

**Reserve Asset Inventory Committee
Report and Recommendations
June 2019**

Background

Best practices and the High Desert governing documents require that reserve funds for the repair and replacement of capital assets be maintained and that the reserve analysis be updated periodically. High Desert Investment Corp. established the initial Master Association reserve account balances in approximately 2001, and HDROA has made annual contributions to the reserve accounts since fiscal year 2005. The first reserve study update was conducted by Felix Reserve Group in 2009, and reserve study updates have occurred every other year since. Beginning in 2011 the reserve study updates have been conducted by Great Boards Community Association Services LLC. Association policy has been to use the amounts in the reserve study report to set required reserve asset balances and annual contributions.

Starting in 2016, the balances and annual contribution amounts for the Master Association set forth in the reserve study update reports began to show dramatic annual increases, and the Board of Directors became concerned that these contribution and balance requirements were becoming excessive.

A committee to study the reserve asset inventory and funding requirements for the Master Association was formed in the third quarter of 2018. This report presents the conclusions and recommendations of that committee.

Recommendations

The Reserve Asset Inventory Committee recommends that the HDROA Board of Directors adopt the following Reserve Account procedures for the Master Association:

1. Discontinue using the account balance and contribution data shown in the reserve study report to determine the required reserve account balance and annual contribution amounts.

Each reserve study update makes adjustments to the items in the asset inventory. Example: a significant number of high value irrigation system components were recently added to the list. Because these items were high value and nearing the end of their expected lifetimes, they had a disproportionately adverse impact on reserve balance and contribution requirement calculations. Inspection of the irrigation components showed that all are functioning well, and that their lifetimes will exceed the values in the reserve study. Other asset items are similarly situated. In addition, a review of the annual reserve expense amounts showed minimal correlation between the projected and actual expenses. The conclusion of the committee is that the reserve study expected lifetimes are not a good predictor of item failure and should therefore not be used as the basis for calculating the reserve account balance or annual contribution.

2. Repair and/or replace reserve asset items as needed rather than as calculated by the reserve study report.

As noted above, experience has shown that asset expected lifetimes are typically longer than those predicted by the reserve study. The conclusion of the committee is that a reserve asset should be replaced when failure occurs or is imminent. Assets for which a failure would cause significant consequential expenditures should be identified and replaced when the expected lifetime has been reached.

3. Remove assets valued at \$5,000 or less from the reserve inventory.

This recommendation is based on ABC Analysis principles, widely used by inventory management professionals. More information is available here: https://en.wikipedia.org/wiki/ABC_analysis. The current Master asset inventory contains 68 items and has an estimated replacement cost of \$1,133,249. Removing the 28 under \$5,000 items reduces the replacement cost to \$1,096,342. The Association has ample extraordinary expense funds available for repair and/or replacement of minor items.

4. Maintain the reserve account balance equal to the sum of the previous ten years of actual reserve expenditures, including an inflation and contingency adjustment of 3% and 10% respectively.

An analysis of the previous ten years of actual and forecast reserve expenses is presented in Attachment #1. This clearly shows little correlation between these two numbers. We now have 14 years of reserve expenditure history, and using that data to determine the required reserve account balance will ensure that the reserve funds available are more closely aligned with our needs. The inflation and contingency percentages can be reviewed periodically and adjusted as needed. A larger reserve account balance is not needed because in the event of a catastrophic loss, the Association would file an insurance claim for repair or replacement of the assets. Attachment #1 shows that the required Master reserve account balance would be \$680,118. As of 30 April 2019, our actual reserve balance was \$637,632.

5. Set the annual reserve contribution amount equal to the average of the previous ten years of actual reserve expenditures.

If the proposed method for setting the reserve account balance as described in Recommendation #4 above will yield a more useful balance amount, then it follows that basing the annual required contribution on that balance will provide similar results.

6. Continue to conduct bi-annual reserve study asset reviews and updates.

Continuing to have a reserve study update performed bi-annually will provide a reasonableness test and check to ensure that the proposed methodologies are maintaining sufficient funds for our reserve expenditures.

7. Perform a reserve asset inventory analysis for each gated village and adapt and apply the Master Association recommendations to each village as appropriate.

This recommendation is self-explanatory.

Committee Members:

Jettye Lawrence
Russ Rhoades
Joe Vargo

For the Committee

Thomas L. Murdock
HDROA Treasurer

