

**MILHAVEN HOMEOWNERS ASSOCIATION
RESERVE STUDY FOR CAPITAL COMPONENTS**



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Prepared by the MHOA Board of Directors

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1.0 INTRODUCTION

The Milhaven neighborhood was developed in the early 1990's. The properties in Milhaven are subject to the terms and conditions of several **governing documents**: the Articles of Incorporation, the By-Laws and the Declaration of Restrictions. Included in these documents, is reference to the "**common areas**" which the Homeowners Association (the "HOA" or "MHOA") is responsible for maintaining.

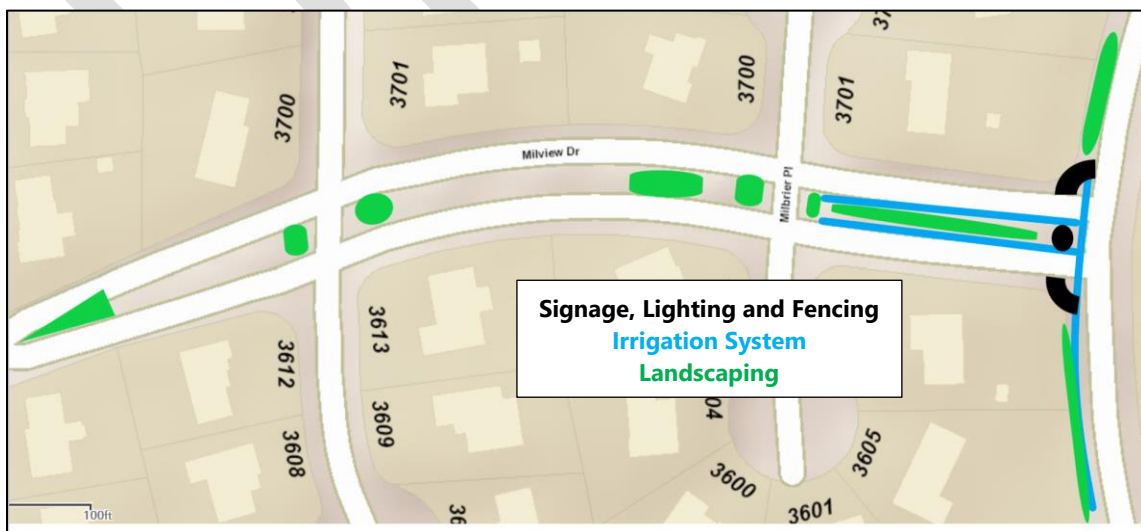
In Virginia, developments of this type have three general characteristics:

1. Property is subject to **governing documents** that organize the community, provide for the administration of the community and common area through an association, and establish the rights and obligations of the association, individual owners, and the association's governing board.
2. By virtue of ownership, membership in the association is mandatory and automatic.
3. Members are required to pay **assessments** to fund the association and maintain the property.

Milhaven is governed by the Milhaven Homeowner's Association and the owners of the lots in the community have shared responsibility with other owners in the maintaining the **common areas**. The association is obligated to maintain, repair, and replace, elements of the common area – these elements are called the **capital components**.

The number and nature of capital components vary from community to community. In Milhaven, the common area includes the area at the entrance to the neighborhood and the "median" of Milview Drive, **generally** as depicted in the following figure. Elements that are maintained by the Association include landscaping, the irrigation system, fencing, signage, and lighting at the entrance of the neighborhood.

Figure 1-1: Elements Maintained by the Milhaven HOA



In order to ensure capital components are properly maintained, repaired, and replaced in a timely manner, associations establish a **reserve fund** consisting of a budgeted portion of monies collected from assessments imposed on owners. Funds in reserve are set aside for the dedicated purpose of paying for costs to repair and replace capital components when the need arises. In this sense, a reserve fund is like a “piggy bank.” By establishing and funding a reserve, associations can lessen the potential of having to impose costly special assessments to pay for repairing or replacing capital components.

1.1 Virginia Law

Virginia law requires that the governing board of homeowner associations conduct a study, called a **reserve study**, to determine the necessity and amount of reserves required to repair, replace and restore the capital components. *Communities that have been operating without a reserve study are not in compliance with Virginia law and must schedule and implement a reserve study.* The statutes require the governing board of a homeowners association to conduct a reserve study at least once every five years and review the results of the study annually in conjunction with budget development.

Sections 55-79.83:1, 55-471.1, and 55-514.1 of the Code of Virginia state, in part:

Except to the extent otherwise provided in the governing documents, the governing board shall:

1. Conduct at least once every five years a study to determine the necessity and amount of reserves required to repair, replace, and restore the capital components, as defined in the Code of Virginia;
2. Review the results of that study at least annually to determine if reserves are sufficient; and
3. Make any adjustments the governing board deems necessary to maintain reserves, as appropriate.

Additional information can be found on the website of Virginia’s Department of Professional and Occupational Regulation.

Because a homeowner association’s governing board has a fiduciary duty to manage association funds and property, establishing a reserve fund and making provision in the association budget for reserves is important. The information provided by a reserve study aids association members in understanding the physical condition of the property, and the financial condition of the association, in order to allow for adequate planning. A reserve study can serve as an important tool for the association to balance and optimize long-term property values and costs for members, as reserve planning helps assure property values by protecting against decline in value due to deferred maintenance and inability to keep up with aging components.

By establishing a reserve fund and maintaining sufficient reserves, a governing board can reduce the need to impose special assessments on association members when it comes time to replace capital components, particularly if the replacement cost is high. Even if a community only has a limited number of components, setting aside funds in advance will help guard against “financial shock” when repair or replacement is needed. In addition, it creates a more equitable balance

between newer owners in a community, and older owners, as newer owners will not have to assume the burden of the cost to repair or replace older components in the community.

A reserve study is also beneficial to purchasers of property in the neighborhood. A reserve study can aid in the potential buyer's understanding of which components are to be maintained by the association and the condition of the capital components, and show a more accurate and complete picture of the association's financial position to handle the expense of maintaining the capital components.

1.2 Operating Reserve

In addition to establishing a reserve fund for capital components, associations should also consider establishing an operating reserve for budget overages. An operating reserve provides the association with funds in case of unexpected budget overages or unforeseen operating expenses.

Capital reserve funds should not be used to cover unanticipated operating expenses.

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2.0 MILHAVEN HOA

2.1 Approach

There are two components of a reserve study: (i) a **physical analysis** and (ii) a **financial analysis**. The physical analysis provides information about the physical condition or status of the capital components and the estimated repair or **replacement cost** of components the association is obligated to maintain. The physical analysis entails conducting an **inventory** of components, an assessment of component condition, and **life and valuation estimates**. The financial analysis assesses the association's reserve income and expenses, by examining the reserve **fund status**, measured in cash or **percent funded**, and recommending an appropriate contribution for the fund.

2.2 Milhaven HOA Assets

The capital components the Milhaven HOA operates and maintains consist of the following:

- Fencing, signage and lighting at the entrance to the neighborhood,
- Hedges along Causeway Drive,
- an irrigation system and related controls, and
- landscaping in the medians of Milview Drive.

Due to the nature of these assets – the assets enhance the aesthetic value of the entrance to the neighborhood - this study assumes that the Milhaven HOA assets do not necessarily need to be replaced at the calculated "end of useful life", but rather, the HOA needs to have funds available to make repairs or replacements at the time that repairs or replacements are needed.

The table on the following page provides an "inventory" of the assets the HOA maintains, the approximate date the asset was originally installed, or most recently replaced, the approximate useful life of each asset, current age, remaining useful life and estimated cost to replace.

Table 2-1: Calculation of Required Reserve

| Component | Estimated Useful Life | Approximate Year of Installation or Replacement | Remaining Useful Life (in 2020) | Approximate Replacement Cost | Notes |
|--|-----------------------|---|---------------------------------|------------------------------|--|
| Irrigation System | | | | | |
| Controls | 15 | 2000 | -5 | \$ 500 | Based on estimate made by Green Dreams Landscaping |
| Piping, Valves, Heads along Causeway | 20 | 2019 | 19 | \$1,500 | Actual Replacement Cost - 2019 |
| Piping, Valves, Heads along Causeway | 20 | 2000 | 0 | \$1,500 | Estimate based on 2019 Actual Replacement Cost |
| Piping, Valves, Heads across Milview Drive | 20 | 2000 | 0 | \$3,000 | Based on estimate made by Green Dreams Landscaping |
| Piping in the Median | 20 | 2000 | 0 | \$3,000 | Approximate - based on actual 2019 replacement costs |
| Lighting | | | | | |
| Lighting Fixtures and Wiring | 15 | 2015 | 10 | \$ 400 | 2015 Cost |
| Signage | | | | | |
| Entrance Signs (2) | 15 | 2015 | 10 | \$1,500 | Actual 2016 Cost |
| Fencing | | | | | |
| Fencing and Brick Columns at Entrance (2) | 35 | 1995 | 10 | \$8,000 | Estimate Only |
| Landscaping | | | | | |
| Hedges along Causeway | 15 | 1995 | -10 | \$5,000 | Green Dreams estimate - 2019 |
| Entrance (Median) | 15 | 1995 | -10 | \$1,000 | Estimated - based on actual 2019 costs |
| Entrance (Both Sides) | 15 | 2019 | | \$1,500 | Actual Cost - 2019 |
| Median Planting | 15 | 2000 | -5 | \$ 750 | Estimated - based on actual 2019 costs |
| Median Planting | 15 | 2000 | -5 | \$ 750 | Estimated - based on actual 2019 costs |
| Median Planting | 15 | 2000 | -5 | \$ 750 | Estimated - based on actual 2019 costs |
| Median Planting | 15 | 2000 | -5 | \$ 100 | Estimated - based on actual 2019 costs |
| Removal or Replacement of Major Trees | | | | | As needed |
| Subtotal | | | | \$ 29,250 | |
| Add 10% Contingency | | | | \$ 2,925 | |
| Total | | | | \$ 32,175 | |

2.3 Existing Capital Reserve

The Milhaven HOA has maintained a end-of-year reserve of approximately \$20,000 - \$25,000 over the past few fiscal years. On July 1, 2019 (the beginning of FY 2020), the reserve balance was \$24,781. It is anticipated that the reserve at the end of FY2020 will remain at approximately \$25,000. Therefore, *the reserve is approximately \$7,000 less than the estimated reserve requirement.*

2.4 Special Assessments

Section 17(b) of the Declaration of Restrictions allows for the levy of a special assessment for the purpose of defraying unexpected repair or replacement of a capital asset. The special assessment has to be approved by 2/3 of the Owners, a special meeting must be called in order to entertain the vote, and the assessment would need to be invoiced and collected.

Recognizing that the Milhaven HOA Board is a volunteer board, the process of calling a special meeting, providing the written notice required by the Declaration and achieving enough votes or votes by proxies to enact a special assessment if a repair is needed – is an undue burden for the Board. In addition, if the special assessment is approved, the Board would need to prepare and mail invoices and collect the assessment from the 83 Owners.

Therefore, it is more prudent and efficient to maintain adequate reserves to repair or replace capital assets as needed – as opposed to relying on special assessments.

2.5 Recommendations Regarding Reserves

It is recommended that the HOA implement the following policies:

2.5.1 Capital Reserve

- Each year, the annual budget shall include a line-item in the budget for repair/replacement of capital components that may be required that year. It is recommended that the line-item routinely be approximately 10% of the total annual operating budget. Based on the FY2020 budget, the line item for unexpected repair or replacement would be \$1,500.
- Any known capital repair or replacement projects in excess of \$1,500 scheduled for the fiscal year should be clearly identified in the budget and any transfer from the reserve should be noted.
- Any budgeted funds not expended for repair or replacement during the current fiscal year would be transferred to the capital reserve fund at the end of the year.
- Any revenue from "Disclosure Packages" should be directed to the capital reserve. Currently, the charge for the Disclosure Package is \$100 and one to three homes are sold each year.
- Each year, in establishing the annual budget, the capital reserve and the related estimates of repair and replacement costs should be evaluated and the targeted reserve should be adjusted, as needed.

2.5.2 Operating Reserve

- The HOA should also establish an operating contingency each year that is at least 10% of the annual operating budget – in any year that the operating contingency is not used, the balance should be transferred to an operating reserve.
- The current operating reserve is \$0. The targeted reserve should be \$1,500 - \$2,000.

2.6 Summary and Recommendation

The annual assessment (\$175 per home) has not been increased since 2014. It is recommended that the FY2021 assessment include an increase of \$25 to be used to fund the operating reserve and to increase the capital reserve. It is recommended that the revenue generated by the \$25 increase per home be allocated to the reserve funds as shown below. Over a 4-5 year period, the \$25 increase would generate adequate revenue to fully fund the reserve funds.

Table 2-2: Revenue Generated by \$25 Increase

| | # of Homes | Annual Revenue | Revenue over Five Years |
|----------|-------------------|-----------------------|--------------------------------|
| \$ 20.00 | 83 | \$ 1,660 | \$ 8,300 |
| \$ 5.00 | 83 | \$ 415 | \$ 2,075 |
| \$ 25.00 | | | \$ 10,375 |

Further, it is recommended that the Board consider increases in the assessments on a regular basis so that the income from the annual assessments can keep pace with the regular increases in costs to operate – the cost of landscaping, water, electricity and repair costs.