

BAY WATCH III
CONDO ASSOCIATION
BOARD OF DIRECTORS

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BayWatch III Condominium Association

2014 Reserve Study

April, 2014

For Period Beginning: January 1, 2014

Ending: December 31, 2038

Date Prepared: April 7, 2014

EXECUTIVE SUMMARY

Association : Bay Watch III Condominium Association
Location: Ocean City, Maryland
of Units: 48
Report Period: January 1, 2014 through December 31, 2038

Results:

Starting Reserve Balance:	\$ 45,881
Fully Funded Reserve Requirement:	\$650,685
Current Funding Rate:	\$ 16,000
Total current 25 year funding:	\$445,881
Current Shortfall:	\$204,804
Percent currently funded:	68.9%
Recommended Funding Rate/year	\$ 26,000
Additional Funds (each 5 th year)	\$ 24,000
Recommended Special Assessment	\$ 0
Total Recommended Funding:	\$734,000

Assumptions:

- Annual Inflation Rate: 3%
- Term of the Reserve Study is 25 years
- Items not requiring replacement within the 25 year period are not included in the spending forecast
- The 772' bulkhead is not included in the spending forecast as it was replaced in 2006 and has a "lifetime" warranty and is therefore expected to last 40+ years
- Yearly Reserve Contribution to be increased to \$26,000 starting in 2015
- The current "1 in 4" building maintenance program is changed to "1 in 5" and on the 5th year an additional \$24,000 is added to the Reserve Contribution, making a total of \$50,000 each 5th year (\$26k + \$24K)
- Some minor items are included on the Reserve Study (mailboxes, chimney caps) but are not included in the Spending Forecast as they should be replaced under normal maintenance budgets
- This recommendation is intended allow for all reserve items to be completed without special assessments and will leave a balance in the reserve fund of \$201,277 for items required after 2038.

Introduction:

The primary responsibility of the Board of Directors is to maintain, protect, and enhance the assets of the association. As the physical assets age and deteriorate, it is important to accumulate financial assets to deal with replacement and repair. This Reserve Study is a budget planning document. The primary information that you will get from this document is a list of your major Reserve components, a finding of the current status of our Reserve Fund, a listing of the remaining life of each item and a recommended funding plan. This information is provided in Table 1 and 2. With this information and an assumed inflation rate, we are able to project the array of future major expenses facing the association.

Physical Assets Covered by the Reserves

Reserve expenses are the larger, infrequent expenses that require significant advance planning. Operating expenses, on the other hand, are those daily, weekly, or monthly expenses that occur and recur throughout the year. Small surprises are typically handled as maintenance contingencies, while larger ones may be covered by insurance or require special assessments.

By national standards, an expense item should meet four requirements to be considered a “Reserve Item”:

1. Common Area Maintenance Responsibility

2. Limited Life
3. Predictable Life Limit
4. Cost Must Be Significant

The items included in this Reserve Study do meet these requirements. Finally, it is inappropriate to include unpredictable expenses such as damage due to fire, flood, or earthquake since these typically cannot be considered “reasonably predictable” and are generally covered by Association insurance policies.

Funding Principles for Reserves

There are four Funding Principles that we try to balance in developing our Reserve Funding Plan:

1. Sufficient Cash to complete repair/replacement
2. Stable Contribution Rate
3. Evenly Distributed
4. Fiscally Responsible

For fairness, it is important to evenly distribute the contributions over the years so each owner pays their fair share of the deterioration in direct proportion to the amount of time that they are owners. Additionally, the stable contribution rate to fully fund the Reserves is intended to avoid Special Assessments, if at all possible.

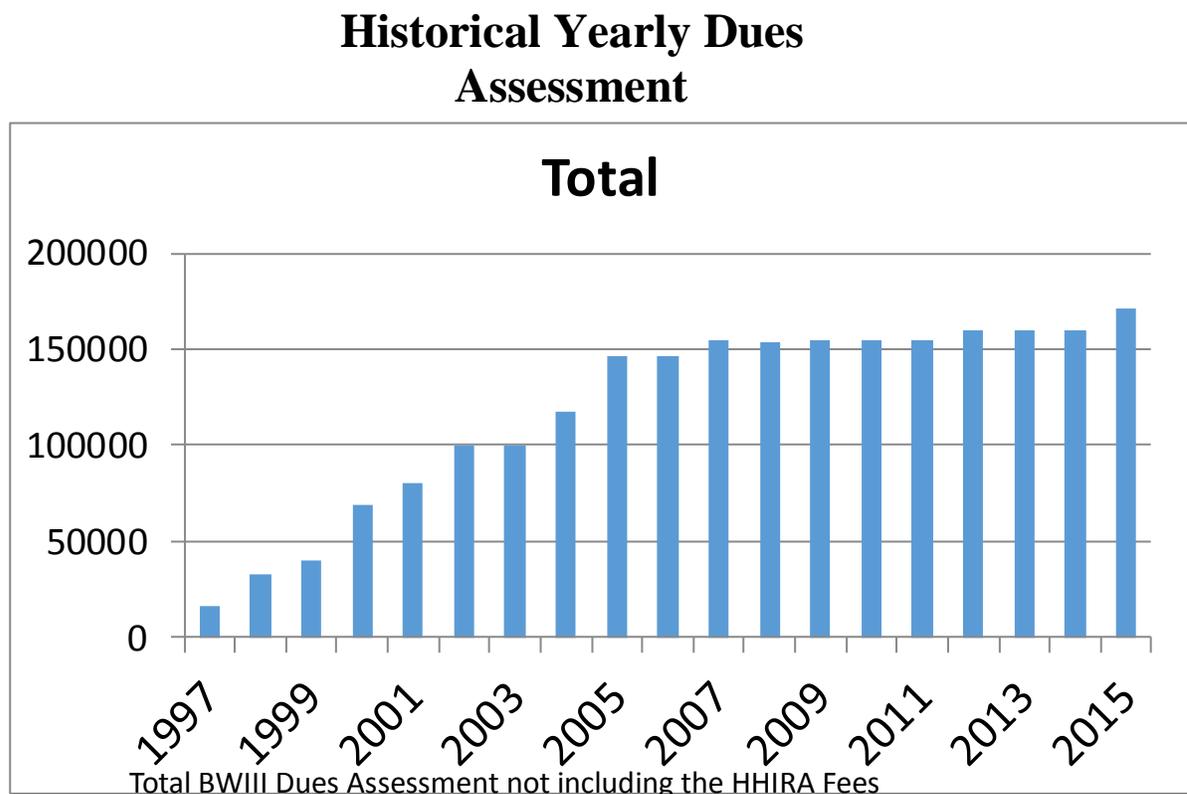
The goal of our Reserve financial position is to be “Fully Funded” so that the reserve cash is sufficient to cover the

projected expenses each calendar year. With the recommendations in the Reserve Study, this will be accomplished.

Members of Fully Funded Associations enjoy low exposure to the risk of special assessments or deferred maintenance. Board members will enjoy peace of mind that the Association's physical and financial assets are in balance.

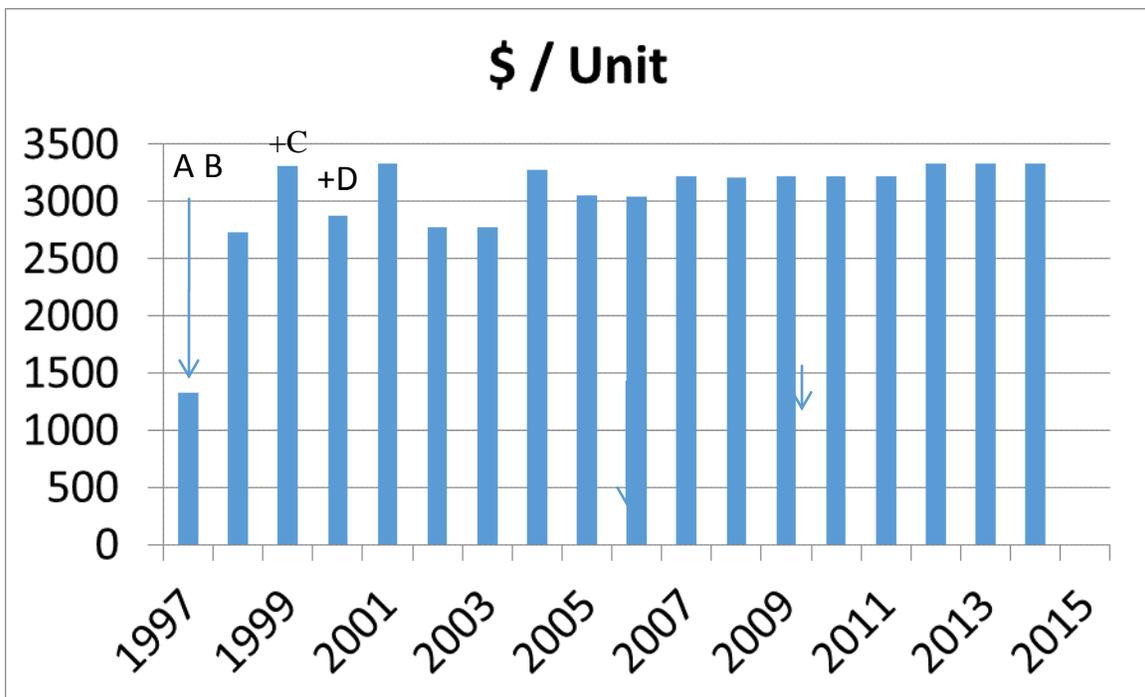
Historical Assessment Fees of BayWatch III

Below is the chart of the historical assessment fees for BayWatch III Condominium Association:



The total assessment grew as the buildings were added to the Association. Building A in 1996, Building B in 1997, Building C in 1999 and Building D in 2000. Since that time there have been only moderate increases (less than inflation) since 2005.

These numbers can be looked as on a per unit basis in the following chart:



Total BWIII Dues Assessment not including the HHIRA Fees

Current Reserve Fund Status

The starting point of our financial analysis is with a current Reserve Fund balance of \$45,881. The fully funded requirements of the Reserves is \$650,685 over the 25 year term of the Reserve Study. Under the current policy of adding \$16,000 per year to the Reserve balance, this would result in \$441,881 in total available reserves over the period. The projected fund requirement over the period for reserve replacement is \$650,685, thus leaving an unfunded balance of \$208,804. Without change, the Reserve Fund is currently funded at 68.9%.

Recommended Funding Plan

Based on the current percent funded and projected cash flow requirements, the Board of Directors is recommending a change in the yearly reserve contribution from the current levels. Two changes are recommended:

1. Increase the normal yearly reserve contribution from \$16,000 to \$26,000 annually
2. Additionally, change the “1 in 4” building maintenance program to “1 in 5” and in that 5th year, take an additional \$24,000 from the maintenance budget and increase the total funding to \$50,000 for that year.

These two recommendations will take the Reserve Cash position from 68.9% funded to over 100% funded.

Table Descriptions

Table 1 summarizes the funded Reserve Components, useful life, remaining life, current cost of replacement/repair, future cost with inflation and replacement year.

Table 2 summarizes financial forecast and the year by year replacement cost and elements to be replaced/repared along with the yearly addition to the Reserve Fund. It also tracks the Reserve Fund balance yearly.

Accuracy, Limitations, and Disclosures

Because we have no control over future events, we cannot claim that all the events we anticipate will occur as planned. We expect that inflationary trends will continue, and we expect the financial institutions will provide interest earnings on funds on-deposit. We believe that reasonable estimates for these figures are much more accurate than ignoring these economic realities. The things that can be controlled are starting Reserve Balance, yearly Reserve deposits, and repair and maintenance.

Because both the physical and financial status of the Association change each year, the Reserve Study is by nature a “one year” document. The Reserve Study should be reviewed each year and updated whenever necessary. We fully expect that a number of adjustments will be

necessary through the interim years to both the cost and timing of distant expense projections.