

# Reserve Fund Plans Make 'em SMOOOOTH

## **First ... About our Book**

The chapter you are about to read (next page) is identical to the material in our book "Reserve Fund Essentials". This 94-page book covers a wealth of need-to-know reserve-related wisdom. Its 17 chapters deliver insights, suggestions and processes designed to ensure that co-owned and co-managed properties create healthy reserve funds that can be managed to everyone's satisfaction.

Thirteen chapters can be accessed from our website [oliver-group.com/rfund](http://oliver-group.com/rfund). (Click on Book/Articles). The four chapters that cannot be accessed are "**Reserve Fund Fundamentals**" and "**Reserve Funds: What Does Adequate Really Mean?**" These are major, significant chapters and are included in our "Reserve Fund Essentials" book. To find out more about the book and how to order it, please click [MORE](#).

## **Now ... About the Authors**

You may wish to learn more about the authors of "Reserve Fund Essentials" (and the chapter you are about to read). To do this click [MORE](#).

## **Next ... Your Selected Chapter Begins**

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# Reserve Fund Plans Make 'em SMOOOOTH

## A Good Plan is a Smooth Plan

Making an effort to arrive at a smooth year-to-year expenditures schedule can really pay off. This article will reveal how bumpy repair and replacement programs can really play havoc with funding issues. It's not usually possible to get your expenditures as smooth as a billiard table, but you'll get some hints that will take you part way.

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## PART ONE — THE PRINCIPLES

Reserve Fund Plans, or Studies, depict two main series of numbers. One of them is the expenditures forecast, the year-by-year estimates of the expected costs of major repairs and replacements for the plan-period. The other is the funding schedule. That's the series of annual dollar amounts contributed by unit owners as part of their monthly fees.

Of course there are the all-important balances as well, but the balances are derived from the two series mentioned above. Establishing and maintaining adequate balances is critical and many of this book's chapters address that challenge. But right now we're just going to talk about the expenditures and funding numbers.

Let's start with expenditures.

Your total estimated expenditures are derived from the sum of all the specific expenditures. For example, you may have for a given year, estimates for driveway paving at a cost of \$25,000, central air conditioning replacement for \$15,000, and some balcony restoration amounting to \$55,000. So your total that year will be \$95,000. All the other years have their own repairs and replacements and will add up to annual totals, the same way.

It could happen though, (and it often does), that total annual expenditures will be “high” for a few consecutive years, and “low” for a few consecutive years. If the annual expenditures were graphed, you’d have a line with significant peaks and valleys, as opposed to a flatter line. It would mean that your repairs are “bunched up” in some periods and at a low level in other periods.

If this is the case, you may have cause to re-think the expenditures plan. Here’s why.

In the span of years where your expenditures are going to be high, you’ll have reserve fund balances that become low and stay low until that period is over. Maybe you can get through it okay, but ... if you run into unexpected costs — a not unusual experience — your fund may be in trouble.

The other side of the coin is equally perilous. If you enter a period where your estimated expenditures are low, you’ll run excessive balances for a while. Not good either, as you’ll see.

So either way, you have a potential problem.

One way to fix the balances that get too low or too high is by raising or lowering the owners' contributions. Right? Yes, but that introduces another set of problems.

For one thing, owners prefer steady (or reasonably steady) monthly fees. They don't like to pay a lot for a while, and then pay a little for a while. So if you "use" the level of fees to level out the fund's balances, you'll get a flood of complaints.

Okay then. Why not just set the contributions (fees) at a high level and leave them there?

Not a good solution. In periods where expenditures are low the fund's balances will become excessive, and the owners will wonder why all that money is in the property's hands and not in their pockets, where it should be. And they would have a point!

The answer? It's found in the annual expenditures totals. If you have to work with a volatile expenditures series you'll run into the kinds of difficulties we've described. So the answer is to do as much as you can to level out the yearly expenditures estimates.

An approach that can do wonders to level out an up-and-down expenditures plan is to look at the possibilities of "staging" your repairs and expenditures. Consider the chances of refurbishing 25% of the balconies every second year, over eight years, for example. For big jobs that must be done all at

once — roofing would be typical — you'd try to move other work out of the same timeframe.

Another idea: A greater level of detail in your components listings will enable you to schedule more “little jobs”, and avoid big expenditures. For example, if, instead of having a line called Hot Water System you might break it down among boiler repair, coil replacements and so on.

Our suggestion is to do two things. Well ... do one thing first, and if necessary do the next thing. The first thing. Determine if you do, in fact, have an excessively variable series of annual expenditures. Usually just scanning a graph of them will give you the answer. But if you want to be sure, you will want to find out how your expenditures measure up on a smoothness index. The second part of this chapter goes into some detail on how the Condition Index is calculated.

The second thing. If your scan (or your index) says ... yes, your expenditures are too volatile, you can try some of the strategies we suggested above, to smooth them out. Trying what-ifs on a range of expenditure smoothings can ensure you'll come up with a good one. You will also find some tips on doing what-ifs in our software chapter (see page 88), as well as more detail on the expenditures index.

Summarizing so far ... the benefits of putting time and effort into producing a plan with smooth expenditure and funding patterns is well worth it. A smooth plan really is a good plan!

PART TWO — THE INDEXES<sup>1</sup>

The Condition Index is easily explained. If you have a plan that shows expenditures totaling a certain dollar amount over a 30-year period — say \$3,000,000, or an average of \$100,000/year, you would expect to see a normal 3-year period's expenditures amount to 1/10 (10%) of the 30-year total. So Condition Index takes the total for the 30-year periods, calculates the “moving-total” for every 3-year period, and describes the percentages. It is these percentages that make up the Condition Index of a property.

One qualifier. Condition Index is actually these percentages subtracted from “100”. A percentage of 10, (in this case a normal percentage) would show a Condition Index of 90 (100 – 10). Because of this “inversion” (turning 10% into an index figure of 90%), expenditure periods that are “going high” will appear as trough on the index chart, and vice-versa.

We used expenditures in the example, above. The index calculation for funding (contributions) works exactly the same way.

Condition Index tells you whether you have a smooth, or relatively smooth, expenditures plan.

When you look at a Condition Index chart, if you see that most of the readings lie between 85% and 95% your expenditures plan is a very smooth one. We call it “optimal”. If you

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<sup>1</sup> The plural of index, preferred by many people, is indices. Others prefer indexes. We flipped a coin and chose indexes. After all, the correct plural of condominium is condominium, isn't it?

English usage aside, we wish to acknowledge that the concepts of the Condition Index and the Funding Index were created by Gerald R. Genge Building Consultants Inc. (GRG) and used with sincere appreciation by this book's authors.

see readings that are above 95%, or between 80% and 85% you are in the “advisory” region. This is where you might take a second look at your expenditure plan to see if some of the variations can be smoothed. If you are under the 80% line, you are in the “Review your Plan” region. If you have readings in this region you should definitely look for ways to reduce the variations in your expenditures plan.

The index calculations and acceptability-zones are exactly the same for funding-plan improvements. The **Funding Index chart** is designed to tell you whether you have a smooth — (or relatively smooth) — contributions plan. That is, a plan where the owners’ contributions do not change significantly from period to period.