



Interactive Reserve Analysis

HOW YOUR RESERVE STUDY WORKS

PURPOSE

Your community contains infrastructure and amenities (i.e. capital assets) that are owned in common by all property or unit owners. Your owners association is responsible for replacing these assets when they wear out or become unusable. A capital reserve account is a savings account designed specifically to accumulate funds for eventual replacement of your commonly owned assets when they reach the end of their useful lives. Each capital asset is referred to in this study as a component of your Capital Reserves. All components eventually need to be replaced in full or in part, although they may normally function for 10, 20, 30 years, or longer. Regular operating and maintenance budgets do not cover the funding required for these needs. This Capital Reserve Study looks at various ways to fund your Association's reserve accounts in order to adequately fund your reserves.

A FUNDING PLAN - NOT A MAINTENANCE SCHEDULE

This plan is a general predictor for replacement of components however it is not a required maintenance or replacement schedule. Specific decisions about replacement of each component should be made by the Board of Directors based on the actual condition of the component at the time replacement appears certain.

HOW MANY RESERVE ACCOUNTS?

It is possible to maintain separate accounts for individual components or groups of components, and some communities have requirements in their Declarations for dedicated reserve accounts, such as for private roads. Many Certified Public Accountants recommend that the number of reserve accounts be kept to a minimum. We normally recommend that you keep just one combined (pooled) account. Having one account gives you the spending flexibility to respond to an unexpected expense for one component

without having to transfer funds from other dedicated accounts. Unless otherwise noted in our funding recommendation, our study will develop one account with one annual deposit amount that will meet the replacement needs of all components.

PHYSICAL ANALYSIS – SCHEDULE OF COMPONENTS

The Schedule of Components identifies each component to be included in the capital reserve account(s) and provides quantity information, the expected useful life and the remaining useful life of each component. We also assess the condition of each component. Please review our separate article titled "An Explanation of the Physical Property Analysis" for a more detailed explanation of the Schedule of Components.

CASH FLOW ANALYSIS

In this analysis, each anticipated component replacement is plotted on a schedule over time. This schedule then calculates the annual total reserve account deposits required to fund all projected component expenses and maintain a minimum account balance over the entire period. Using this method of analysis requires that we set several parameters first. These include:

Actual Reserve Balance at the End of the Prior Fiscal Year

This is the dollar amount provided on your association's year-end financial statement. The number that we enter becomes the beginning balance of the reserve account in year one (1) of our study. If you do not have a reserve account, we will enter \$0.00 for this balance.

Anticipated Annual Inflation Rate

This is based on historical inflation data provided by R.S. Means Company based on their recorded historical cost indices. From



Interactive Reserve Analysis

these, we will recommend an inflation rate, expressed as a percentage (%), to use in the study.

Annual Income Rate on Reserve Account

We base this on your community's current and/or anticipated returns on investments from savings accounts, Certificates of Deposit, Money Market accounts or other fund investments. If funds are deposited in several different accounts, we will take an average of the earnings rate on all of the accounts. This number, expressed as a percentage (%) is input into the study.

Account Threshold

The goal of the Cash Flow funding plan is to keep your account above a minimum balance over the life of the study while insuring that all components are fully funded when they are scheduled to be replaced. We can set that minimum balance at zero (\$0.00), which is called "baseline" funding. We can also set a minimum account balance, or "threshold", at some amount above zero, in order to provide a buffer for the variations in actual expenditures that will inevitably occur over the life of the study. We typically use a percentage of your total expected reserve expenditures over a 20-year period to establish this amount. The amount is input into the study as a bottom limit for the cash flow in the account. This amount will increase every year at the rate of inflation.

Annual Contribution Escalation

As inflation decreases the value of the dollar over time, it is necessary to introduce an escalation factor so that the contribution grows in relation to the growth in actual costs over time. If we did not do this - if we kept the contribution constant - owners today would have to contribute a much larger amount in order to offset the declining value of the same contributions made in the future. The escalation rate provides parity for present and future owners.

In communities that are significantly underfunded, it may be necessary to use an escalation factor that is greater than the inflation rate to gradually increase your contributions to an acceptable level.

The annual contribution escalation is expressed as a percentage (%) and is initially input into the study to match the rate of inflation. We can adjust this rate as a constant over the entire study period, or manually adjust it from year to year, to help us design the appropriate funding plan.

The 30 Year Cash Flow Study

Having identified the above parameters, we conduct our cash flow study. This study can balance out contributions over the next 30 years, to distribute the responsibilities for reserve funding between present and future owners in various ways. It can also incorporate funding tools such as special assessments and bank loans into the overall calculations. Our spreadsheets are designed to allow us to conduct this analysis dynamically in a physical or online meeting format so that community leaders and management can have test alternate funding plans and decide on the plan best suited to the needs and priorities of the community.

In the report we provide a list of the expected reserve expenditures by component for each year of the study. All costs shown in these schedules are presented in current dollars as of the report date. The total values of these annual expenditures are revised to reflect the input inflation rate, in the cash flow spreadsheets.

The results of this study are summarized in a five year funding schedule and a 30 year funding plan graph. These results comprise our recommended funding plan for your community as of the date of the study. The financial aspects of this plan can be updated annually upon request, and we recommend an update of the full study, including the physical analysis, every 3 to 5 years.

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.