



POOLED RESERVES ENSURE THERE'S CASH WHEN NEEDED

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Q: Our board of directors has been talking about switching over to “pooled” reserves. Can you explain what this means? **L.A. (via e-mail)**

A: The concept of funding condominium reserves through the “pooling” method, sometimes also known as the “cash flow” method, came into vogue about seven years ago.

The Florida Condominium Act requires an association to include as part of the annual budget, a reserve schedule. Reserves must be set aside for roof replacement, pavement resurfacing, building painting, and any other item of association responsibility with a replacement cost or deferred maintenance expense of \$10,000.00 or more.

Traditionally, the reserve schedule accompanying the proposed budget has used the “straight line” method of calculating required reserves. For example, assume that the roof on a condominium building has a twenty year useful life, is ten years old, and will cost \$100,000.00 to replace. Further assume that the current amount of money in the roof reserve is \$50,000.00. The association will need to collect \$5,000.00 per year, over the next ten years, to accumulate another \$50,000.00 so as to “fully fund” the roof reserve. This is traditional, “straight line” funding of reserves.

Similar calculations are then made for all other required reserve items (building repainting, pavement resurfacing, and other items with a replacement cost or deferred maintenance expense in excess of \$10,000.00), and the annual contribution required to “fully fund” the reserve account is thus arrived at.

If no vote of the unit owners is taken, the board of directors is obligated to collect “fully funded” reserves as part of the monthly or quarterly assessment. The law does permit unit owners to vote to reduce the funding of required reserves, or waive funding of reserves altogether. The law was also amended in 2008 to require that any reserve reduction or waiver vote include bold-faced disclaimer language on the proxy and ballot.

It is important to understand that when reserves are funded on the straight line method, whether fully funded or partially funded, the law provides that reserve funds can only be used for their intended purposes. For example, money could not be taken out of the roof reserve account to pay for painting the building. However, the association can use reserve funds for non-scheduled purposes if approved in advance by a majority vote of the unit owners.

The vote required to waive or reduce reserve funding and the vote to use reserves for non-scheduled purposes (which are technically, two separate votes), each require approval of a majority of the voting interests present, in person or by proxy, and voting at a duly noticed meeting of the association. As with the reserve reduction/waiver vote, a vote to use reserves for non-scheduled purposes must also be accompanied by bold-faced disclaimer language on the meeting proxy and ballot.

The concept of “cash flow” or “pooled” reserve funding is a bit different. Under pooled reserves, it is still necessary for the reserve schedule which accompanies the annual budget to set forth required reserve items (roofs, painting, paving, and other items with the replacement cost/deferred maintenance expense of more than \$10,000.00). Further, the “cash flow” reserve schedule must still disclose estimated remaining useful life and replacement costs for each reserve component. The main difference in the cash flow presentation of reserves is that instead of each reserve line item having its own fund balance, there is a “pool” of money in the reserve fund, which is available for costs affiliated with any item in the reserve pool. For example, the painting and roof reserve monies are “pooled” into one fund, so a vote of unit owners is not required for expenditures from the fund, as would be the case in a straight-line reserve scenario where monies from one reserve account would be used for another reserve purpose.

It is important to note that even with pooled reserves, a vote of the unit owners is still required to use reserve funds for operating purposes, or for any expenditure involving items that are not part of the “pool”.

The pooling method of reserve funding attempts to predict when a particular item will require replacement or deferred maintenance, and reserves are scheduled and funded so as to insure that a necessary amount of funds are on hand when the work needs to be done. Theoretically, monthly or

quarterly reserve contributions can be lowered, while still avoiding special assessments.

Of course, what works in theory does not always work when placed in human hands. In addition to needing a crystal ball to predict exactly when a reserve expenditure will need to be made, reserve contributions may be substantially higher in certain years, such as when the fund is depleted for the replacement of a required item, and there is a short useful life for the next asset that needs to be replaced. Personally, I neither encourage or discourage association clients from switching from straight line funding of reserves to cash flow. There are pros and cons, and it ultimately boils down to a matter of choice. Clearly, straight line funding is the more conservative funding mechanism.

The law is not entirely clear as to how the switch from straight line funding to cash flow funding is supposed to occur. I believe it is the position of the Division of Florida Condominiums, Timeshares, and Mobile Homes that the board of directors has the authority to present pooled reserves, even when straight line reserve funding has typically been used in past years.

However, I also believe that it is the Division’s position (and I believe consistent with the law) that if funds that were previously deposited in straight line accounts are going to be put into the “pool”, then majority approval of the unit owners is required. Accordingly, as a practical matter, every association which switches from straight line funding of reserves to cash flow funding will need to take a vote, so that the existing money in the straight line accounts can be put into the “pool.”

Q: It is my understanding that a condominium association’s bylaws take precedence over the condominium statute, as long as the bylaws do not violate the law. It is also my understanding that the condominium statute does not address term limits for board of directors, and that therefore term limits are valid. Is that correct? **J.G. (via e-mail)**