

“Distinguishing Between Statutory and Non-statutory Reserves under the Florida Homeowners’ Association Act,” FCAP Managers Report

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Considering the fiduciary responsibilities officers and directors have to the homeowners’ association’s members, it is important to understand not only the importance of including reserve accounts in an association’s budget, but also to understand when reserve funding is mandatory under the Florida Homeowners’ Association Act. Unlike condominium associations, maintaining fully funded reserve accounts is not always mandatory for homeowners’ associations.

Reserve accounts allow the association to set aside funds for deferred or long-term maintenance of common areas or for capital expenditures, so as to eliminate the need for special assessments.

Although Homeowner Associations may collect periodic assessments from homeowners for the regular operation and maintenance of these common areas, such as routine pool cleaning, a large repair or replacement due to deterioration, such as pool remarketing or replacement of a clubhouse roof, will not typically be covered by these periodic assessments. Deterioration of common elements is unavoidable, and can be accounted for over years, rather than upon needing replacement. Akin to a safety net savings account or a rainy-day fund, reserves can also cover large and unexpected expenses, which will inevitably arise.

Without a reserve fund, the association may have no choice but to raise assessments or levy a special assessment on homeowners. Even if homeowners may initially be reluctant to pay more to fund reserves, they usually will be more displeased with a large, unexpected bill due to the association’s lack of planning. This also results in an uneven penalization of current homeowners, who are now responsible for deterioration that occurred over the years but was not paid for by prior owners. Additionally, delay in collecting on special assessments may delay repair, cause further deterioration, and result in a loss of property value.

Because of their significance in running a financially healthy community, the Homeowners Association Act was amended to provide for reserves. However, the statute does not *mandate* reserve accounts for all homeowners’ associations. Reserve accounts thus fall into two categories: statutory reserves, which are

mandatory and must follow the requirements of the statute, and non-statutory reserves, which are board-created and limited by the association's governing documents.

Statutory Reserves

The Homeowners Association Act was amended to provide for reserve accounts, but has only made reserves mandatory if they fall into the following two categories: reserves initially established by the developer or mandatory reserves affirmatively elected by members of the association. A reserve account established in one of these two ways means that the association must determine, maintain, and waive the reserves in accordance with the statutory requirements laid out in section 720.303(6) of the Homeowners Association Act.

If the developer initially established reserves, the developer has an obligation to fund the reserves while it maintains control of the homeowners' association. In the event that the developer fails to fund or properly waive the reserves, homeowners will have a cause of action against the Developer for recoupment of such funds. That type of action is beyond the scope of this article. The statute further requires that the budget reflect in what manner developer created reserves will be used. While the developer still controls the association, it will not be able to vote to use the reserves for other than intended purposes, unless approved by a majority of non-developer voting interests. Once the developer has turned control over to the association, the developer may still vote its interest to waive or reduce the funding of the reserves for the units it owns. It is therefore recommended that a community approaching turnover from developer control double check that the developer is properly funding its reserves or properly waived or reduced the funding.

In associations where reserve accounts are not initially provided for by the developer, the members may elect to establish statutory reserve accounts by a majority of the total voting interests of the association at a duly noticed meeting where the item is on the agenda. This can be done either by a vote at a duly called meeting or by written consent. Like developer-established reserve accounts, under this method, the vote must designate the components for which the reserves are to be used. In the years following the approval, the board must include the required reserve accounts in the budget and continue to do so every year after that.

Once established either by the developer or by the membership, statutory reserves must be funded, or must be waived. To waive or decrease funding for such reserves, a majority vote at a meeting with quorum present must be taken. Notably, this vote to waive or reduce the reserves applies to only one budget year. The association, if it so chooses, may terminate such a reserve account by approval of the majority of the voting interests of the association. The Homeowners' Association Act also explains the formulas for properly calculating the funding of these reserve accounts, and the accounting must be done as provided. For those who are familiar with condominium reserves, statutory homeowner association reserves generally must be treated in the same manner as condominium reserves.

Non-Statutory Reserves

As noted above, funding reserves for homeowners' associations is only mandatory under the statute if the developer has established reserve funding or if the owners

have voted to establish statutory reserves. However, an association may choose to maintain a “non-statutory reserves.” Essentially, these accounts are board-created and their funding is limited by the governing documents of the association. The most significant difference is that these accounts are not mandatory and do not have to be maintained or waived according to the Homeowners’ Association Act (as required in the Condominium Act).

Subject to document-based limitations on assessment increases, the board decides how much to include in the reserve account as part of its regular budgeting process. The association is obligated to prepare an annual budget reflecting annual operating expenses, including estimated revenues and expenses for the year. The association should endeavor to accurately calculate its estimated expenses and revenues as overstating anticipated expenses to put into a reserve account is not consistent with the statute’s budgeting requirements. As with calculating statutory reserves, it is recommended that the association consult a reserve professional.

Because the reserve accounts are not bound by the statutory requirements, the board may choose to waive, reduce, or even eliminate the reserves. Further, the board may also decide to use the reserves for other than intended purposes. Although this means that the board may have more leeway in how to spend the reserves or in deciding to underfund the reserves in times of hardship, it is important to remember that the board still owes a fiduciary duty to the association’s members. Underfunding reserves or waiving reserves altogether may lead the association to rely on special assessments, as described above. An association that decides not to provide for reserves but is responsible for repair and maintenance that may result in a special assessment is obligated to include specific statutory language addressing this conspicuously in its annual financial report.

Since the amending of the Homeowners’ Association Act, a distinction between statutory and non-statutory reserves has arisen. Because the board may not have to fund reserves at all, or may have to strictly follow statutory requirements *to* fund such reserves, it is important to understand how the reserve accounts were initially set up. If reserves are not mandatory, it is recommended that the association nevertheless set up reserve funds to ensure a continuing healthy financial future for the community.