Fully Funded Balance Explained

Fully Funded Balance: The value of the deteriorated portion of all the reserve components.

$$FFB = \text{the sum of } \frac{\text{replacement cost} * \text{effective age}}{\text{useful life}} \text{ for all reserve components}$$

The percent fully funded relates to how much the building has deteriorated, or been used up, compared to the cost of making it new again. Another way of thinking of this is the percent fully funded illustrates how much you should have saved thus far to pay for the future replacement of a component, based on the replacement cost and how many years you have to save.

Example: You have a roof that will last 10 years and cost $100,000 to replace.

- To pay for the future replacement in 10 years, you should save $10,000 each year to have enough money to cover the replacement cost.
- When it is 2 years old, it is 20% used up, and the Fully Funded Balance for its future replacement is $20,000. If you have saved $10,000 for the future replacement in 2 years, you are 50% fully funded. If you have saved $20,000, you are 100% fully funded.
- When the roof is 8 years old it will be 80% deteriorated, and its Fully Funded Balance would be $80,000. If you have saved only $10,000 by Year 8 you are 13% fully funded. If you have saved $20,000, you are at 25%, and at $80,000 you are at 100% fully funded.

So why care about the percent fully funded?

In effect the percent fully funded is a measure of how well an association can withstand the risk of unexpected expenses. Such unexpected expenses include: emergency expenses not covered by insurance, expenses that are more expensive than predicted, and expenses that are required earlier than anticipated.

A higher percent funded means more money is in the bank, and that lowers the risk of special assessment when unexpected expenses occur. A poorly funded association would have less money available for unexpected expenses, and a higher risk of a special assessment to generate the needed funds.

We typically recommend that an association select a minimum reserve account balance (or Threshold) it wants to maintain, and select a contribution rate to maintain that minimum rather than try to build their account to 100% fully funded. We typically recommend that the association consider a threshold equal to the recommended annual reserve contribution because this is the average maintenance expense over the thirty years. However, each association must judge their unique risk tolerance.

What if an association is unhappy with the percent fully funded? How can it be quickly increased?

We recommend that all associations review their Declaration to make sure that the report did not consider items that are the homeowner's responsibility to maintain. If needed, a lawyer can advise whether component responsibility can be shifted from the Association to the homeowners. Another option is to levy a special assessment to increase the amount of cash in the reserve fund.

Fully Funded Balance Calculations

Here is a sample of how the Fully Funded Balance is calculated for a simple association with 6 building components. For ease of calculation, one reaches the end of its useful life each year, each has a useful life of 6 years, and each costs $100,000 to replace.

Fully Funded Balance Calculations SAMPLE ASSOCIATION

COMPONENT DESCRIPTION	USEFUL LIFE	EFFECT. AGE	REMAIN USEFUL LIFE	CURRENT REPLACE COST	FULLY FUNDED BALANCE
Plumbing	6	6	0	$ 100,000	$ 100,000
Parking lot	6	5	1	$ 100,000	$ 83,333
Roof	6	4	2	$ 100,000	$ 66,667
Paint	6	3	3	$ 100,000	$ 50,000
Decks	6	2	4	$ 100,000	$ 33,333
Siding	6	1	5	$ 100,000	$ 16,667
			TOTAL FULLY FUNDED BALANCE		$ 350,000
			ACTUAL RESERVE BALANCE =		$ 50,000
			PERCENT FULLY FUNDED =		14%

Every year, this association needs $100,000 as a reserve CONTRIBUTION RATE to fund its repairs to avoid special assessments. This is true regardless of how much money it has in reserves to start.

If the association starts with a reserve of $50,000 it is 14% funded. If it starts with a reserve balance of $300,000, it is 86% funded. Either way, the contribution rate should be $100,000, because that is the average repair expense each year. The only exception to this is the odd case of an overfunded association (more than 100%) where your contribution would be less for a few years because you would be living off your savings as you came back down to 100% funded.

With an unexpected $100,000 expense, the 14% funded association shown above runs out of money and needs a special assessment to cover the cost. The 86% funded association drops to 57% funded, but does not require a special assessment. The CONTRIBUTION RATE remains unchanged for both.

What the RCW 64.34 and 64.38 say about Fully Funded Balance

RCW 64.34.382(2)(j) and 34.38.070 (j) both say that a reserve study shall include: “Projected reserve account balance for thirty years and a funding plan to pay for projected costs from those reserves without reliance on future unplanned special assessments”

RCW 64.34.382(2)(e) 34.38.070 (e) both say that a reserve study shall include “The percentage of the fully funded balance that the reserve account is funded”.

"Fully funded balance" means the current value of the deteriorated portion, not the total replacement value, of all the reserve components. The fully funded balance for each reserve component is calculated by multiplying the current replacement cost of that reserve component by its effective age, then dividing the result by that reserve component's useful life. The sum total of all reserve components' fully funded balances is the association's fully funded balance. RCW 64.34.020 (22) & 64.38.101 (9).