Percent Funding

What is Percent Funding?

Percent Funding is merely a performance indicator of the strength of your reserve fund. If your reserve fund is fully funded, it means that it has sufficient funds to cover all of the depreciation of your all your reserve components. To be fully funded at any point time means that you have the total of the accrued depreciation of all of the components. This does not mean that at any given point in time that you have 100% of the funds required to cover full replacement of all of the components.

To best explain this concept let's look at an example. Let's say that the cost to replace interior carpet is $10,000 and the plan is to replace it in 10 years. Each year the cost of depreciation is 1/10th of the replacement cost. Therefore, each year $1,000 of cost is accrued. In year 2 the Fully Funded Balance would be $2,000. In year 5, the total accrued depreciation is $5,000, and so on.

To determine the Percent Funded the FFB is compared with the Reserve Fund Balance. To continue the above example, let's say you have $2,000 in your Reserve Fund in year 2. The total accrued depreciation or FFB is $2,000. Therefore, you are 100% funded. You have 100% of the accrued depreciation or 100% of the Fully Funded Balance. If you have set aside only $1,000 are you 50% funded. You have saved 50% of the existing depreciation. Let use another example. Let say that the cost to replace the roof is $100,000 with a useful life of 20 years. Each year 1/20th of the cost of replacement is accrued. In year 5 the FFB is $25,000. If in year 5 you have $25,000 then you are 100% funded. If you only have $15,000 then you are 60% funded. As already mentioned, Percent Funded is used as a way to measure the strength of the Reserve Fund. The strength can be described as weak, fair, strong or over funded.

Guidelines for Percent Funding

Percent funding is a common performance indicator for reserve funding analysis. There is strong evidence to support that the risk of special assessments, loan requirements and/or deferred maintenance increases as the percent funding decreases.

Percent Funding	Classification	Risk of Special Assessment, Loan or Deferred Maintenance
0% to 30%	Weak	Moderate to High Risk
30% to 70%	Fair	Moderate Risk
70% to 100%	Strong	Low Risk

The above risk is subjective. There are many factors that need to be taken into consideration when determining the target percent funding. If any analyst tells you that you must be 100% funded, you need to ask why and to show the analysis … because 100% funded is not always the right approach for every community. Obviously, it would be ideal, but that will come at the expense of higher annual dues or other means of income.

Factors to Consider for Percent Funding

- Size of Community … larger communities can generally tolerate lower percent funding targets.
- Distribution of reserve fund expenses … are expenses evenly distribution over time? Or more inconsistent?
- Average reserve fund expense … are any expenses outliers? That is do you have one or two very high expenses compared with others?
- What alternative actions are available to you in the event of inadequate funds at the time of scheduled maintenance of a reserve component? Generally, this implies special assessments or loans. A careful analysis of alternatives may reveal that they may favorable.

- What is the consequence of unscheduled or unplanned reserve fund expenses at any point in time? For example, can you defer maintenance without severe consequences?
- What does the annually percent funding look like? Are you trending up? Trending down? Are there large peaks and valleys?
- While a reserve account balance (and percent funding) may remain in a low funded range for many years or even decades, the large expense years (Peak Expense Years), when infrequent but large component projects are expected, will typically bring to light the true financial health of the reserve account.

Summary

Use percent funding as a target when creating your funding plan. It is more important that you ensure that you have funds to meet expenses with a contingency (e.g., 5% of available funds) to meet unplanned or unscheduled expenses. Remember, percent funding is a good measure of the association's overall financial health, but the ultimate purpose of reserve study and not ultimate indicator of the association's ability to meet financial responsibilities. These are the key take-aways:

- Percent funding is good indicator of overall financial health
- Percent funding will fluctuate over time
- Percent funding is a moving target
- Make note of the current percent funding and the trend over time … then move on.