DMA
Interactive Reserve Analysis

HISTORIC FUNDING ANALYSIS (a.k.a. COMPONENT METHOD or FULL FUNDING METHOD)

The Historic Funding Analysis (also known as the Component Method) provides a picture of the results of the historic funding contributions made by the Owner's Association over the years since the first component was placed in service. The Analysis shows the adequacy of the Reserve Account to fully fund the components at this point in time. This does not necessarily mean that the current contribution amount is insufficient to fund the components from this point forward.

The fairness theory of funding requires that all owners whether recent or long term owners should pay their fair share for the replacement and repair of their capital assets. The theory is based on the premise that the owners have enjoyed the use of assets for the period of time that they have lived in the community and therefore should have contributed their fair share in proportion to the time that they have lived in the community. The closer the Association is to the 100 percent funding level the better off it is because this indicates that the owners have been paying their fair share during the previous years. Any percentage below the 100 percent funding level indicates that the owners have not been paying their fair share during the previous years. Any percentage over the 100 percent funding level indicates that the owners have been paying more than their fair share during the previous years.

Historic Funding Analysis Method

In the report we perform a historic funding analysis that looks at both the current funding level and the current fund balance of your reserve account. We then compare that to the amount of annual funding that would have had to have been set aside each year for each component to be funded at 100 percent of its replacement value. This is calculated by dividing the original cost of the component by the number of years in its estimated useful life. This is also commonly referred to as "component method funding" and represents the annual straight line depreciation value of each component.

By multiplying the annual depreciation value of each component by its present age, we arrive at the amount of money for each that should be in the capital reserve account as of the study date. The total amount for all components added together is the target "fully funded" level of the reserve account. We divide the actual reserve account balance by this amount, yielding the percentage that the account is fully funded. A 100 percent funding level means that the account is fully funded. A value less than 100 percent means that there may be a deficiency in the capital reserve account.

Drawbacks

In our experience, many communities are not fully funded from their beginning date, and simple conversion to full funding using this method of analysis will often place the entire cost burden of a "correction" on the present owners. The historic funding analysis or component method must be recomputed every year. Gradually, the annual funding amount will be reduced over time as the Association "catches up". It must be noted that this does not necessarily mean that the current annual contribution amount is insufficient to fund the reserve account from this point forward. The Association over the course of the years may have adjusted the annual contribution amount to where it is now adequate to fund the reserve account going forward if all funds are "pooled" into a single account.

The primary "drawbacks" to the Historic Funding analysis are:

1. This method does not take into account the rate of inflation.
2. It must be conducted every year.
3. The annual funding levels can go up or down in any succeeding year.
4. It almost always results in an initial higher contribution rate then the "Cash Flow Method".
5. It almost always results in "over funding" in future years.

6. Eliminates the benefit of the use the "pool" of funds available over time because the allocations are fixed to each component.

The only real benefits to the Historic Funding (a.k.a. Component Method or Full Funding Method) analysis are that:

1. It is easy to understand and compute.
2. It works well enough for Associations with a very few assets.

Generally speaking, all of the on-line software versions offered to the general public for creating a reserve study are based on this method.

If you have additional questions about DMA reserve studies, please contact us at our office at 804-644-6404 or by e-mail at admin@dma-va.com.