

# THE COMMUNITY BUILDER

## Budgeting... and the Bottom Line

We are closing in on "Budget Season". Who knew that budgets would have a "season"? But, as a board member, community manager or CPA, we all know it is exactly that. Time to get out the notes from the year with proposed or contemplated projects or expenses that have been discussed; time to pull together year to date figures and compare them with the budget and see where the numbers worked and where they haven't and why. The compilation of this information is important for many reasons. We have to be realistic about what the fixed costs are going to be and then what any anticipated costs might be.

Budgeting for a condominium or homeowners or community association actually involves, not one but two budgets. Each covering a specific range of expenditures. Recurring (and more or less predictable expenses like utilities, contracted services, taxes, etc.) expenses and then there are major projects and long term plans for a capital or reserve budget. The recurring expenses can be fairly easy to determine. Calls to utility providers, contract services and insurance agents asking if there are any proposed increases they foresee, will help in determining what might need increasing and how much to increase or what to leave the same. Maintenance will be a little more difficult to predict, because we're not clairvoyant... most of us anyway. However, based on the age of the buildings or structures, past performance and current condition, that too can be fairly adequately guesstimated. Unless the association has just completed major renovations or replaced major structural components, subject to age, wear, tear, weather and other factors, costs to maintain generally do not go down. So it is prudent to have some room for unexpected repairs. Repairs and general maintenance, unless they extend substantially the life of the component, should not be considered a Reserve expense.

When looking to budget for the capital budget, a current Reserve study is likely called for to give a starting point. There are a number of states that have requirements for reserve studies to help determine capital budgets. Virginia, for instance, calls for an updated reserve study every 5 years (by statute) and the reserve budget is required to be funded to the numbers in the study. Unlike Florida, where reserves can be reduced by a vote of a majority of the owners,



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Virginia condominiums do not have that option. In states where there are no statutes regarding reserves, it still pays to look at and assess the building or structures from a realistic standpoint. I've heard it said many times by owners, "I'm not going to be here when the roof is replaced, so why should I pay for it now". It's because they are using their share of the component now, and that use should constitute reason to contribute to its future replacement. I've never seen a roof that wouldn't need replacing at some point, or roads that don't require resurfacing or a pool that needs to be resurfaced... these things do wear out and as they are big ticket items, funds for that should be budgeted.

Consistently using special assessments to pay for long term, predictable replacements or major repairs will ultimately have a deleterious effect on the community and create receivables, adding expense for collection and resulting in longer periods for component replacement. If you're not using a Reserve study to determine replacement cost, at the very least proposals from contractors specializing in that component should be requested to see what real-dollar costs are for the major component replacement at this time. There is a pretty simple formula used that will provide at least an estimate of what funds may be needed for the reserve budget. It calls for determining the Estimated Useful Life (competent contractor can guesstimate); the Remaining Useful Life (based on the actual age of the component); the Cost to Replace (estimate from contractor); the Amount Funded to Date (if any funds exist currently) and the Amount to be Funded (the coming year's proposed contribution). The formula calls for the Amount Funded to Date to be subtracted from the Cost to Replace, then divide by the number of years of remaining useful life. This will provide the amount that should be part of your capital budget. This is the formula required by Fl. Statutes for both HOA's (with statutory reserves) and condominiums. It is called straight line depreciation. There are other methods for funding reserves, pooled reserves or cash flow as it is sometimes referred to. These methods are not nearly as clear cut as straight line and the ability for the funds to be there when needed are often affected by not being able to collect assessments at 100% and readjustments to the actual numbers are dependent on updating the reserve study fairly frequently.

Communities that are running at a deficit in the current year need to take a good hard look at the causes. Sometimes this issue does not affect the operational side



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for a while, because there may have been cash from prior year(s) that is now being used to make up for the lack of income. If the association is using pre-paid assessments (income not yet earned) to pay current bills, it is indicative that the current budget is not working and ultimately will add to the deficit. Not addressing this will also have a deteriorating effect on the association's ability to maintain, make repairs and continue sound operations.

A good first step to all of this is to closely review your current months financial to ensure that the expenses shown are actually in the appropriate chart of account. If there are questions, your manager can run a Purchase Journal for those COA's to see what has been coded there and then can make any adjustments needed. This way when your community manager pulls a Budget Worksheet from CommunityPro, it will automatically provide the current year-to-date amounts for each line item in your budget; the current year-to-date budget; the proposed 12 month expenses based on your current total and the current annual budget, all for comparison. Additionally, there is room for the proposed budget figure. With all of these figures at hand and pulled directly from your financial statement, it allows everyone to see how the figures for the 2016 budget year are determined. From this point, the numbers can then be transferred to your regular budget format along with the basis and assumptions providing explanations as to what each expense is, and explaining why there are any increases in particular line items.

So, we certainly have our work cut out for us for the immediate future. Starting now will allow plenty of time to solidify numbers, have any meetings that might be necessary and get the notifications out to the members. All in a good days work!