Reserve Study Fiscal Fitness

By Robert W. Browning, PCAM, RS, RSS #5

“It's budget time again… Hooray!” Said no one ever.

Budgets are often thought of as perfunctory tasks boards and managers must do. The importance of budgets can get lost in the myriad of details mandated by laws, regulations, disclosures, reserve requirements, font sizes, printing deadlines, and the like. But what if we look at a budget, not as a task, but as a reflection of what we want our communities to be?

> ***“Don't tell me what you value, show me your budget, and I'll tell you what you value.”***
>
> ***-Joe Biden***

Not everyone will agree with everything the vice-president has said. But his remark was spot on. The budget is the starting point for how community associations are managed. This translates to outward appearances such as curb appeal, maintenance, and upkeep, risk mitigation, financial solvency, etc. It is important to take the time to evaluate everything in the budget, with an emphasis on how these decisions impact member’s home values, as well as increase their sense of pride in the community.

The reserve contribution can be the largest line item in most community association budgets. Fortunately, the manager and board can rely on help from the reserve analyst for this important line item. The association’s “Fiscal Fitness” the theme of this issue, is dependent on having adequate reserves for reserve components maintained by the association.

As part of an association's "Fiscal Fitness," which is best? Special assessments, reserve assessments, or bank loans?

Spoiler Alert! The best answer is "None of the above." And for two good reasons.

First, in Nevada, NAC 116.425 defines adequately funded reserves in a reserve study as:

> "Without using the funds from the operating accounts or without special or reserve assessments, except for occurrences that are a result of unforeseen catastrophic events."

Secondly, special assessments, reserve assessments, and bank loans are all symptoms of a reserve fund not adequate for the purpose for which it was created. Let's look at each of the three, one at a time, and then talk about ways to avoid them. Always check with legal counsel and the governing documents before proceeding. Language in the association's documents may impact options available to the board.

Special Assessment and Reserve Assessment

The reserve assessment is specifically defined in Nevada Revised Statutes Chapter 116. NRS 116.3115(2)(b):

> "…the executive board may, without seeking or obtaining the approval of the units' owners, impose any necessary and reasonable assessments against the units in the common-interest community. Any such assessments imposed by the executive board must be based on the study of the reserves."

For special and reserve assessments, the board must disclose annually to the members, per NRS 116.31151, if it

> "anticipates that the levy of one or more special assessments will be necessary to repair, replace or restore any major component of the common elements or any other portion of the common-interest community that the association is obligated to maintain, repair, replace or restore or to provide adequate funding for the reserves designated for that purpose."

An important note on special and reserve assessments- Special or reserve assessments should be a result of unforeseen catastrophic events [NAC 116.425(2)(b)].

Bank Loan

Depending on the governing documents of the association, some community associations in Nevada can obtain market-rate loans from financial institutions. This process does not directly affect a member's interest in the community because the collateral for the loan is from the association's income stream, not through an encumbrance on an owner's parcel.

A few things to remember about bank loans:

- These are commercial loans, not residential loans, and the interest rates may reflect this reality and have more restrictive terms than a home loan.
- The bank may initiate several requirements during the approval process.

- A reserve study may be required for the bank to determine the viability of the loan in the associations' term reserve funding plan.
- The association’s legal counsel should be consulted. This may be a bank requirement.
- The association may be required to deposit funds in the lending bank.

Loans can be a life-saver for some associations facing large impending expenses from reserves. The reserve analyst can run models for the board to determine the impact of different interest rates, loan terms, loan payment amounts, etc. The board should always consult with their reserve analyst before approving a loan for reserve component replacements.

An important note- Never include funding from a bank loan, special assessment, or reserve assessment in a future year, in the reserve study. For example, it would be wrong to “help” the funding plan by inserting an unadopted, prospective reserve assessment or bank loan proceeds in 2030, the year the roofing is replaced.

Which is better, a loan or reserve assessment? Like all good experts say… it depends. There is not much overall difference between a bank loan and a reserve assessment except the loan has debt service. This means interest is paid to the bank for use of the bank’s money. When this is factored in, the reserve assessment is usually less expensive for the members. There are many other variables with loans and reserve assessments and an analysis by the reserve analyst will help to sort this out.

A sound budget and reserve study should comply with the law and also include visionary goals and objectives of the association. This will help to ensure bank loans, special assessments and reserve assessments will not be needed. Surprises will be averted. Take some extra time this budget season, have some fun and see how the budget process can help the community show off its vision to the members.

Your reserve analyst wants to hear from you and can be a big help.

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