

New Mexico Reserve Fund Statutes — Board Briefing

Prepared for board member distribution

1. General New Mexico "Reserve Fund" Statutes

New Mexico does not have one unified "reserve fund" law. The term appears in several unrelated parts of the state code, most of which do not apply to HOAs:

- State budget: the "tax stabilization reserve" (NMSA 6-4-2.2) is the state's rainy-day fund.
- Public schools: the "state-support reserve fund" (NMSA 22-8-31) backstops school funding distributions.
- Public employee retirement: a "retirement reserve fund" is one of PERA's trust accounts (NMSA 10-11-123).
- Economic development bonds: a reserve fund secures certain state bonds (NMSA 6-25-13).
- HOAs/condos: NOT subject to any statewide minimum reserve funding requirement (see below).

2. Homeowner Association Act (NMSA 47-16-1 et seq.)

Key takeaway: New Mexico is a disclosure-based state, not a mandate state.

- No requirement to conduct a reserve study.
- No minimum reserve balance or contribution formula set by statute.
- "Common expenses" (which owners can be assessed for) expressly include allocations to reserves — NMSA 47-16-2(F).
- At resale, the association's disclosure certificate must state: (a) anticipated capital expenditures for the current and next two fiscal years, and (b) the amount of reserves for capital expenditures and any portions designated for approved projects — NMSA 47-16-2(M)(4)-(5), 47-16-12.
- The board must adopt an annual budget and distribute it to owners within 30 days of adoption — NMSA 47-16-7(E).
- Reserve funding levels are left entirely to the board's discretion, subject to general fiduciary duty ("ordinary and reasonable care," NMSA 47-16-7(A)).

3. Condominium Act (NMSA 47-7A to 47-7D)

- Grants associations express power to adopt and amend budgets for reserves and collect assessments to fund them — NMSA 47-7C-2.
- Like the HOA Act, sets no minimum funding level or required funding formula.

4. Commingling Reserve and Operating Funds

- No New Mexico statute expressly prohibits commingling reserve and operating funds at the association level — unlike states such as Florida, which regulate this by rule.
- If a licensed property manager holds association funds, NMAC 16.61.24.11(E) prohibits commingling of the broker's trust account with other funds — but this governs the broker's trust account generally, not reserve-vs-operating funds specifically.
- In the absence of a specific statute, segregating reserves remains best practice and is the safer course under the board's fiduciary/"prudent person" duty (often analyzed under the Nonprofit Corporation Act, NMSA 53-8, for associations organized as nonprofits).

5. IRS Tax Treatment of Reserve Funds

This is federal tax law, not New Mexico statute — included here because it directly affects reserve fund planning.

- Most HOAs elect to file IRS Form 1120-H under IRC Section 528. Under this election, member assessments used for management, maintenance, and capital repair/replacement of association property ("exempt function income") are excluded from taxable income — including amounts allocated to reserves — provided the association meets the 60% income test and 90% expenditure test each year.

- Only non-exempt income (e.g., interest/investment earnings, income from non-members) is taxed, at a flat 30% rate (32% for timeshare associations).
- If an association instead files the standard Form 1120, the analysis is more complex: merely labeling excess assessments a "reserve" does not shield them from tax (Rev. Rul. 70-604). However, special assessments collected for a specific capital project and held in a separate account are generally treated as non-taxable, since the association acts as an agent/fiduciary for the owners (Rev. Rul. 75-370).
- Interest earned on reserve fund balances is taxable regardless of which form is filed.
- Recommendation: association's tax filing approach (1120-H vs. 1120) should be confirmed annually with the association's CPA.

6. Fannie Mae / Freddie Mac Reserve Rules Taking Effect 2027

Important distinction: these are lender/investor guidelines from the government-sponsored enterprises (GSEs) that buy conventional mortgages — not New Mexico statutes. Nothing in state law requires compliance. But they function as a practical mandate, because non-compliant communities lose access to conventional financing for buyers.

- Effective January 4, 2027: minimum reserve allocation for condo/HOA projects reviewed under Fannie Mae's "Full Review" process rises from 10% to 15% of annual assessment income. Freddie Mac is aligning with the same threshold.
- Effective August 3, 2026: the reserve-study alternative to the 15% figure gets stricter. The "baseline" funding method (letting reserves run near zero) is no longer permitted. If a reserve study is used to justify funding below 15%, the association's budget must reflect the highest recommended funding level in that study, not merely an adequate one.
- The reserve study used for this purpose must be no more than 36 months (3 years) old to count toward loan eligibility.
- Consequence of non-compliance: the community can lose "warrantable" status, meaning buyers can no longer obtain Fannie Mae/Freddie Mac-backed loans in the community. This shrinks the buyer pool and can depress resale values association-wide — not just for one unit.
- Practical impact: associations currently funding at the old 10% floor will likely need to raise assessments, commission a current reserve study to justify a different number, or both.
- Intersection with New Mexico law: NMSA 47-16-2(M) and 47-16-12 already require disclosing reserve amounts and anticipated capital expenditures at resale — this data will face more lender scrutiny under the new rules. An underfunded or poorly segregated reserve account will also be harder to document favorably during a Full Review.

Bottom Line for the Board

- New Mexico law gives the board broad discretion over reserve funding — but broad discretion means broad responsibility. There is no statutory floor protecting the board if reserves are inadequate.
- Maintaining a segregated reserve account, even though not statutorily required, is the strongest practical protection against fiduciary-duty claims.
- Reserve fund disclosures at resale are a hard legal requirement — recordkeeping should stay current.
- Confirm the association's tax election (1120-H vs. 1120) supports the way reserves are currently being collected and held.
- Begin evaluating reserve funding now against the incoming Fannie Mae/Freddie Mac 15% threshold (effective January 4, 2027) — even though it's not state law, losing warrantable status has real consequences for owners' home values and financing options.

Note: This summary is for informational purposes and reflects statutes and IRS guidance as researched. It is not legal or tax advice; consult the association's attorney and CPA for decisions specific to this association.