

“Red Flags” that Signal Potential Reserve Account Problems

by [Lawrence Szabo, Esq.](#) | May 18, 2020 | [Finances](#)

Homeowners associations must conduct periodic reserve studies in order to have a realistic estimate of the costs of repairing and replacing major common area components such as roofs. Ideally, an association will have funds set aside in a reserve account to cover the cost of all major repairs and replacements so that the funds are available when needed. Having the necessary reserve funds necessitates: (i) an examination of the association’s repair and replacement obligations; (ii) a determination of the costs and timing of replacements; and (iii) a determination of the availability of the necessary cash resources (reserve funds).

Because an association’s board of directors has a fiduciary duty to manage the association funds and property, the maintenance of an accurate replacement reserve budget is very important. Not only does the information supplement the association’s operating budget, but it also is an important tool for the preservation of property values and the control of annual costs for the association’s membership. A good reserve study provides owners and potential buyers (and their lenders) with a more accurate picture of the association’s financial strength and market value. When evaluating an association’s reserve study, the following indicators may be “red flags” which are indicators of problems that call for remedial action:

Indicators that an Association’s Reserve Study Data is Incomplete

- The association does not have a specific policy to distinguish reserve expenditures from operating expenses;

- The association does not have an established list of major components;
- The association does not have a stated funding goal;
- The association has not conducted a physical analysis of the components that should be included in the reserve study;
- The association has not conducted a funding analysis;
- The association does not maintain complete and current information on the remaining life and current replacement cost for all major components;
- The association's operating budget does not contain reserve study information or assumptions;
- The association does not have a documented maintenance schedule and related assumptions for each major component;
- The list of components that is maintained by the association is incomplete and does not include all significant common area components that are identified in the association's declaration and/or CC&Rs;
- The association does not maintain a separate bank account(s) for reserve funds;
- The association's reserve deficit is staying constant or increasing over time;
- Special assessments are required in order to fund major repairs;
- The association's income from assessments does not equal or exceed the dollar value of the annual component wear.

Association boards should evaluate whether their association has the indicators of an insufficient reserve study and, if so, they should resolve

to have a proper reserve study performed and become committed to taking the necessary steps to establish and maintain a realistic reserve budget and account. Because of the importance of proper reserve funding, it is a prudent practice for associations to seek professional assistance in the preparation of their reserve studies and budgets.