

# Why Do Associations Need Reserves?

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New Associations in today's economic environment are struggling with the need for having reserves, but reserves are critical for an Association to preserve the property and have funds for capital expenditures. Equipment and major components (like the roofs) must be replaced from time to time, regardless of whether we plan for the expense. We prefer to plan and set the funds aside now. Reserve funds aren't an extra expense. They just spread out expenses more evenly. There are other important reasons we put association monies into reserves every month:

1. Reserve funds meet legal, fiduciary, and professional requirements. A replacement fund may be required by:

- \* Any secondary mortgage market in which the association participates (e.g., Fannie Mae, Freddie Mac, FHA, VA).

- \* State statutes, regulations, or court decisions.

- \* The community's governing documents.

2. Reserve funds provide for major repairs and replacements that we know will be necessary at some point in time. Although a roof may be replaced when it is 25 years old, every owner who lives under or around it should share its replacement costs.

3. Reserve funds minimize the need for special assessments or borrowing. For most association members, this is the most important reason.

4. Reserve funds enhance resale values. Lenders and real estate agents are aware of the ramifications for new buyers if the reserves are inadequate. Many states require associations to disclose the amounts in their reserve funds to prospective purchasers.

5. The American Institute of Certified Public Accountants (AICPA) requires the community association to disclose its reserve funds in its financial statements.

Therefore, Association management firms must work with Association boards to impress upon the board to maintain the reserve in order to insure that the capital projects can be funded without having to resort to lending or special assessments. Imagine a special assessment of a large one time payment of a few thousand dollars to repair a roof at a condominium complex that has to be paid in a short period of time. Would you as a homeowner in a community enjoy a large bill being dropped on your lap right before the holidays to pay for an emergency roof repair? Community associations leaders understand that the unexpected bill is not feasible; and this puts a premium on planning and budgeting to reduce the chances that all Santa brings a homeowner is a special assessment.

