

# Reserve Funds For Homeowners' Associations

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To function as intended, a homeowners' association (HOA) must rely on assessment revenue from its members. Most communities calculate [assessments](#), at least in part, based on an annual budget of anticipated expenses. These typically include the costs involved in performing all of the [HOA's maintenance duties](#), procuring necessary insurance, and covering overhead, along with any other fixed or reasonably foreseeable outlays. The resulting gross budget is then divided among the members of the association, and homeowners are assessed accordingly.



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When creating an annual budget in this manner, it's generally a good idea to be as precise, analytical, and transparent as practically possible. However, a budgeting approach that relies exclusively on predetermined, repeating, line-item expenses doesn't leave much room for error. After all, what if an essential common element is unforeseeably damaged—resulting in significant repair or replacement costs—and there's no money in the budget or insurance to cover the loss? Or it may be that the association has some legal issues arise and incurs attorney's fees much higher than could have been reasonably anticipated. And, of course, some common elements don't need maintenance every year, but, when maintenance time comes, it's costly.

Rather than get caught scrambling for cash when an unexpected contingency or

major maintenance need arises, many communities maintain “reserve accounts” or “reserve funds,” as a sort of back-up savings slated for emergencies, long-term upkeep costs, and irregular expenditures. Although reserve funds are often not mandatory, an ample reserve can play a big role in protecting a community’s long-term financial health.

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## What are Reserve Funds?

We’re all familiar with the differences between checking and savings accounts. Aside from cash itself, a checking account is as liquid as assets get. You use it to pay bills, buy groceries—the sort of everyday expenditures it takes to run a household. A savings account, on the other hand, serves as a rainy-day fund you can tap when something unexpected arises—like, say, your vehicle needs a new catalytic converter.



## Simple Trick To Eliminate Dust

How this grandma turned her dusty house into a fresh air paradise without lifting a finger

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Most homeowners’ associations have an operating account or similarly designated

checking account to cover the routine expenses. Office supplies and regular maintenance of common elements, for instance, are typically paid from the operating fund.

An HOA's reserve fund, in contrast, is an account dedicated to unanticipated and deferred expenditures, particularly large ones. The association allocates money toward its reserve account over time so that, when a costly repair or comparable outlay becomes necessary, cash reserves are available to handle the expense without sacrificing day-to-day functions.



## Simple Trick To Eliminate Dust

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By way of example, an HOA might pay out the costs of routine snow removal from its operating account. If the community expects to need plowing a few times each winter, the board will build the costs into the annual budget. But when all the plowing over the years leaves a significant portion of the

development's roads in need of repaving, the money is more likely to come from a reserve fund.

Reserve requirements are not addressed under every state's [HOA laws](#). And some states that do address them, leave a lot to the board's discretion. More commonly, reserve account standards are found in a community's declaration or bylaws. Statutes governing condominiums are usually more explicit in setting forth precisely what is required of an association with regard to reserves.

## The Purpose of Reserve Funds

An association's annual budget takes into account reasonably foreseeable expenses like landscaping, equipment upkeep, and payroll if the HOA has employees. But when an association-owned building needs a new roof, the community pool requires a major repair, or all the equipment in the fitness center starts breaking down, the unbudgeted costs will need to be paid from reserves.

5/1 ARM  
**3.03%**  
APR | \$300,000

15-YR FIXED  
**2.13%**  
APR | \$300,000

30-YR FIXED  
**2.27%**  
APR | \$300,000

A reserve fund can also be used to cover expenses that are not necessarily unforeseen, but arise infrequently enough that it wouldn't make sense to include them within annual budgets. If the community's tennis courts need to be resurfaced every ten years, the board might hold back in reserve around ten percent of the cost each year so that, when the time comes, the resurfacing costs can be paid outright. Of course, it's not always so easy to predict precisely how much money will be needed.

## Boards and Reserve Accounts

For the most part, deciding just how much cash a community needs to hold in reserve is the responsibility of an association's board. Under state HOA and condominium statutes, board




members owe a “fiduciary duty” to the association. *See, e.g., Fla. Stat. §§720.303(1), 718.111(1); 765 ILCS 605/18.4.* The obligations of a fiduciary are among the highest recognized by the law. In carrying out their responsibilities, a board and its members must act in good-faith, prudently and loyally, and always in furtherance of the association’s best interests. *Id.*

“Board members must avoid conflicts of interest when budgeting and allocating reserves.”

The duty of good-faith loyalty includes not wasting or misappropriating an association’s money, including reserves. HOA funds should only be used for their intended purposes and in the best interests of the community. Anything less potentially breaches the board’s fiduciary obligation. Condo associations in Florida, for instance, can only expend reserve funds for authorized reserve expenditures or if a specific outlay is approved in advance by majority vote of

the association. [Fla. Stat. §718.112\(2\)\(f\)](#)  
[\(3\)](#).



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In furtherance of their fiduciary duties, board members must avoid conflicts of interest when budgeting and allocating reserves. If a board member, family member, or related business could potentially bid on or otherwise benefit from an association contract, that board member should recuse him or herself from any discussion or voting related to that contract. *See*, [Tex. Prop. Code § 209.0052](#).

The duty of prudence means taking reasonable steps to avoid a scenario where a cash-strapped HOA is unprepared for a major expense it should have seen coming. This means budgeting realistically and ensuring the association has sufficient reserves. Deciding what is “sufficient,” though, can be difficult because, by definition, reserves pay for

expenses that are irregular and not reasonably foreseeable. Even a board making a good-faith effort to act prudently might not recognize all potential expenses a reserve fund needs to cover.

When setting reserve requirements, the key questions board members need to ask are (1) what unbudgeted expenses are likely to arise over an extended timeline; (2) how much are those expenses likely to cost; and (3) how much additional savings will that necessitate per year. Most board members are volunteers just trying to help keep their communities running on all cylinders, so it's probably unrealistic to expect them to know the answers without some professional assistance—especially in large communities with substantial common elements. Fortunately, though, there are accounting professionals who specialize in “reserve studies” designed to calculate the cash-reserve needs of HOAs and similarly situated organizations.

## Reserve Studies for Homeowners' Associations

Reserve funds present something of a

conundrum for HOA boards. If you maintain reserves for the express purpose of paying expenses that are unanticipated and infrequent, then how does the board decide how much it needs to hold in reserve? If the association holds back too much, it is essentially over-taxing its members. But if reserves are inadequate, then the HOA might find itself insufficiently liquid to meet its obligations without imposing a costly special assessment or taking out a loan—neither of which is likely to be popular with homeowners.



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Reserve studies are intended to help Goldilocks (i.e., the HOA board) find the porridge (i.e., the reserve amount) that's just right. A reserve study is an examination conducted by a consultant or accounting firm for the purpose of analyzing probable long-term expenses. The idea is to use the analysis to estimate

the community's reserve needs as scientifically as possible.

Along with reviewing the association's assets (including current reserves), budget, and anticipated revenue, the auditor will survey community equipment, buildings, and other common elements. Based on all available information, the auditor comes up with a long-term schedule of expected repairs, replacements, major maintenance, and any other relevant liabilities likely to affect the HOA's bottom line.

Once the study is concluded, the board uses the estimates to calculate the level of regular homeowner assessments needed to maintain the optimal reserve account balance. For instance, if the study estimates that a parking lot within the community will need new asphalt in ten years, and that the cost will be around \$20,000, the board might adjust the budget and assessments to hold back \$2,000 in additional reserves each year.

That additional \$2,000 is divided among all members' annual dues so that, when the time comes for new asphalt, the funds are already available in the reserve account.

Of course, a study will in all likelihood identify numerous potential expenditures

over the relevant period, and the reserve recommendation will be based on the aggregate anticipated long-term cash needs—not just any single item. But the principle is still the same.

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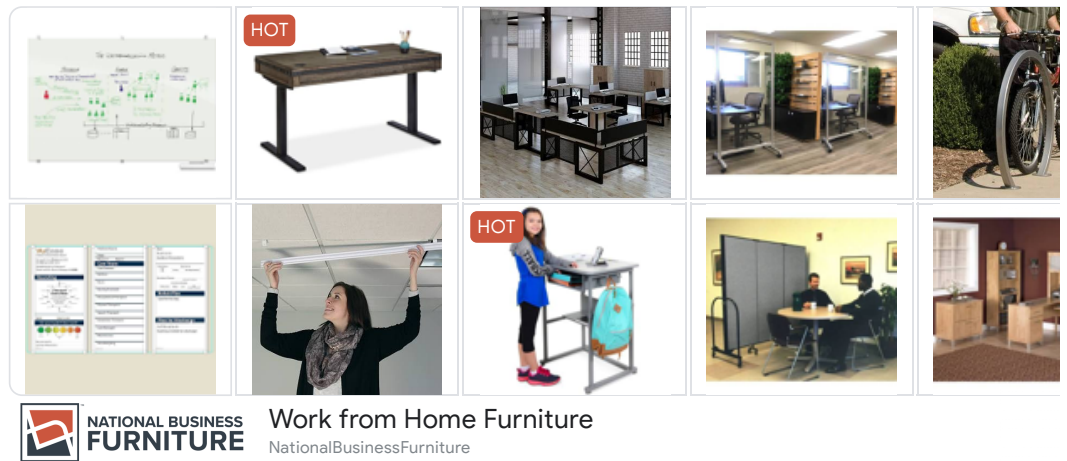
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Reserve studies cost money, so they don't make sense in every situation. In a small association with only minimal commons and simple maintenance duties, a reserve study would probably cost more than the value it could reasonably be expected to provide. At the same time, a large association with elaborate commons and extensive duties would be imprudent not to use a reserve study or other means of scientifically calculating reserve needs.

## Reserve Funding Requirements

The appropriate dollar balance for any given community's reserve fund depends in large part on the size of the association, the nature of the common elements, and the extent of the HOA's obligations. Some state HOA and condo laws establish specific reserve

requirements, but funding needs are more commonly set by the board in accordance with standards detailed in the association's governing documents. A reserve account is "fully funded" if it covers 100% of the community's reasonably foreseeable expenses. Many communities choose to set reserve requirements at a percentage of anticipated expenses, as estimated by the board or identified in a reserve study. So, for example, an association might require the board to hold in reserve at least 75% of anticipated expenses at any given time, adjusted based on the schedule for deferred maintenance.



“Deciding just how much cash a community needs to hold in reserve is the

# responsibility of an association's board."

A few states establish specific funding requirements for reserves stated as a percentage of the association's overall budget. *See, e.g.,* [Ohio Rev. Code §5311.081\(A\)\(1\)](#) (requiring annual reserve contributions of at least 10% of budget, but allowing waiver by majority vote). More common states adopt statutory principles for reserves but leave the specifics to the discretion of the board or community as a whole. Generally, condo laws go into much more detail when it comes to reserve requirements.

Florida's condo statute requires an association's annual budget to include reserves for "capital expenditures and deferred maintenance ... [including but not limited to] roof replacement, building painting, and pavement resurfacing," and any other deferred maintenance or replacement cost exceeding \$10,000. [Fla. Stat. §718.112\(f\)2a](#). For each included item, the calculation must be based on the "estimated remaining useful life and estimated replacement cost or deferred maintenance expense." *Id.*





Though Florida's condo statute requires reserves by default, it also allows a condo association to waive reserve requirements, or require a lesser amount, by majority vote. *Id.* Florida's HOA statute likewise makes reserves optional. If a community opts for reserves, the reserve account funding must be calculated based on each asset's estimated deferred maintenance or replacement cost divided by its predicted useful life remaining. [Fla. Stat. §720.303\(6\)\(g\)](#).

California requires associations to maintain reserve balances based on reserve studies conducted at least once every three years and including diligent, on-site inspections. [Civil Code §5550](#). The study must, at a minimum, identify all major components the HOA is obligated to maintain, the estimated costs and useful life associated with each, and the annual reserve contribution necessary to defray the costs. *Id.*

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Rate Type	Rate	APR	Amount
5/1 ARM	3.03%	APR	\$300,000
15-YR FIXED	2.13%	APR	\$300,000
30-YR FIXED	2.27%	APR	\$300,000

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Similarly, Washington requires calculation of reserve contributions in communities with “significant assets” (defined as assets valued at 50% or more of the association’s gross budget) based on regular reserve studies. [Wash. Code §64.34.020](#). At least every three years, the study must be conducted by an independent professional who visually inspects the relevant assets. Notably, though, the Washington statute merely “encourage[s]” HOAs “to establish a reserve account... to fund major maintenance, repair, and replacement of common elements.” [Wash. Code §64.34.380](#).

State legislation routinely recognizes the importance of reserve funds to homeowners’ associations but doesn’t make them mandatory. However, deferred maintenance, repair and replacement of major elements, and surprise expenses

will inevitably come up. When adequate reserves aren't available, a community will need to employ alternate means of paying for these significant costs.

## Alternatives to Reserve Funds

Boards often face a temptation to underfund reserves—or even dip into reserves to pay for what would normally be regular operating expenses—to cover increasing operating costs without raising assessments. Homeowners often object to additional assessments or reject them altogether. But paying a little extra up front to make sure sufficient cash-flow is available for adequate reserves can actually save money over time. And, the alternatives—special assessments, loans, and putting off repairs and replacements—are not particularly attractive options.

“The duty of prudence means taking reasonable steps to avoid a scenario where a cash-strapped HOA is unprepared for a

major expense it should have seen coming."

With a special assessment, the community is paying all-at-once what it could have paid over time. In effect, current owners are footing the bill for costs that were rightfully the responsibility of prior owners. And, of course, special assessments often require member approval. A rejected special assessment is just as helpful to a board facing a major expense as an unfunded reserve account.

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If an HOA can't cover unexpected expenses and long-term maintenance directly from member assessments, there's also the option of taking out a loan in the name of the HOA. Obtaining a loan probably won't be too difficult for

an association with regular revenue and relatively little debt, but it may require the use of community assets as collateral. And, just as significantly, loans require interest.

Even assuming the HOA can secure a loan with a competitive interest rate, the cost of repaying the loan still ultimately comes from assessments, but members end up paying a lot more than the actual expense cost due to interest and transaction costs. By contrast, an adequately funded reserve account itself earns interest, leading to the opposite result—members pay less out of pocket because money applied to reserves is earning interest up until the expenses become necessary.

And there's also the option of simply not paying for maintenance, repairs, and replacements that aren't included in the annual budget. In this scenario, homeowners lose access to benefits of the community. If the pool needs an overhaul, but there's no money to pay for it, members and their families no longer have a neighborhood pool to swim in. Not to mention, property values may decrease, as the allure of living in a community with a pool is reduced when the pool is inaccessible.

Kicking the can down the road by underfunding reserves almost always leads to losses in the end. With this in mind, Florida's HOA statute requires associations without reserves to notify members annually that no reserves are held and that special assessments may be enacted to pay for capital expenditures and deferred maintenance. [Fla. Stat. §720.303\(6\)\(c\)](#).

Inadequate funding can lead to safety concerns as well. Association-owned equipment or facilities that are not receiving scheduled maintenance due to insufficient reserve funding can increase the risk of injury and create unnecessary liability exposure.

Under the right circumstances, insurance coverage can help defray some of the costs caused by underfunded reserves. Many states mandate that HOAs carry insurance coverage. Arizona requires property damage coverage for at least 80% of the value of common elements and liability insurance with coverage limits decided by the board. [A.R.S. §33-1253A\(1\) – \(2\)](#). Eight states (Alaska, Colorado, Connecticut, Delaware, Minnesota, Nevada, Vermont, and West Virginia) have adopted the [Uniform Common Interest Ownership Act](#)

“UCIOA”), which has requirements similar to Arizona’s, along with mandatory fidelity insurance. *See, e.g., Conn. Gen. Stat. §47-255.*

Insurance, though, isn’t foolproof. A policy won’t cover every major expense that comes up. A property policy might cover losses due to accident but not if damage results from inadequate maintenance. A major expense like a new roof might be needed as a result of ordinary wear and tear that a regular property damage policy excludes from coverage.

And for insurance to help, you have to actually procure a policy. State condo association laws often require insurance, but it’s frequently optional for HOAs. Even in states that ostensibly require insurance like Arizona and the eight UCIOA states, there’s a limitation—a policy must be obtained “to the extent reasonably available.” *Id.*

HOA insurance is generally a good thing to have; it’s just not a foolproof substitute for reserves. Ideally, it’s more of a supplement, avoiding a scenario in which a catastrophe like a fire or major storm completely saps a community’s reserve funds or forces the association to write off common elements that were once

valuable community resources.

## Reserve Disclosure Requirements

Most state HOA laws require associations to make regular budgetary disclosures to members, usually including the status of reserve funding. Florida HOAs, for instance, must prepare yearly budgets estimating anticipated expenses and revenue and identifying any reserve accounts or funds set aside for deferred expenditures. [Fla. Stat. §702.303\(6\)](#).

The screenshot shows a webpage titled "lendingtree Today's Refinance Rates" with a "Calculate Payment" button. It displays three loan options:

Loan Type	Interest Rate	APR	Amount
5/1 ARM	3.03%	APR	\$300,000
15-YR FIXED	2.13%	APR	\$300,000
30-YR FIXED	2.27%	APR	\$300,000

In Washington, the statutorily mandated annual budget report must state amounts currently held in reserve, estimate year-end reserve balances, propose a plan for funding reserves, and project future reserve balances if the plan is adopted. [Wash. Code. §64.38.025](#). Colorado requires a similar disclosure of present



reserve balances, along with the board's proposal to ensure the community's reserve needs are adequately funded. Col. Rev. Stat. §38-33.3-209.5.

California requires a detailed reserve report based on the most recent reserve study, including the remaining useful life of each major component, estimated repair or replacement costs, and the amount of reserve money held by the HOA. [Civil Code §5565](#). California HOA members also have a right to notice of “the mechanism or mechanisms by which the board of directors will fund reserves ... including assessments, borrowing, use of other assets, deferral of selected replacements or repairs, or alternative mechanism.” [Civil Code §5300](#).

Particularly in condo associations, prospective purchasers often have a right to receive notice of current reserve balances. [Tex. Prop. Code § 82.157](#); [A.R.S. §33-1260](#). Absent an affirmative disclosure requirement, homeowners have a right to request inspection of association records. *See, e.g.,* [Fla. Code §720.303\(4\)](#). Records subject to an inspection typically include financial records and budgets.

# Homeowner Recourse

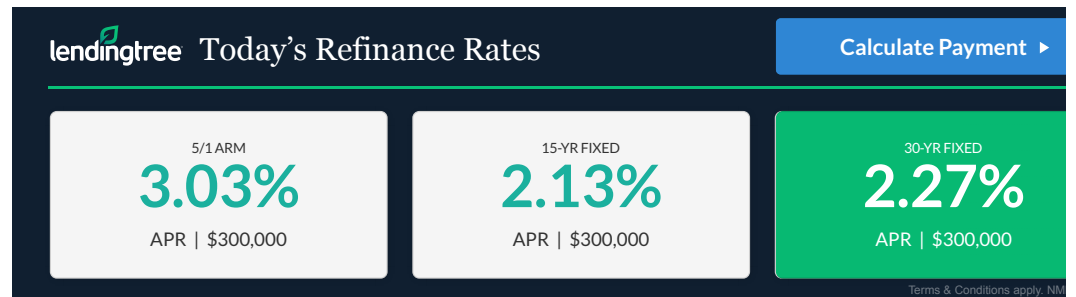
A homeowner who believes an association's board is mishandling or underfunding reserves has a few options. First, the homeowner can bring up reserve issues at the next homeowners' or open board meeting, or informally discuss concerns with a board member. A formal records request can also help provide detailed information about how reserves are being maintained and used and whether there is in fact a problem.

Because of the democratic character of community associations, there's also the option of running for the board in the next election or organizing a campaign to amend the association's declaration to include more stringent or specific reserve requirements. If misconduct or fiduciary lapses are involved, an individual homeowner or group of homeowners usually have standing to pursue legal claims against the board or its members, depending upon the specifics of the situation and whether actual damages have been incurred. It's almost always a good idea to consult with an experienced attorney before asserting or pursuing legal claims.

In situations involving outright fraud or

embezzlement, homeowners should bring the matter to the attention of local law enforcement agencies. Misappropriation of funds entrusted to an individual is criminal conduct in every state, though, of course, the precise standards vary by jurisdiction.

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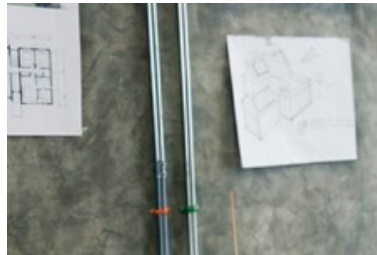


The banner features the LendingTree logo on the left, the text "Today's Refinance Rates" in the center, and a blue "Calculate Payment" button on the right. Below this, three white boxes display refinance rates: 5/1 ARM at 3.03% APR for \$300,000; 15-YR FIXED at 2.13% APR for \$300,000; and 30-YR FIXED at 2.27% APR for \$300,000. A green box highlights the 30-YR FIXED rate. Small text at the bottom right reads "Terms & Conditions apply. NM".

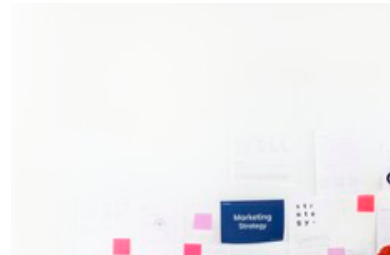
Term	Rate	APR	Amount
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15-YR FIXED	2.13%	APR	\$300,000
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