

COLORADO HOA INFORMATION & RESOURCE CENTER



COLORADO
Department of
Regulatory Agencies
Division of Real Estate

HOA FORUM: RESERVE FUNDS

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WHAT IS THE HOA INFORMATION & RESOURCE CENTER?

What the HOA Information & Resource Center does:

- Provides information to homeowners regarding their basic rights and responsibilities under the Colorado Common Interest Ownership Act (“CCIOA”).
- Gathers, analyzes, and reports information through complaints and HOA registrations.
- Creates resource materials.
- Provides education and forums.
- Provides a website with information for the public.
- Registers HOAs pursuant to §38-33.3-401(1), C.R.S.
- Provides an Annual Report to the Legislature.

What the HOA Information & Resource Center does not do:

- Is not a regulatory program.
- Does not mediate/arbitrate.
- Cannot provide legal advice.
- Does not act as an advocate.
- Cannot assess fines or penalties.
- Does not enforce an HOA’s failure to register.

DISCLAIMER

- The information in this presentation is for educational purposes only and is not meant to be construed as legal or financial advice. Any legal or financial questions should be directed to an attorney or a qualified financial professional in Colorado.

HB23-1105

- <https://engagedora.org/hoa-task-force>

TODAY'S TALKING POINTS

- Reserve Funds: Important Definitions and Concepts
- Statutory Requirements - What are they?
- Reserve Study Example
- Previous Legislative Efforts
- Industry Best Practices
- HOA Center Pro Tips

RESERVE FUNDS: IMPORTANT DEFINITIONS AND CONCEPTS



WHAT IS THE HOA RESERVE ACCOUNT?

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

WHAT IS A RESERVE STUDY?

- **Reserve Study** - An examination conducted by a reserve specialist, consultant or accounting firm for the purpose of analyzing any probable long-term expenses. The reserve analysis is then used to estimate the association's reserve needs as accurately as possible. It is an educated estimate as to how much an association should contribute to the reserve account in order to meet unplanned, large expense items in the future. It is not a guarantee of the future.

WHAT IS THE DIFFERENCE BETWEEN RESERVE FUNDS AND RESERVE EXPENSES?

- **Reserve funds** - funds an association sets aside to cover the anticipated costs for replacement or significant repair of the major common area elements (or “components”) the association is responsible for maintaining.
- **Reserve expenses** - expenses incurred by the association for such replacement or repairs.
 - ❖ Note, reserves should be separate from regular maintenance. For example, regularly cleaning the rain gutters/downspouts would not be a reserve expense, but replacing the rain gutters/downspouts at the end of its useful life would be.



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“COMMON ELEMENTS” (CCIOA §38-33.3-103)

- (5) *“Common elements” means:*
 - *(a) In a condominium or cooperative, all portions of the condominium or cooperative other than the units; and*
 - *(b) In a planned community, any real estate within a planned community owned or leased by the association, other than a unit.*

Note: Bolded, italicized text = actual statutory language

“LIMITED COMMON ELEMENT” (CCIOA §38-33.3-103)

- *(19) "Limited common element" means a portion of the common elements allocated by the declaration or by operation of section 38-33.3-202 (1)(b) or (1)(d) for the exclusive use of one or more units but fewer than all of the units.*
- *§ 38-33.3-202(1)(b): If any chute, flue, duct, wire, conduit, bearing wall, bearing column, or other fixture lies partially within and partially outside the designated boundaries of a unit, any portion thereof serving only that unit is a limited common element allocated solely to that unit, and any portion thereof serving more than one unit or any portion of the common elements is a part of the common elements.*
- *§ 38-33.3-202(1)(d): Any shutters, awnings, window boxes, doorsteps, stoops, porches, balconies, and patios and all exterior doors and windows or other fixtures designed to serve a single unit, but located outside the unit's boundaries, are limited common elements allocated exclusively to that unit.*

“COMMON EXPENSES” (CCIOA §38-33.3-103)

- (7) “Common expenses” means expenditures made or liabilities incurred by or on behalf of the association, together with any allocations to reserves.

SAMPLE HOMEOWNERS ASSOCIATION OPERATING AND RESERVE BUDGET Calendar Year 2020			
OPERATING BUDGET			
REVENUES			
Assessments (60 homeowners * \$2,400)	144,000.00		
Bank Interests	12.00		
Miscellaneous Revenues	2,000.00		
TOTAL REVENUES		146,012.00	
EXPENSES			
Bank Charges	200.00		
Common Area Maintenance and Supplies	24,000.00		
Electrical	5,000.00		
Federal Income Taxes	300.00		
Insurance	12,000.00		
Landscaping Services	10,000.00		
Legal Fees	6,000.00		
Management Fees	6,000.00		
Office Expenses	500.00		
Property Taxes	12,000.00		
Reserve Study	1,200.00		
Secretary of State Filing	100.00		
Special Events	5,000.00		
Street Cleaning	18,000.00		
Telephone	300.00		
Trash Removal Services	12,000.00		
Water	3,000.00		
Reserve Contribution		28,800.00	
TOTAL EXPENSES & RESERVE CONTRIBUTION		144,400.00	



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TYPES OF ASSOCIATION BUDGET ACCOUNTS

- **Operating** - Fixed annual expenses such as management fees, maintenance fees, utilities, etc.
- **Reserve** - Capital expense items such as asphalt, roofing, fencing, mechanical equipment that don't normally occur on an annual basis.

PHYSICAL AND FINANCIAL ANALYSIS

- **Physical** - physical status and replacement cost of common elements the association is responsible for maintaining.
- **Financial** - Evaluation of the association's balance, income, and expense statements.

STATUTORY REQUIREMENTS - WHAT ARE THEY?



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PUBLIC DISCLOSURE REQUIREMENTS CCIOA §38-33.3-209.4

- *(2) Within ninety days after assuming control from the declarant pursuant to section 38-33.3-303(5), and within ninety days after the end of each fiscal year thereafter, the association shall make the following information available to unit owners upon reasonable notice in accordance with subsection (3) of this section:*
- *(d) Its annual financial statements, including any amounts held in reserve for the fiscal year immediately preceding the current annual disclosure;*
- ❖ How? Website, literature table or binder at HOA principal place of business, mail, or personal delivery.

Note: Bolded, italicized text = actual statutory language

RESPONSIBLE GOVERNANCE POLICIES

CCIOA §38-33.3-209.5

- As part of the nine (9) required HOA governance policies in Colorado, associations must adopt policies and procedures relating to:
- *(VI) Investment of reserve funds, and;*
- *(IX) When the association has a reserve study prepared for the portions of the community maintained, repaired, replaced, and improved by the association; whether there is a funding plan for any work recommended by the reserve study and, if so, the projected sources of funding for the work; and whether the reserve study is based on a physical analysis and financial analysis. For the purposes of this subparagraph (IX), an internally conducted reserve study shall be sufficient.*

POWERS OF UNIT OWNERS' ASSOCIATION

CCIOA §38-33.3-302

- An association may:
- *(b) Adopt and amend budgets for revenues, expenditures, and reserves and collect assessments for common expenses from unit owners;*
- ❖ Levy special assessment to fund the reserve account, take out a loan on behalf of the association, or raise dues (subject to governing docs).

EXECUTIVE BOARD MEMBERS AND OFFICERS

CCIOA §38-33.3-303

- *(2.5) With regard to the investment of reserve funds of the association, the officers and members of the executive board shall be subject to the standards set forth in section 7-128-401, C.R.S.; except that, as used in that section:*
 - *(a) "Corporation" or "nonprofit corporation" means the association.*
 - *(b) "Director" means a member of the association's executive board.*
 - *(c) "Officer" means any person designated as an officer of the association and any person to whom the executive board delegates responsibilities under this article, including, without limitation, a managing agent, attorney, or accountant employed by the executive board.*

EXECUTIVE BOARD MEMBERS AND OFFICERS (CONT.)

CCIOA §38-33.3-303

- C.R.S. §7-128-401. Act:
 - *(a) In good faith;*
 - *(b) With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and*
 - *(c) In a manner the director or officer reasonably believes to be in the best interests of the nonprofit corporation.*

BYLAWS

CCIOA §38-33.3-306

- If an HOA with thirty (30) or more units delegates financial authority to other persons or to a “CAM” (community association manager), then CCIOA says:
- *(II) That the other persons or managing agent maintain all funds and accounts of the association separate from the funds and accounts of other associations managed by the other persons or managing agent and maintain all reserve accounts of each association so managed separate from operational accounts of the association;*

BYLAWS

CCIOA §38-33.3-306

- *(III) That an annual accounting for association funds and a financial statement be prepared and presented to the association by the managing agent, a public accountant, or a certified public accountant.*

INSURANCE

CCIOA §38-33.3-313

- *(9)(b) The cost of repair or replacement in excess of insurance proceeds and reserves is a common expense.*
- *(10) If any unit owner or employee of an association with thirty or more units controls or disburses funds of the common interest community, the association must obtain and maintain, to the extent reasonably available, fidelity insurance. Coverage shall not be less in aggregate than two months' current assessments plus reserves, as calculated from the current budget of the association*
- **Example:** Suppose you have an 18 unit condo building with monthly assessments of \$400/per unit owner. $18 \times 400 \times 2 = \$14,400$. If there is \$80,000 in reserves, then fidelity bond needs to be for more than \$94,400.

SURPLUS FUNDS

CCIOA §38-33.3-314

- *Unless otherwise provided in the declaration, any surplus funds of the association remaining after payment of or provision for common expenses and any prepayment of or provision for reserves shall be paid to the unit owners in proportion to their common expense liabilities or credited to them to reduce their future common expense assessments.*

ASSOCIATION RECORDS

CCIOA §38-33.3-317

- Associations must retain, and produce to unit owners on request:
- *(k) The association's most recent reserve study, if any;*

STATUTORY, IN LAYMAN'S TERMS

- “Does Colorado require a Reserve Study be conducted?”
 - No, but the HOA must have a reserve policy.
- “Is there a minimum amount that should be set aside for the reserve fund?”
 - Nothing set by the state, but industry best practices.
- “So do we need to, or should we, conduct a reserve study?”
 - Check your association governing documents as a reserve study may be required, or at the very least, a reserve fund established.



(*NOTE: THE BELOW TABLE AND ANALYSIS SHOULD **NOT** BE RELIED UPON AS AN ACTUAL RESERVE STUDY FOR ANY ASSOCIATION. IT IS INTENDED AS AN EXAMPLE ONLY*)

Significant Components				Significance:		
ID	Asset Name	UL	RUL	Ave Curr Cost	(Curr Cost/UL) As \$	As %
105	Comp Shingle Roof - Replace (PH 1)	22	8	\$379,500	\$17,250	15.3696%
105	Comp Shingle Roof - Replace (PH 2)	22	9	\$379,500	\$17,250	15.3696%
120	Raingutters/Downspouts - Replace (PH 1)	22	8	\$68,063	\$3,094	2.7565%
120	Raingutters/Downspouts - Replace (PH 2)	22	9	\$68,063	\$3,094	2.7565%
204	Building Ext Surfaces - Repaint (2018)	6	0	\$65,600	\$10,933	9.7415%
205	Building Ext Surfaces - Repaint (2019)	6	1	\$65,600	\$10,933	9.7415%
206	Building Ext Surfaces - Repaint (2020)	6	2	\$65,600	\$10,933	9.7415%
403	Concrete - Repair/Replace	3	0	\$34,175	\$11,392	10.1498%
601	Concrete Sidewalks/Drain Pans - Repair	3	0	\$17,100	\$5,700	5.0786%
801	Monument - Rebuild	18	3	\$8,875	\$493	0.4393%
803	Mailboxes - Replace	18	3	\$11,100	\$617	0.5494%
1008	PVC Vinyl Fencing - Replace	20	6	\$221,150	\$11,058	9.8521%
1602	Exterior Wall mount - Replace	17	3	\$58,950	\$3,468	3.0896%
1701	Irrigation System - Major Repairs	10	1	\$41,250	\$4,125	3.6753%

UL = useful life

RUL - remaining useful life

PROJECTIONS (FROM PREVIOUS SLIDE)

- Projected starting balance as of January 1, 2024 - \$405,000
- Ideal Reserve balance as of January 1, 2024 - \$965,000
- Percent Funded as of January 1, 2024 - 42%
- Recommended Reserve Allocation (per month) - \$15,400
- Minimum Reserve Allocation (per month) - \$14,500
- Recommended Special Assessment - \$75/unit owner

SAMPLE RESERVE STUDY ANALYSIS

- 0% - 25% Funded - Red or “weak financial position”. High probability of association levying a special assessment. Action needed!
- 26-65% Funded - Orange or “moderate financial position”. Less a chance of special assessments. Continue to fund reserve account.
- 66-98% Funded - Green or “strong financial position”. A good goal for associations to strive for.
- 99-100% Funded - Blue or “ideal financial position”. The association has zero concern of being able to afford any and all unexpected expenses in the future, regardless of any economic or financial uncertainties/conditions.

WHAT ABOUT INVESTING THE RESERVE FUNDS?

- There must be a policy.
- Manage the funds as a prudent investor would using sound business judgment (fiduciary duty).
- FDIC-insured bank accounts.
- Consider best interest rates.

PREVIOUS LEGISLATIVE EFFORTS



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COMMON INTEREST COMMUNITIES (CIC) RESERVE FUNDS

HB22-1387

STATUS: DID NOT BECOME LAW

- Would have:
 - Required a minimum level of reserve study and necessary components (common elements) of the reserve study at each level;
 - Required a declarant (developer) to obtain reserve studies commencing with the development of the community and to provide reserve studies to potential purchasers of units in the CIC in the seller's disclosures; and
 - Required the declarant to provide a reserve study at the time the declarant turns the CIC property over to the association, along with recommendations for funding.

COMMON INTEREST COMMUNITIES (CIC) RESERVE FUNDS (CONT.)

HB22-1387

STATUS: DID NOT BECOME LAW

- Would have also:
 - Defined "emergent life circumstances" and authorizes an association's executive board to obtain additional funding from unit owners to address dangerous conditions if the reserve funds are not sufficient to address the conditions, and;
 - Limited the investment of reserve funds in financial instruments that are not insured by a federal agency.

INDUSTRY BEST PRACTICES



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-
- Reserve contribution should fall around 20-40% of the association's total budget in financially healthy communities.
 - Reserve studies should be reviewed on an annual basis.
 - A new reserve study should be conducted every 1-3 years.
 - An on-site review should occur every 5 years.

HOA CENTER PRO TIPS



FOR THE HOMEOWNER

- Attend your board and annual member meetings. Ask questions about the HOA reserve account, your community components, and estimated useful life remaining. How are these things being determined in your community?
- If you're aware of maintenance concerns, bring it to the attention of your board of directors. Don't assume someone else will do it. Speak up.
- If your board does not seem sure or hesitant to answer your question, they may simply not be as knowledgeable as you. Direct them to resources where they may learn more about their roles and responsibilities. Run for the board yourself!
- If you are knowledgeable about finance and HOA operations, volunteer your time and expertise to possibly serve on a committee.
- Most everything is increasing in cost. If your dues haven't been raised in a while, this might be a concern.

FOR THE BOARD MEMBER

- Under-funded reserve account? Raise the dues a reasonable amount to begin funding the reserve account.
- Explain the process to your homeowners, Colorado weather, Mother Nature, etc. Be as transparent as possible about the need for the additional funds. Most people will be understanding and willing to help.
- Things fall apart after a while and need replacing. Plan ahead.
- Make sure you're following your governing documents when making changes to the reserve account, such as increasing the deposit amount or making transfers.
- Pay for a reserve study by a company or accountant that specializes in HOA's. Talk to your lawyer.
- Board members could be held liable for their failure to act as a breach of fiduciary duty.

FOR THE CAM

- Make sure you are properly advising your client of the need/importance of adequately funding the reserve account.
- CAM's may be held liable for breach of contractual responsibility

QUESTIONS?

- Dora_dre_hoainquiries@state.co.us
 - <https://dre.colorado.gov/hoa-center>
 - <https://dre.colorado.gov/hoa-frequently-asked-questions>
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- Thanks for attending!