Reserve and sinking funds

Why buildings put money aside for future major works, how much to collect, where to hold it and how to explain it to residents.

Large items such as a new roof, lift or boiler come around rarely, and cost a great deal. A reserve fund, sometimes called a sinking fund, spreads that cost over many years, so it does not arrive as a large bill in one year.

Does your lease allow it?

Not every lease allows a reserve fund. Check the service charge provisions for words about setting money aside for future expenditure. If the lease is silent, collecting reserves may not be possible, and you should take advice before you try.

What it is for

Reserve money is for the major cyclical items on your maintenance plan: external redecoration, roof coverings, lift replacement, heating plant and communal floor coverings. It is not for routine costs or a general overspend.

How to decide how much

1. List each major item and its estimated cost, from your condition survey.
2. Note when each is likely to be due.
3. Work out the annual amount needed to meet each one by that date.
4. Add them up, and compare with what the lease and the leaseholders can bear.
5. Review every year as costs and dates change.

A fund that is far below what the plan needs means a demand for a large sum when the work comes. A small increase each year is usually kinder than a sudden jump.

Where the money is held

Service charge funds, including reserves, are held on trust for the leaseholders. They should be kept separate from other money, in a designated account in the name of the company or on trust. Make sure the bank account is set up correctly. Ask your advisers about the tax treatment of any interest.

Using the fund

- Use reserves only for the purposes the plan and the lease allow.
- Keep a record of what has been spent from the fund and why.

- Where work is above the consultation limits, follow the statutory consultation before you start.
- Tell residents when the fund is used.

Communicating it

Show the fund as a separate line in the budget and the accounts, with the opening balance, payments in, payments out and closing balance. Residents are far more willing to contribute to something they can see being used for a stated purpose.

When leaseholders sell

Buyers and their solicitors will ask about the reserve fund. A transparent, funded plan makes your building easier to sell and to mortgage.

> Review it each year. Do not leave the figure unchanged for a decade. Building costs rise, and plans change.

General information, not advice on your circumstances. Leasehold law is detailed and changes: check the current position and take advice before acting. Leasehold Clarity is provided by Leasehold Clarity Limited (company no. 16963931), with management and professional services from Murphy Thompson Moore LLP (LLP No. OC314041).