Your Reserve Fund's Shock-Absorbers

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 olivergroup.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 our more about the book and how to order it, please click **MORE**.

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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.**

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Your Reserve Fund's Shock-Absorbers

Your Fund's Pain-Killers

Almost everyone knows that reserve funds are created to protect unit owners from"something". But from what, exactly? We think it boils down to three risks, essentially. And they are risks that are well-worth avoiding.

Most of the time we think of a reserve fund as a cache of money to be used, when required, to handle major repairs and replacements. Not a bad description really, but perhaps it would be more accurate to see it more as three caches of money that are in place for three eventualities.

Let's call them three "shock-absorbers".

The first one — and it's one that almost everyone would think of right away — is a shock-absorber to even out the "bumps in the road" when the big bills come in. A good reserve fund plan shows relatively smooth owners' contributions, even though the expenditures from the fund are bumpy — more volatile. Thus, by planning carefully, a few years of high costs would not result in high fees, because the high costs were anticipated. They were "saved for" earlier so they wouldn't be unduly burdensome when they occurred.

That's the shock-absorber effect at work in a well-managed fund. It's sensible, and it works.

But there are two more shock-absorbers that should be in your plan.

One of these addresses the problem of expenditures almost never being quite what they were expected to be. Even the most experienced and professional Reserve Fund Specialist would admit that histories of actual payouts versus the costs that were forecast will show that expected-to-actual variances were normal, throughout any period you chose to examine.

We all know why. Costs come in at levels that simply were not the levels you expected. More work was necessary to do a job than the planner predicted. Happens all the time. Or repairs planned for 2009 became necessary in 2006.

Doesn't mean the plan was "no good". It's a fact of life that forecasts are always wrong. Luckily, most of the time they're wrong by tolerable differences, (and sometimes they're not), but they're wrong just the same. Hence the need for Buffer Number Two — another shock-absorber.

What this means in practice is that you should not plan your reserve fund balances "too close to the line". In other words, if you could rely 100% on the fact that all the estimates of costs — their level, and their timing — were correct, you could literally run you balances in some years at close to zero. You'd "know" that going over estimate was not going to happen, so you'd "know" you'd be safe from going in the hole.

But in reality you cannot know this, so you have a shock-absorber to, essentially, take care of the forecast-to-actual variances that are sure to occur.

Now for your third and final shock-absorber. It's a bit like the last one, but, if anything, bigger. It's the shock absorber you need to handle occurrences that are totally unexpected. And there are two types of these. One of them can be called "natural" occurrences … of the unexpected kind. The other kind stem from legislative changes that are imposed by outside bodies.

Natural occurrences are, if anything more unexpected even than the unexpected variances discussed initially. At least with the variances, you did expect a repair cost, it's just that the amount of it and the timing of it was off. In this case, however, you are blind-sided by a driveway that caves in due to an underground stream you didn't know was there or the discovery that inferior metal was used in the stress rods for the garage floor and they have all rusted. Or that winds reached a velocity never before experienced in your area and badly damaged the roof.

Legislative effects — these can be really costly. Let's look at some possibilities.

- Fire Code retrofit requirements to bring building components to current flame spread and fire separation ratings.
- Elevating devices branch demanding that one elevator be equipped with special firefighter over-rides.
- Pending Environmental legislation requiring that only R-123 refrigerants be used.
- Playground equipment safety legislation.
- City bylaws requiring particular underground garage painting and signage standards.
- Building Code changes restricting the height and configuration requirements of balcony and stair guards.

We're going to insert an anecdote here, stemming from the fire regulations item, above.

A particular community has experienced a fire in a high-rise where the damage from smoke and heat was considerable. No one was hurt, but it was a wake-up call to explore ways of lessening the potential risk in any future events.

One of the recommendations was to require, for all similar buildings in the city, better hallway doors for each unit. The recommendation became law, and an expensive project was undertaken to replace all the doors in these buildings. The Boards, of course, complied with the new law, had the new, more costly doors installed and used their reserve funds to pay for them. These expenditures were unexpected, and properties that had marginal slack in their funds had to find ways to bring their reserves back up to scratch.

So far, our story could be described, as "thought-provoking". But it gets worse. The new doors, as it turned out, besides providing added protection, were also quite soundproof, rendering the hallway-situated fire bells ineffective. This meant installing alarms inside each unit, which greatly added to the cost of the project. An unexpected increase to an already unexpected requirement.

An added complexity is the question of the payment for the bells. Since they are inside the premises of each unit, would they be a reserve expenditure — they were after all necessitated by the doors — or should they be billed to the owners, individually?

The matter of defining what is, and what is not, a reserve expenditure is still another reason for building in some shock absorption!

Getting back to our thread, that's the lot! We've discussed a number of situations that all have one thing in common. Namely … they all make even the best-laid plans go askew. Nothing is certain, except of course uncertainty itself. Hence the need for protection.

Yes, we know, you can't just have a couple of hundred thousand dollars lying around just in case of a highly improbable

contingency. But these kind of events usually call for at least some emergency work and a few thousand dollars would be just the ticket to get it done fast, before a loan or special assessment or even an insurance payment were arranged for.

Our lessons for today. Don't rely, more than you should, on the exactness of your expenditure predictions. Don't plan for a reserve fund that runs its balances too close to the line. Don't dismiss the idea of having a little extra put away for the true emergency situation, should it ever arise.

There's a related question, of course. It's … given the principles above, how do we calculate the right amounts to keep our reserve funds consistently healthy? We've tackled that in the chapter called … "Reserve Fund Balances — What Does 'Adequate' Mean?" Take a look at it. We're sure you'll enjoy it as much as this one!