

Heritage Glen 3<sup>rd</sup> Addition – Reserve Study  
04/04/2011

The HG3 HOA By-Laws specifies that the Board of Directors (BOD) is responsible for maintenance of the common areas and the sound financial management and operation of the Association.

One of the primary duties of the Board of Directors is the preparation and/or review of the annual budget. The annual budget process must, at a minimum, address two areas; Operating Funds and Reserve Funds. The net result is a determination of the annual assessment to be charged to members, which will consist of an operating assessment and a reserve assessment.

The operating budget is intended to provide for all annually recurring expenses of the Association, including routine maintenance of common areas. Such routine maintenance is the basis of the annual budget, and to a large degree, will dictate the timing and amount of future expenditures of the reserve fund. The normal budget process is to estimate the required expenditures for the Association's governance: business, member services, and maintenance activities, then determine the assessment required to provide for those costs.

Reserve funds are a part of the annual assessments paid by owners of an individual lot. These funds are intended to be set aside specifically for major repairs and replacements and not be used for any other purpose. These funds are accumulated by the Association, earn interest, and should be expended as approved by the BOD only for major repairs and replacements of the common area components.

A reserve study assists the Board of Directors by providing the information to determine the appropriate amount of money to assess owners. Specifically, the reserve study report provides a 15 to 30-year funding plan to assure an equitable assessment structure to provide for the non-annual major repairs and replacements of common area components. The report is a financial projection that is based upon an evaluation of the common area components.

The reserve study is also an important information tool as the Association strives to balance and optimize long-term property values and costs for the membership. For Association members, reserve planning helps assure property values by protecting against declining property values due to deferred maintenance and inability to keep up with the aging of components. A good reserve study also shows owners and potential buyers a more accurate and complete picture of the Association's financial strength and market value. The reserve study should disclose to buyers, lenders, and others the manner in which management of the Association (i.e., the BOD) is making provisions for non-annual maintenance requirements.

The reserve study consists of two parts; the physical analysis, and the financial analysis.

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The Physical Analysis provides information about the physical status and repair/replacement cost of the items that the Association is obligated to maintain. The Physical Analysis is comprised of the item inventory, an estimate of the useful and remaining life of the major items, and an estimate of the current replacement cost of these items.

The item inventory lists the items that are the responsibility of the Association to maintain and/or replace and whose estimated useful life is greater than one year and less than 30 years.

For HG3 these items are:

1. Roads (approximately 1.5 miles)
2. Entrance Fence and Monument
3. Storm Water Pond and Fence
4. Storm Drains
5. Mailboxes
6. Security Lights

“Useful life” is typically defined as the number of years the item is expected to serve its intended purpose if given regular and proper maintenance. If the association fails to provide proper maintenance, then it becomes difficult to anticipate the “useful life” of components. Consequently, in determining the remaining life of an item, a certain level of continued preventive maintenance is assumed. These maintenance assumptions are stated explicitly so that proper maintenance can be continued throughout the item’s remaining life. The remaining life of a component implicitly specifies the year in which it must be repaired or replaced.

The Physical Analysis lists and estimates the replacement costs and the timing for replacement of the major items whose repair or replacement is to be funded through association reserves. The study estimates when such repairs or replacements will be needed and what they will cost. A budget timeline is used to show the year of replacement for each component. This timeline can serve as a schedule for expected component replacements and can be updated or changed when the Physical Analysis is updated or as components last for shorter or longer periods than expected.

The findings of the physical evaluation, including identification of components, their condition, useful and remaining life, and replacement cost, are summarized in this report. The financial analysis consists of the evaluation of the current reserve funding status, and a 15 and 30-year projection of cash inflows and outflows.

Because the reserve study is a projection of future events, it necessarily is based upon a number of assumptions (i.e., annual inflation rate, useful life, etc.). The reserve study process is an exercise in refining those assumptions to those most likely to occur. Future events occurring near term are inherently more predictable than those occurring long term. For this reason periodic updates to the reserve study should be performed to update

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and refine the assumptions based on the passage of time and actual maintenance activities that have occurred.