

## COMMUNITY ASSOCIATION BUDGETING BASICS

Community association leaders can protect their community's financial health by using effective management practices and sound business principles. Developing a budget is a critical part of that process. Check the association's declaration and bylaws for budget due dates and other requirements. The following example schedule is based on a fiscal year that begins on Jan. 1, and it allows ample time for each step in the process. Some associations may skip some steps or allot more or less time for others.

### JUNE 15

RFPs for new contract bids are mailed to service providers.

**Schedule:** 30 days for contractors to send proposals and 60 days for the board, manager, or committee to evaluate, interview, and make final selections in time for the budget work session in 90 days.

### JULY 1

Member-preference survey is mailed or emailed to all owners.

**Schedule:** 15–21 days for members to complete and return the survey.

### AUGUST

Member survey results should be tabulated by and considered at the August board meeting. The board establishes its goals and budget priorities at this meeting. If the reserve study is completed at this time, the board should decide on funding levels that support the association's goals.

### SEPTEMBER

A budget work session is conducted either as part of the September regular board meeting or a separate work session, and a balanced draft budget is developed. The reserve study must be completed and integrated with the budget at this time.

**Schedule:** 30 days for the board, manager, or committee to prepare the draft.

### OCTOBER

Draft budget with annotations mailed to members for review.

**Schedule:** 14–30 days for members to review data.

### NOVEMBER

At the regular board meeting two months before the new fiscal year begins, allow additional time for members to comment on the proposed budget.

**Schedule:** 14 days for the board, manager, or committee to make adjustments based on member comments.

### MID-NOVEMBER

The final budget is approved by the board and sent to the association members.

**Schedule:** When the final budget is sent to association members depends on state statute and governing documents, but 30–45 days prior to year-end seems to be common. This gives members approximately six weeks' notice of the budget and assessment amount before the beginning of the new fiscal year. If assessments are going up significantly, owners will appreciate as much advance notice as possible.

### JAN. 1

New fiscal year begins. Budget goes into effect.

—Adapted from CAI's book *How to Draft a Budget*



## ADDING IT UP

### Take charge of your community's budget planning process in 10 easy steps.

By Karen Martinez

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YOUR ASSOCIATION'S BUDGET impacts the financial and physical health of the community and residents' property values. The budget is the first, crucial step to restoring aged, once-beautiful communities to their former glory, and it determines the enjoyment residents will derive from their community.

Too often, board members tend to copy and "tweak" last year's budget to fit the current year. With technological advances, new practices, and green rebates, opportunities abound for saving money and protecting residents' most valuable asset from gradual decline.

#### BACK TO BASICS

First, let's distinguish between the two budgets from which an association functions: the operating budget and the reserve budget. Without a clear plan for the issues an association needs to tackle and the accounts that will pay for them, these budgets can be misused.

Consult your association's documents to determine what each budget covers. In simple terms, the operating budget is like a checking account, and the reserve budget is your savings account. A board isn't necessarily restricted from paying for items from the regular operating budget if it determines these don't need to be paid out of reserves.

The operating budget pays for the services that help carry out the everyday functions in the community, such as landscaping, management costs, security, insurance and taxes, utility expenses, office expenses, and fees for accounting and legal.

The reserve budget is used for larger-scale projects that don't occur on an annual basis, such as roof replacement on common area buildings, replacement of failing mechanical systems, and repair of roads and sidewalks.

Some items will be listed in the operating budget and some in the reserve study. Which items go where? Generally, the answer depends on how much the item costs to replace and whether the expense occurs annually. High-ticket items usually get placed on the reserve component inventory so they can be financed over time. Small, relatively inexpensive items would be included in the operating budget.

If a component is covered in both the operating budget and the component inventory of the reserve

budget, place it in the most appropriate area and remove it from the other. Ask a professional adviser (reserve specialist, accountant, manager, or engineer) if it isn't clear which area is appropriate.

#### OPERATION SAVE

Association boards can take several steps to optimize their operating budget to save money and improve the community. Get started with these 10 steps.

**1. Set goals.** In reviewing the association's budget each year, it's critical that boards plan for long-term goals and challenges to avoid maintenance and financial issues that could cause unreasonable hardship for residents. As well as addressing prevention, long-term planning is an opportunity to substantially upgrade the community and increase property values, with the added benefit of increasing residents' quality of life.

The community should answer the following questions:

- What expenses must the association cover?
- What other expenses could it cover to improve the community or satisfy residents?

This list will become the line items in the association's budget. Expenses that must be covered—utilities, taxes, maintenance—are established line items that remain from year to year. Items to improve the community or satisfy the residents will differ annually, so arrange them in rank order for budgeting purposes.

**2. Determine assessments.** One of the purposes of drafting an annual budget is to determine what the annual assessment will be. How the assessment is allocated to each unit (ownership basis or equal division) and payment frequency (monthly, quarterly, annually) will be specified in the governing documents.

In some communities, the basic equation for determining association assessments is as simple as totaling your total operating expenses and the annual reserve contribution, then dividing by the percentage of ownership.

Instead of starting with your income first and then planning for expenses, an association must estimate costs first and then determine their revenue source,

most of which is made up of assessments. To start with income first may create a budget shortfall the next year and, ultimately, require levying a special assessment to cover costs.

Once you determine your annual assessment, examine the number. Is it the same or close to the same as what you charged last year? If so, that's a good sign for your budget. If not, it's time to make revisions to your assessments or budget.

**3. Look for trends in past budgets.** In addition to a current year's budget, boards should examine each line item cost in their association's budget within the past five years. Note any trends. This will help anticipate future costs that may impact the operating budget and reserves beyond the current year.

**4. Review collections procedures.** Closely examine your collections policies.

Reducing bad debt, such as delinquencies, can save your community money. However, collection expenses and legal fees to pursue bad debt create a line-item expense in the budget, and that expense is integrally tied to estimating bad debt—that is, the less spent on collections, the more delinquencies the association can expect. Watch for a tipping point where collection costs approach the amount to be recovered.

Ideally, your delinquency rate should not exceed 5%. If it does, be sure late fees are being charged consistently, and consider tightening your collections policies.

**5. Don't defer maintenance.** Attaining top market values and ensuring residents' quality of life requires that the community be well-maintained and aesthetically pleasing. Allocate a portion of the operating budget for regular housekeeping items, such as:

- Rotating exterior painting to keep the exterior fresh and vibrant
- Replace dilapidated or broken gates, fencing, and retainer walls
- Repair damaged stucco or wood throughout the exterior
- Replace faded, torn, or stained poolside cushions
- Consistently enforce resident violations that degrade common area and exterior aesthetics of the property

**6. Spend money to save money.** Many cost-saving measures require an investment in newer or improved systems or materials. Long-term planning becomes important, especially if the investment is to be spread over several budget cycles.

Always keep residents informed about the decisions behind cost cutting, and cut wisely.

Your community might consider conducting an energy audit to identify inefficiencies and implement energy-saving practices. Many communities, for example, have been converting common-area lighting from incandescent and fluorescent bulbs to LEDs.

A few other ideas include:

- **Water and landscaping.** Gradually change out



water-intensive vegetation in favor of water-wise landscapes. These will not only require less water but also require less maintenance, which can significantly reduce landscape maintenance costs.

- **Smart pool systems.** If your community has a pool and spa, consider converting to a smart system to operate systems automatically to reduce cost and manual management time and expense.
- **Solar.** Installing solar panels can reduce the cost of lighting and electrical features, as well as pool and spa operations.
- **Bundle services.** Internet, cable, and waste removal vendors often offer reduced pricing at community bulk rates.

**7. Invest in smart projects.** In your community's long-range plans and goal-setting, you should be thinking about any capital improvements that enhance residents' lives and boost property values.

Capital improvements are typically large, expensive projects, and sometimes members must approve them. Reserve funds cannot be used to pay for a capital improvement unless a reserve fund was established specifically for the project.

Many communities, for example, are installing electric vehicle charging stations. As electric vehicles become more popular, associations will need to accommodate the trend—whether due to owner demand or legislative requirements. Some states and companies offer rebate programs for charging stations. Do your research.

**8. Keep an eye on your funds.** Strive to maintain three months of budgeted operating expenses. This should include housekeeping tasks like painting,

repair, and landscape and lighting conversions. There is no need to allocate reserves for these when they can be addressed in the operating budget.

**9. Raise assessments or levy a special assessment.** Don't hesitate to raise monthly assessments to set your community on a permanent path to fiscal and physical integrity.

Failing to raise assessments to cover actual expenses is a breach of fiduciary duty on the board's part. It's also a breach of contract with owners who expect the board to protect their assets.

You might consider minimal annual assessment increases, about level with inflation. By increasing assessments 2–5% per year—rather than 10–15% in two to five years—the increases are spread out over the time of ownership.

Special assessments should always be a last-resort funding option, not a stopgap for budget shortfalls.

**10. Consult the experts.** Your community manager, accountant, reserves specialist, attorney, and other business partners can help boards develop and fine tune their budgets. They can help you set affordable goals for the property, bolstered by realistic, comprehensive fiscal and maintenance schedules.

Ultimately, however, the board needs to understand what they're doing, how, and why. The board has the responsibility for the association's finances. It has a fiduciary duty to review, monitor, and follow the budget.

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## BASIC BUDGETING GUIDELINES

By Chelsie Throckmorton, CMCA, AMS, PCAM, and Jill Allen, CMCA, AMS, LSM, PCAM

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A BUDGET IS THE SINGLE MOST IMPORTANT tool a community's board needs to manage and implement the association's objectives effectively while maintaining fiscal responsibility. The budget is balanced every year with projected expenses equal to projected revenue. And while understanding and getting through the budget process can seem daunting for managers as well as association boards, proper documentation and some basic guidelines can make it a breeze.

### COLLECT DATA

Start with a stroll through the association's declaration, which may specify a timeframe within which the board of directors must adopt the budget. Consider establishing a budget-planning calendar that indicates each deadline the board needs to meet to comply with your community's governing documents and ensure that the board meets its fiduciary obligations to adopt the budget each fiscal year.

The declaration also may stipulate how and when the board should notify the membership once the budget is approved.

It's imperative to obtain and reference historic data to understand how the association's money is spent. To develop next year's budget, use the current budget as a baseline. This also is the time to go over all the community's contracts to verify the upcoming year's expenses and evaluate them for potential increases, including a consumer price index (CPI) increase.

Also, contact utility companies to find out what rate increases are expected. A five-year budget trend summary shows historical trends for each line item in the budget for last five years.

And reference the most current reserve study or reserve study update, which occur in alternating years, so you can include annual contributions for repair-and-replacement reserves.

Reference all of these items as

you start to plug in and play with the numbers in your draft budget.

### INCLUDE NEEDS AND WANTS

The manager, board members, and committee chairs should compile wish lists of what projects they'd like to see completed in the next fiscal year. Determine the level of services that each committee requires or has planned, and request justification and estimates for increases in existing work and new proposals.

Be prepared to discuss projected expenditures for the next fiscal year and plan for upcoming or pending projects and/or repairs that must be completed in the next 12 months.

To ensure costs are recorded properly and changes in contracts are reflected, work with the association's budget or finance committee—if there is one—to review every income and expense account line by line.

Base estimates for as-needed contractual services on experience. Use a five-year trend analysis that favors the most recent years to compute the remaining expense accounts. Doing this will help you evaluate areas to reduce spending without jeopardizing the community's overall objectives.

Prioritize any new capital improvement projects the board has already approved and include new expense requests and wish-list items, if funds are available, in your budget.

### EXPECT THE UNEXPECTED

There's another unknown factor: Mother Nature. You cannot predict such events, so how do you plan for expenses like extreme snowfall or extra irrigation during a drought in your budget?

If your association doesn't have an extreme weather contingency fund, consider establishing one to cover overruns incurred due to Mother Nature's whims. If you don't use all the funds in the current fiscal year, simply roll the money over to the next year. Without such a fund, your association could face an assessment increase or worse—the dreaded special assessment.



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When inserting line item amounts, explain in detail how you determined each line item's draft amount. List the name of each contract vendor and the actual annual expenses associated with that vendor. Even if there are several vendors or justifications for expenses in a single line item, take the time to list and itemize each. This provides the board, committees, and manager with first-hand knowledge on what, why, and how much is coded to that specific general ledger line item. And avoid using "based on historical trends" to justify designated dollar amounts; instead, explain why and how you reached each conclusion.

#### **ADDITIONAL DETAILS**

Paying next year's invoices helps everyone who's working on the draft budget comprehend the community's actual expenses; it's also a great reference tool. And include detailed summaries for each line item to make next year's budget process easy as pie. All homeowners' full and timely assessment payments are essential to cover expenses throughout the year.

Many states require that associations set aside a portion of monthly assessments for reserve funds that are exclusively for maintaining, repairing, and replacing common areas and infrastructure, such as sidewalks, streets, buildings, landscaping, and recreation facilities.

Once the board has completed the budget, it still

must formally adopt it, which may entail a special meeting dedicated to going through the draft budget line by line for accuracy.

All this leads up to the million-dollar question: How much will my assessments be for the coming year? As you go through the budget cycle, your community may opt to increase assessments. Depending on circumstances, sometimes an association will, in fact, lower assessments.

Whatever your community decides regarding assessments, send a copy of the newly adopted budget—along with a cover letter that explains in detail what led to the new assessment amount—to each individual homeowner in hard copy via U.S. mail and email. Also post the new budget and assessment rates on the community's website, social media, and an article in the community newsletter, and make hard copies available in a convenient community location such as the management office or clubhouse.

Your association board's goal in the budget process is to remain financially sound while strengthening the community's overall value for current residents and potential buyers alike.

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