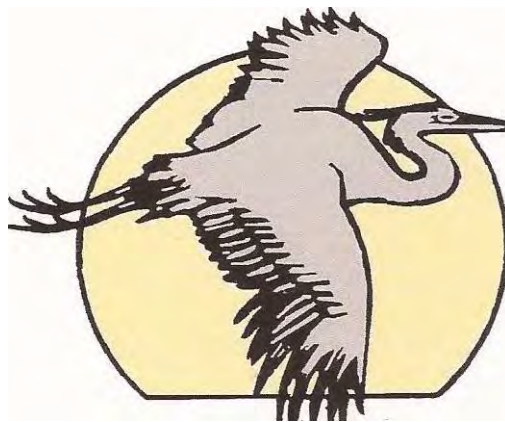


THE COVES AT WILTON CREEK OWNERS ASSOCIATION



RESERVE STUDY 2015

The Coves at Wilton Creek Owners Association
23 Mariners Point Lane
Hartfield VA 23071

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Executive Summary

Association: The Coves at Wilton Creek Owners Association, Hartfield VA
Number of Units 132
Report Period Calendar year 2015

Results:

Projected reserve balance at year-end	\$604,000
Fully funded reserve balance	\$412,439
Percent funded	147%
Recommended 2016 annual reserve contribution	\$ 27,502

Economic assumptions:

Net annual after-tax interest earnings on reserves	1%
Annual inflation rate	2%

Evaluation:

- Reserve fund over 100%, therefore deemed strong
- Multi-year funding plan to reduce funding level to 120%
- Major reserve expenditure in 2014-15 was completion of Wells 7 and 8
- Implications for budget and assessments 2017 and forward (see pp 10-12 and 17)

Introduction

Physical description and number of units

The Coves at Wilton Creek is in Hartfield, Virginia, located between Twiggs Ferry Road to the west and Wilton Creek to the east, and about two miles south of the intersection of Routes 3 and 33 in Hartfield. The development consists of 132 lots, homes and condominium units: 70 lots with 46 single-family homes, 42 units in the Villas and 20 units in Mariners Point. All owners are members of The Coves at Wilton Creek Owners Association. Each condominium owner is also a member of the respective condominium unit owner association of the Villas or Mariners Point.

Coves at Wilton Creek common properties include the clubhouse and swimming pool, which are available to all owners of lots, homes and condo units. Similarly, the Coves owns and is responsible for certain parking lots and roads, two tennis courts, a fenced storage facility that owners may use, an entrance sign and some streetlights. Additionally, the Coves owns and operates a water/sewer system, with wells, a pumphouse, drainage fields and other equipment.

The common elements described in the paragraph above are the subject of this reserve study. They are presented in detail in Table I, “Reserve Components Listing.”

Note that the two condominium associations have their own respective common properties and maintain their own reserves.

The Coves at Wilton Creek Owners Association is a Virginia non-stock corporation.

Mailing address:

The Coves at Wilton Creek Owners Association
c/o Chesapeake Bay Management, Inc.
603 Pilot House Drive
Newport News, Virginia 23606.

Reserve Study 2015

General statement as to reserve fund status

Reserve funds on hand are \$577,628 at June 30, 2015 and projected to be \$604,000 at December 31, 2015—as compared to a calculated requirement based on estimated useful lives and estimated replacement costs of \$412,439—or 147 % of the calculated amount.

Reserve funds are invested in certificates of deposit and checking accounts, all federally insured.

General statement as to methods and objectives used in evaluating the reserve fund status

As required by Virginia law, this reserve study was performed with a blank-slate approach, using all fresh data—as opposed to merely updating the previous study from 2010. Components were identified freshly, resulting in additions to, as well as deletions from, the list of components in the previous study.

Useful lives and replacement cost information came primarily from authoritative reference sources, such as Washington State DCA Office of Affordable Housing, the International Association of Certified Home Inspectors and costhelper.com, among others.

The study also draws on replacement cost information based on the association's experience over the past several years, a specific example being the two new wells started in 2014 and put into service this year.

For the calculations supporting the final answers, refer to the following:

Table I, “Reserve Components Listing”

Table II, “Reserve Components—Year Placed in Service and Sources for Useful Life and Cost”

Table III, “Reserve Expenditures by Year Based on Ages, Assumed Lives and Assumed Costs”

Table IV, “Projections to 2045 of Reserve Funds Balance”

Table V, “Projections to 2045 of Reserve Requirements and Percent Coverages, Inflation-Adjusted”

Table II documents the sources for the useful lives and costs that are used in the computations.

Table III shows what replacement expenditures would be, in 2015 dollars, based on the lives and costs from Table II.

Table IV shows a scenario for the association making level contributions to the reserve fund (the asset side of the reserve equation), such that the percent coverage never drops below the target threshold of 120%: it starts with the opening fund balance for each year, adds after-tax interest and the level contribution and deducts the expenditures (from Table III, adjusted for inflation) to arrive at the ending fund balance.

Finally, Table V provides a similar year-by-year analysis of the reserve requirement (the liability side), starting with the beginning amount, adding the annual reserve requirement, and then deducting expenditures to arrive at the ending amount. This is compared to the fund

balance (from Table IV) to get each year's percent coverage figure. This table uses "current," or inflation-adjusted, dollars.

As was the case five years ago, the association has the policy objective of being more than 100% funded.

The tables appear on the pages immediately following.

TABLE II-RESERVE COMPONENTS, YEAR PLACED IN SERVICE AND SOURCES FOR USEFUL LIFE AND COST

Description	Useful Life	Useful Life Source	Cost Source	Year Placed in Service
Building and Grounds				
Decks-clubhouse and pool	15	WashSt,NACHI	Costhelper	1989
Carrier heat pump	15	WashSt,NACHI	Costhelper	2007
Trane heat pump	15	WashSt,NACHI	Costhelper	2006
Roof	15	WashSt,NACHI	Costhelper	2006
Carpet	7	WashSt	Costhelper	2006
Sauna	15	NACHI	Experience	2007
Pool lining	10	NACHI	Experience	2014
Pool cover	7	NACHI	Experience	2014
Entrance sign	40	2010 study	2010 study	1987
Street lights	25	FNMC	Present estimate	1987
Road-fill cracks	5	WashSt	Experience	
Roads-resurface	25	WashSt	Experience	
White fence	25	WashSt	Costhelper	2005
Tennis court resurface	15	WashSt	Costhelper	2007
Tennis court fence	40	WashSt	Costhelper	1990
Boat ramp	50	See note	Present estimate	1989
Tending dock	25	See note	Costhelper	1989
Storage fence	40	WashSt	Costhelper	1990
Water/Sewer				
<i>Drain fields</i>				
Drain field 1	40	See note	See note	1989
Drain field 2	40	See note	See note	1989
Drain field 3	40	See note	See note	1999
Drain field 4	40	See note	See note	2001
Drain field 5	40	See note	See note	2001
Wood fence	12	WashSt	Costhelper	2005
<i>Wells</i>				
Well 1	30	Ca state controller, others	Experience	2009
Well 2	30	Ca state controller, others	Experience	1986
Well 3	30	Ca state controller, others	Experience	2009
Well 4	30	Ca state controller, others	Experience	1986
Well 6	30	Ca state controller, others	Experience	1988
Well 7	30	Ca state controller, others	Experience	2015
Well 8	30	Ca state controller, others	Experience	2015
<i>Pumphouse</i>				
Storage tank	43	Sydnor at 2015 cleaning	Sydnor est.	1989
Pressure tank	43	Sydnor at 2015 cleaning	Sydnor est.	1989
Transfer pump 1	20	WashSt	Experience	1990
Transfer pump 2	20	WashSt	Experience	2006
Miscellaneous equipment	20	NACHI	Estimate	2000

Note-Boat ramp in poor repair, replacement should last indefinitely, tending dock life based on experience.

Note-Drain fields were added to the reserves components list for this study. The nominal 40-year life can be extended by good maintenance practices; also, the incomplete build-out of homes and the seasonal use of many condos will tend to extend the lives as well.

Coves at Wilton Creek Owners Association-2015 Reserve Study
TABLE III-RESERVE EXPENDITURES BASED ON AGES, ASSUMED LIVES AND ASSUMED COSTS
(2015 Dollars)

2016	2029
Street lights 10,000	Drain field 1 24,000
Road-fill cracks 5,000	Drain field 2 24,000
Boat ramp 30,000	Wood fence 9,000
Tending dock 6,500	Total 57,000
Carpet 5,300	
Total 56,800	
2017	2030
Wood fence 9,000	Carpet 5,300
	White fence 13,200
	Tennis court fence 17,600
	Storage fence 20,500
	Total 56,600
2021	2031
Roof 7,000	Decks-clubhouse and pool 42,000
Trane heat pump 6,000	Street lights 10,000
Total 13,000	Road-fill cracks 5,000
	Boat ramp 30,000
	Total 87,000
2022	2034
Carrier heat pump 6,000	Pool lining 11,000
Sauna 3,200	Pool cover 3,600
Well 4 32,000	Total 14,600
Tennis court resurface 16,000	
Total 57,200	
2023	2035
Carpet 5,300	Transfer pump 1 5,985
Well 2 32,000	
Well 6 32,000	
Total 69,300	
2024	2036
Pool lining 11,000	Road-fill cracks 5,000
Pool cover 3,600	Roof 7,000
Total 14,600	Trane heat pump 6,000
	Total 18,000
2025	2037
Decks-clubhouse and pool 42,000	Carrier heat pump 6,000
	Sauna 3,200
	Carpet 5,300
	Tennis court resurface 16,000
	Total 30,500
2026	
Roads-resurface 50,000	
2027	
Entrance sign 13,000	
2039	
Drain field 3 24,000	
Well 1 32,000	
Well 3 32,000	
Total 88,000	

Coves at Wilton Creek Owners Association-2015 Reserve Study
TABLE III-RESERVE EXPENDITURES BASED ON AGES, ASSUMED LIVES AND ASSUMED COSTS
(2015 Dollars)

2041	
Road-fill cracks	5,000
Tending dock	6,500
Drain field 4	24,000
Drain field 5	24,000
Wood fence	9,000
Total	<u>68,500</u>

2044	
Carpet	5,300
Pool lining	11,000
Pool cover	3,600
Total	<u>19,900</u>

2045	
Well 7	32,000
Well 8	32,000
Total	<u>64,000</u>

Coves at Wilton Creek Owners Association-2015 Reserve Study
TABLE IV-PROJECTIONS TO 2045 OF RESERVE FUND BALANCES
 (Current Dollars)

Year	Opening Balance	Interest, Net of Tax	Contributions	Payments	Ending Balance
2016	604,000	5,335	27,502	(56,800)	580,037
2017	580,037	5,566	27,502	(9,180)	603,925
2018	603,925	5,888	27,502	0	637,315
2019	637,315	6,214	27,502	0	671,031
2020	671,031	6,543	27,502	0	705,076
2021	705,076	6,735	27,502	(14,300)	725,013
2022	725,013	6,444	27,502	(64,064)	694,895
2023	694,895	6,005	27,502	(79,002)	649,400
2024	649,400	6,167	27,502	(16,936)	666,133
2025	666,133	6,012	27,502	(49,560)	650,087
2026	650,087	6,338	27,502	0	683,927
2027	683,927	6,668	27,502	0	718,097
2028	718,097	7,001	27,502	0	752,600
2029	752,600	6,638	27,502	(71,820)	714,920
2030	714,920	6,259	27,502	(73,014)	675,667
2031	675,667	5,468	27,502	(114,840)	593,797
2032	593,797	5,790	27,502	0	627,089
2033	627,089	6,114	27,502	0	660,705
2034	660,705	6,241	27,502	(20,586)	673,862
2035	673,862	6,486	27,502	(8,618)	699,232
2036	699,232	6,560	27,502	(26,460)	706,834
2037	706,834	6,446	27,502	(45,750)	695,032
2038	695,032	6,777	27,502	0	729,311
2039	729,311	5,772	27,502	(137,280)	625,305
2040	625,305	6,097	27,502	0	658,904
2041	658,904	5,342	27,502	(110,970)	580,778
2042	580,778	5,663	27,502	0	613,943
2043	613,943	5,986	27,502	0	647,431
2044	647,431	5,981	27,502	(34,029)	646,885
2045	646,885	5,221	27,502	(111,360)	568,248

Coves at Wilton Creek Owners Association-2015 Reserve Study
TABLE V-PROJECTIONS TO 2045 OF RESERVE REQUIREMENTS AND PERCENT COVERAGE

Year	Opening Reserve Requirement	Annual Requirement, Current \$	Payments, Current \$	Ending Reserve Requirement	Ending Reserve Balance, per Table IV	Percent Covered	Inflation Factor
2016	412,439	27,502	(56,800)	383,141	580,037	151.4%	1.00
2017	383,141	28,052	(9,180)	402,013	603,925	150.2%	1.02
2018	402,013	28,602	-	430,615	637,315	148.0%	1.04
2019	430,615	29,152	-	459,767	671,031	146.0%	1.06
2020	459,767	29,702	-	489,469	705,076	144.0%	1.08
2021	489,469	30,252	(14,300)	505,422	725,013	143.4%	1.10
2022	505,422	30,802	(64,064)	472,160	694,895	147.2%	1.12
2023	472,160	31,352	(79,002)	424,510	649,400	153.0%	1.14
2024	424,510	31,902	(16,936)	439,476	666,133	151.6%	1.16
2025	439,476	32,452	(49,560)	422,369	650,087	153.9%	1.18
2026	422,369	33,002	-	455,371	683,927	150.2%	1.20
2027	455,371	33,552	-	488,924	718,097	146.9%	1.22
2028	488,924	34,102	-	523,026	752,600	143.9%	1.24
2029	523,026	34,653	(71,820)	485,859	714,920	147.1%	1.26
2030	485,859	35,478	(73,014)	448,322	675,667	150.7%	1.29
2031	448,322	36,303	(114,840)	369,785	593,797	160.6%	1.32
2032	369,785	37,128	-	406,913	627,089	154.1%	1.35
2033	406,913	37,953	-	444,865	660,705	148.5%	1.38
2034	444,865	38,778	(20,586)	463,057	673,862	145.5%	1.41
2035	463,057	39,603	(8,618)	494,042	699,232	141.5%	1.44
2036	494,042	40,428	(26,460)	508,010	706,834	139.1%	1.47
2037	508,010	41,253	(45,750)	503,513	695,032	138.0%	1.50
2038	503,513	42,078	-	545,591	729,311	133.7%	1.53
2039	545,591	42,903	(137,280)	451,214	625,305	138.6%	1.56
2040	451,214	43,728	-	494,942	658,904	133.1%	1.59
2041	494,942	44,553	(110,970)	428,525	580,778	135.5%	1.62
2042	428,525	45,378	-	473,903	613,943	129.6%	1.65
2043	473,903	46,203	-	520,107	647,431	124.5%	1.68
2044	520,107	47,028	(34,029)	533,106	646,885	121.3%	1.71
2045	533,106	47,853	(111,360)	469,600	568,248	121.0%	1.74

Note that Table IV shows even annual contributions into the reserve fund of \$27,502 over the 30 years of the projection, while inflation drives the annual requirement to \$47,853 in current dollars. This scenario succeeds in achieving the targeted funding percentage of 120%, but what happens in 2046? The annual requirement will have risen to \$48,810, assuming a 2% increase over 2045, and to keep the reserve balance from dipping below the 120% target, the reserve contribution component of the assessment would need to rise 77%. For practical purposes it would be much better to catch up with inflation and experience with more frequent and less drastic increases in the assessment amounts.

Fiscal year for which the study is prepared

This study is for calendar 2015, which is the same as the association’s fiscal year.

Projections of reserve cash balances at start of period

Reserve cash balances are as follows for 2015 (rounded to thousands):

Balance January 1	\$569,000
Transfers from 2014 surplus	40,000
Transfers from operations through June 30	9,000
Interest income through June 30	4,000
Expenditures through June 30	<u>(44,000)</u>
Subtotal June 30	578,000
Estimated interest through year-end	4,000
Estimated surplus from operations through year-end	23,000
Estimated expenditures through year-end	<u>(1,000)</u>
Estimated balance at December 31, 2015	<u>\$604,000</u>

General statement as to computations

Computations were performed using 2015 dollars at the component level, with the reserve requirement accruing evenly (straight-line) over the respective useful life of each component, and with replacement assumed at the calculated end of that component’s useful life, and then adjusted to show the effects of interest, inflation and taxes. See Tables IV and V for results.

Recommended reserve contributions, expenses and ending balances (30 years)

Annual contributions	\$ 27,502
Reserve expenses	
—Highest year (2039, in 2015 dollars)	\$ 88,000
Current dollars 2039	137,280
—Lowest year (various)	-0-
Ending balance (2045, in 2015 dollars)	\$326,579
Current dollars 2045	568,248

Site visit description

This heading normally is used by outside reserve specialists, to document when and for how long they visited the subject property. This study was prepared under the auspices of the finance committee, with input from the association’s president and the chairmen of the building and grounds and water/sewer committees, all of whom are frequently present in the Coves, and have a hands-on, day-to-day familiarity with the association’s assets and systems all year ‘round.

Assumptions for interest, inflation and taxes

Interest income	1.5%
Inflation rate	2.0%
Combined state and federal tax rate	35.0%

These values reflect current conditions. Note that after-tax interest income is only 1.0%, compared to the assumed inflation rate, leaving the association at a 1.0% disadvantage compared to that inflation rate, year after year. This continuing erosion in the value of reserve funds is essentially a fact of life, determined by the longstanding Federal Reserve policy of low interest rates and the practical requirement that our reserve funds be invested in federally insured bank accounts and certificates of deposit. Presumably any improvement in returns would be offset by increases in inflation, leaving only a small net change, one way or the other.

Summary of effects on assessments

Budget Basics

An association such as ours should set its assessments so that revenues will cover the sum of operating and capital expenses. Our operating budget includes the property manager, landscaping costs, the Sydnor contract, utilities, repair and maintenance and so forth, and the amounts are figured based on contracts or experience. The capital budget is figured based on the reserve study, and the amount represents what needs to be set aside each year for replacement or major overhauls, so that there will be cash on hand to cover the associated bills when they become due. The calculation of the annual amount of the reserve requirement is akin to depreciation, but more properly is a sinking fund arrangement, which takes into account the interest on invested reserve funds over the useful lives of the associated assets.

In the ideal situation, the year would begin with the right amount of money in the reserve fund (total amount of replacement cost, less an allowance for remaining useful lives), and during the year spending on replacements would proceed according to previous estimates, with the fund replenished for the year's wear and tear—so that at year-end the fund contains the right amount of money going into the next year.

Of course, the estimated costs and timing aren't going to work out to the penny, but the idea is to keep the goal in mind, and make adjustments up or down in the assessments if the reserve fund balance is shrinking below or growing above that targeted "right amount."

Our Current Situation, in Round Numbers

Reserve funds on hand at the beginning of 2015 were \$569,000 as compared to a calculated requirement of \$438,000 (per an updating of the 2010 study), or 130%. The estimated amounts for year-end are \$604,000 and \$412,000 (147%), an increase in net coverage of \$61,000 and 17 percentage points. We could just call it an embarrassment of riches and let it go at that, but some adjustment is called for. The amount of money in reserves needs to be justified, to the members who are paying the assessments and incidentally to the taxing authorities as well.

General assessments (everything but the water/sewer bill) were reduced by \$60.00 (9%) for the 2015 budget, but the reserve fund still increased as noted above. The budget for 2016 assumes another \$60.00 reduction (10% this time), but the contribution to the reserve fund will be \$39,000 versus an annual requirement of \$27,500 and the funding will rise to 151% if we hit the budgeted numbers, as we are on track to do.

What To Do About It

A sensible policy would be to monitor the balance between reserve contributions and reserve requirements each year, with a goal of bringing the coverage down to, say, 120% over time. But the sensible policy needs to take into account the effects of inflation. Inflation is low these days, but it does add up over time, and it puts pressure on both the operating budget and on the reserve requirement. If assessments are reduced to bring down the funding coverage quickly, inflation will catch up with us sooner and assessments will then need to rise quickly and regularly: once everything is in balance, by definition the annual inflation rate will have to show up in annual assessment increases. That potential for a whipsaw effect makes a more gradual balancing look like the way to go, as described in the next paragraph. (For an illustration, refer to the note on Table V about the abrupt transition in assessments going into 2046 according to the scenario laid out there.)

Present Recommendations

Assume there will be one last \$60.00 reduction in assessments for 2017, and that inflation will be at a 2% rate. Apply those assumptions to the 2016 budget to see what 2017 looks like: total revenues of \$141,373, total expenses of \$111,420, net available for reserve contribution \$29,953. Annual reserve requirement (with the 2% increase) works out to \$27,593, contribution and requirement are now approximately in balance, and the funding percentage is set to start working its way down. In ten years inflation could probably justify increasing assessments back to present levels.

In any event, the balancing of reserve requirements against funding against assessments should require close attention from the board each year.

The balance of this study explains some of the important definitions and conventions regarding reserve studies in general, and is titled “About Reserve Studies.”

About Reserve Studies

A *reserve study* is based on the art and science of anticipating and preparing for major common area repair and replacement expenses: partially art because we are making projections about the future, and partially science because it is a process of research and analysis along well-defined methodologies.

There are general standards for the form and content of reserve studies. The most authoritative come from the Community Associations Institute, which has defined and designated a credential known as Reserve Specialist. Although this study was performed by volunteers, the form and content of the document follow the requirements established by CAI, as reflected in the boldface headings throughout the text. The following pages explain some of the main definitions and assumptions affecting reserve studies in general and have been copied with very few changes from the language in the 2010 study. (Amounts have been updated, of course.)

A reserve study consists of two parts—the physical analysis and the financial analysis. The physical analysis contains the information about the current condition and repair or replacement cost of the major common area components the association is obligated to maintain. The financial analysis contains an evaluation of the association's reserve balance (measured by percent funded) and a recommended funding plan to cover the anticipated reserve expenses.

The primary responsibility of the board of directors is to maintain, protect and enhance the assets of the association. As the physical assets age and deteriorate, it is important to accumulate financial assets keeping the two in balance. The reserve study is the document that helps keep the physical and financial assets of the association in balance. The reserve study is a budget and planning document.

The primary information in this document is a list of the major replacement reserve components, a finding of the current status, or strength, of our reserve fund and a recommended funding plan. The basic objective of the reserve study is to provide a plan to collect funds at a stable rate to offset the predicted irregular reserve expenses. Setting a stable reserve contribution rate will ensure that all owners are paying their fair shares of the ongoing gradual deterioration of the common areas.

Property Owners Act

A reserve study is required by the Property Owners' Act of the Virginia State Statutes, which states:

§ 55-514.1. Reserves for Capital Components.

- A) Except to the extent otherwise provided in the declaration and unless the declaration imposes more stringent requirements, the board of directors shall:

- B) Conduct at least once every five years a study to determine the necessity and amount of reserves required to repair, replace and restore the capital components;
- C) Review the results of that study at least annually to determine if reserves are sufficient; and
- D) Make any adjustments the board of directors deems necessary to maintain reserves, as appropriate.

B. To the extent that the reserve study conducted in accordance with this section indicates a need to budget for reserves, the association budget shall include, without limitation:

1. The current estimated replacement cost, estimated remaining life and estimated useful life of the capital components;
2. As of the beginning of the fiscal year for which the budget is prepared, the current amount of accumulated cash reserves set aside, to repair, replace or restore capital components and the amount of the expected contribution to the reserve fund for that year; and
3. a general statement describing the procedures used for the estimation and accumulation of cash reserves pursuant to this section and the extent to which the association is funding its reserve obligations consistent with the study currently in effect.

Methodology

By necessity, the physical analysis occurs before the financial analysis. First the projected expenses are established and then the association's financial status is determined and a funding plan created. The physical analysis starts with a review of the governing documents, recent reserve expenditures and an evaluation of how expenditures, ongoing maintenance versus reserves, are handled. An on-site inspection is conducted to inventory (qualify and evaluate) the common areas. This enables one to create a reserve component list.

The reserve component list (Table I) contains a description and quantification of individual line items and estimates for the funding plan, remaining funding plan and current replacement cost of each component. The average of the best and worst case cost estimates are used for all calculations throughout the financial analysis. With this information and an assumed inflation rate as shown in the summary, the major expenses facing the association are projected.

Which physical assets are covered by reserves?

Reserve expenses are the larger, infrequent expenses that require significant advance planning. Operating expenses on the other hand are those ongoing daily, weekly or monthly expenses that occur and recur throughout the year. Small surprises are typically handled as maintenance contingencies, while larger ones may be covered by insurance or require special assessments.

There is a national standard four-part test to determine which expense items should be funded through reserves. First, it must be a common area maintenance responsibility. Second, the component must have a limited life. Third, the limited life must be predictable—otherwise it could not be accurately anticipated. Fourth, the component must be above a minimum threshold cost. This limits reserve components to major, predictable expenses.

Building foundations and major infrastructure elements are typically not reserve elements since they do not have limited life expectancies. Light bulbs or other small items are not listed as reserve components since their individual costs are insignificant. Finally, it is inappropriate to include unpredictable expenses such as damage due to fire, flood or earthquake since these typically cannot be considered "reasonably predictable."

How are funding plan and remaining funding plan established?

Funding plan is typically established by our experience with the component adjusted by assumptions for quality, rate of wear and tear, expected normal maintenance and weather exposure. Remaining funding plan is established primarily by the component's current observed condition. The "observed age" of a component may or may not equal the "chronological age" of the component due to factors such as accelerated wear or low usage. For components requiring a particular expertise, it is typical to interview a service vendor to obtain a recommendation for funding plan and remaining funding plan.

How are cost estimates established?

The best way to obtain an accurate cost for a component is for it to be replaced or repaired providing a valuable benchmark from which to make current cost estimates. It may be necessary to contact local vendors who may provide insight into current pricing trends. In the absence of these estimating tools, we look to reliable industry cost guides in books and on the Internet. A "best case" and "worst case" cost estimate is made for each component in an attempt to bracket the actual cost.

What level of reserves is enough?

Reserve cash balance can measure reserves, but the true measure is whether the funds are adequate for the needs of the association. Reserve fund size is therefore measured by percent funded, which is the actual (or projected) reserve balance, divided by the association's calculated fully funded balance (FFB), expressed as a percentage. Table V shows that the fully funded balance (FFB) is the current value of the deteriorated portion (not the total replacement value) of all the reserve components. To show how this works with one component, in the case of a \$10,000 component with a ten-year funding plan, in the third year the fully funded balance is three tenths of \$10,000 or \$3,000. The FFB grows as the assets age but shrinks dollar-for-dollar as components are replaced. Associations with deteriorated assets have a higher FFB than associations with assets in good condition. The fully funded balance changes each year and is a predictable but moving target.

Special assessments and deferred maintenance are common when percent funded is weak (below 30%). While 100% is ideal, a reserve fund above 70% should be considered strong because cash flow problems are rare. Measuring reserves by percent funded tells how well prepared the association is for upcoming reserves expenses. An association with a strong reserve fund should experience smooth sailing financially while an association with a weak reserve fund should expect cash flow problems. New buyers should be very aware of this important disclosure.

How much should be contributed?

There are four funding principles that are balanced in developing the reserve funding plan. First, the objective is to design a plan that provides sufficient cash to perform the reserve projections on time. A stable contribution rate is desirable because it indicates the association is being run on a stable financial platform and not being driven by the winds of change from year to year. For fairness, it is important to evenly distribute the contributions over the years so all the owners are paying their fair share of the deterioration in direct proportion to the amount of time they are owners. And finally, any funding plan must be based on fiscally responsible principles.

What is our funding goal?

There are different funding goals to strive for, ranging from "conservative" to "risky." Establishing a goal if simply having sufficient cash for all future years is called "baseline funding". The drawback is that there is little or no margin for error and expenses that are higher than budgeted or projects that occur earlier than planned will often cause special assessments.

Full funding is when the association has the goal of becoming fully funded (reserve cash equals the FFB). Such an objective means the association is following the simple and responsible principle that you replace what you use up. Believing this to be the responsible choice, our funding plan in 2010 was based on full funding. Owners in fully funded associations enjoy low exposure to the risk of special assessments or deferred maintenance. Strong interest earnings will minimize reserve contributions. Board members enjoy peace of mind that the association's physical and financial assets are in balance, therefore providing a degree of insulation from claims of financial irresponsibility.

Threshold funding is different in that the association selects a target other than 0% or 100%. The objective may be between 0% and 100% funded, higher than 100% funded or a particular reserve cash balance. Associations choosing threshold funding select this option to customize their exposure. We have selected 120% as our threshold target.

Projected Expenses

The summary of projected expenses for 2015 is in the Table III "Reserve Expenditures by Year Based on Ages, Assumed Lives and Assumed Costs." Since the projections are about events that may or may not take place as anticipated, the near term projections are more certain than those many years away.

While the reserve study is a one-year document, it is forward-looking for 30 years into the future.

Reserve fund status

The starting point for the financial analysis is the reserve fund balance at the start of 2015, which is \$569,000. Contribution to reserves from 2014 operations was \$40,000. The fully funded balance in this reserve study conducted in January through June 2015, and projected to the end of the year, is \$455,244. This total represents the deteriorated value of all

common area components. Comparing the reserve balance to the fully funded balance indicates that our reserves are 146% funded. This represents a "strong" status.

(A bit of history is helpful in understanding how this very strong percentage figure developed. Late in the 1990s the Coves board determined that the association was seriously under-reserved and accordingly boosted assessments to correct the deficiency. Each year the contribution to reserves exceeded the increase in repair-replace liability from the year's wear and tear. The 2010 reserve study showed 116% coverage, indicating that the deficiency had been corrected. In 2011-13 about \$150,000 was transferred to reserves from operations, compared to about \$20,000 of expenditures in the same period, and this accounts for the build-up. Spending from reserves was about \$86,000 in 2014-2015 and 2015's dues assessment was reduced by \$60.00 per property, to be followed by another \$60.00 reduction going into 2016 and probably a final one for 2017.)

Expected contributions to reserves from operations

While varying a great deal from year to year because special operations projects are done when needed and transfers of excess funds from operations have not always been done on the same time schedule, reserve contributions from operations have averaged \$43,000 in the last five years. In 2015, we expect this to decrease as we have removed quite a few items from the reserve components list because they were either relatively low cost (less than \$2,500) or should be considered maintenance items such as cleaning/staining decks and painting floors. Expenditures of operating funds for these maintenance items will result in lower transfer of funds to reserves at year-end. Accordingly, reserve expenses will also be lower. We expect the contribution from operations to average around \$27,500/year over the next few years, suggesting a decrease in dues assessments.

Recommended funding plan

Based on the current percent funded, projected cash flow requirements and expected reserve contributions from operations and interest, some adjustment in dues assessment to decrease the contribution rate is recommended at this time. This represents the early years of a 30-year funding plan and this plan is to be reviewed annually and completely assessed every five years. With inflation in expenditures and constant income through no increase in dues assessment, the contributions from operations will decrease over the long term. The reserve contribution was established by testing different contribution levels and interest rates and balancing the four funding principles in an attempt to maintain 120% threshold funding. There is far too much uncertainty in projections of income and expenditures for percent funded projections to be valid out 30 years, but it does show the effect of the assumptions used in this study.