginning of your association's fiscal year. So, how should you use your reserve study?

As a Document of "Continuity"

Common Interest Developments have four documents which record the association's history and tell its members the details of who, what, why and how it exists. These documents are:

1. The Articles of Incorporation:

This document states the Association name and location.

2. **The Bylaws:** This document describes the association's legal duties to its membership, the membership voting process (including electing the Board of Directors), positions and duties of the Board, and how associations may conduct business.

“ The reserve study becomes an important document that records the association's past history. ”

3. The Covenants, Conditions & Restrictions, commonly known as

CC&R's: This document describes the obligations of the association's Board of Directors to its membership. It also defines who owns what on the property and who is responsible for property maintenance.

4. **The Reserve Study:** This document describes the common components that make up the common area of the association. It also describes

when each component is scheduled for maintenance, repair or replacement, and how the Board intends to pay for each component's replacement.

As such, the reserve study becomes an important document that records the association's past history. It also provides a "blueprint" that the Board of Directors may use in making informed decisions regarding the future protection of the membership's investment in the association.

As a Budgeting Tool

The reserve study provides valuable information to your Board of Directors every year. This information is vital in the completion of the following:

1. **Financial Budgeting:** The reserve study is part of the process which results in the annual pro forma operating budget disclosure package. The reserve study financial charts recommend an annual reserve deposit from your regular monthly assessments. Generally, the reserve analyst tries to find an adequate level of fund-

ing that doesn't require future special assessments. Boards will use this information to adopt a budget that is appropriate and sufficient for your association's needs.

2. Component Replacement Budgeting: Every reserve study includes annual expense charts. These charts are used by the Board to make informed decisions with regards to your association's annual reserve replacement projects, and help the Board adequately fund for these projects.

As a Tool to Lower Association Costs

A complete and accurate reserve study can help lower your association's annual expenses in the following ways:

1. Using the annual expenditure charts to make major decisions early in the year. Reviewing the charts early enough in the year will allow your property manager to go to bid earlier and lock in pricing well before major projects are due to be completed. This could allow your project to get on a contractor's calendar well before the project commences as well as eliminating cost increases due to market fluctuations.

2. Allowing the association to practice preventative maintenance rather than reactive maintenance. Too many associations replace components only after they have failed, rather than replacing them before failure. Classic examples of this are the water heater which fails on a Saturday, resulting in the association paying a premium to a plumber, or the roof which fails during a rain storm causing interior damage to a unit for which the association must now pay. Both are examples of wasted funds, which no association can afford—no matter how well funded you may be.

3. As a planning tool for major reconstruction. Using a complete, detailed reserve study which accommodates long-term reconstruction needs allows Boards to determine the best timing and financial methodology for such a project.

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The more detailed and complete a reserve study is, the more accurately annual operating expenses can be projected. While operating expenses are “dollar in, dollar out,” reserve expenses take into account various accounting methodologies, which allow for more component replacement and financial flexibility for your association.

Real World Strategies for Getting the Most Out of Your Reserve Study

1. Use it as a tool to practice preventative maintenance. Replace components before they fail, not after.

2. Use the information in the study during a walkthrough of your association with other Board members. Make decisions regarding your annual reserve replacement requirements early in your budget year.

3. Compare your association to other local associations. It has been shown that the decision to purchase a home is made in the first minute of a viewing. In every HOA that minute is spent looking at common area components. Does your property make a good first impression compared to your neighbors?

In summary, reserve studies can be used as much more than a document to meet the requirements of California Common Interest Development disclosures. It can be used by your Board of Directors to make informed decisions, plan the Association’s future accordingly, and to help mitigate undue expenses for your association. **EJ**

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