

## BUDGETING FOR SUCCESS: WEBINAR OUTLINE

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### What are the Hallmarks of a Successful Budget?

- 1) The association has the cash it needs to function. A boardmember's primary responsibility is to preserve, protect, maintain, and enhance the assets of the association. Not maintain status quo! Not to minimize homeowner assessments! Give the association the cash it needs to function.
- 2) Owners are paying the true cost of running the association. No fictional budgets based more on wishful thinking than facts, no "kicking the can" of expenses (Operating and Reserve!) onto the shoulders of owners in future years. Deal with it, even during your term on the board.
- 3) Management, Board, and Owners expect annual adjustments. We live in an inflationary economic environment. Teach your owners to expect annual changes (increases). Maintaining the same assessment structure for multiple years is shameful, not a point of pride!
- 4) Owners are aware of the issues at the association, and where their money is being spent. Be transparent. It's their money, they should know what the Board is doing to minimize expenses, what expenses are going up, and why the assessments need to increase.



### What are the Hallmarks of a Successful Budget Process?

- 1) Start early – six months in advance of the Fiscal Year End. It takes time. A lot of it. Start early.
- 2) Do your homework and research – make the calls and do the Internet research. Look at year-to-date budget figures and expenses for the last 12 months.
- 3) Prepare a draft budget - so board/management can begin to ponder and deal with priorities and adjustments.
- 4) Follow up, follow up, follow up - The budget is a living document and a guide, so it will never be "perfect", but publish it and get it in place!



## What are the big Mistakes to avoid?

- 1) Aiming towards the wrong goal (of keeping assessments low, limiting assessment changes, hitting a “target” number, or avoiding a necessary special assessment)
- 2) Forgetfulness. Learn the lessons of past years – what cash the association needed to function!
- 3) Lack of foresight. The association was there before you became an owner, it will be there afterwards. See yourself as a “link in the chain” with a multi-yr perspective. Carry the association successfully towards the future, and hand it off in good financial shape to the next board.
- 4) Unsuccessful delegation. Get help, but make sure those who are helping are capable, know their deadlines, and responsibilities.
- 5) No Reserve Study. How are you going to make wise decisions about Reserve funding or which projects should be accomplished using a Reserve Study prepared for a prior year?



## What Helpful Hints pave the way to a Successful Budget?

- 1) Focus on the goal (of providing the association with the cash it needs). That is your job as a boardmember... to preserve, protect, maintain, and enhance the (physical and financial) assets of the association.
- 2) Communicate to the owners, early and often. Communication builds owner confidence and trust in its leadership.
- 3) Start early. Everything takes time, and there are always delays. Budgets typically have distribution deadlines, so build in margin for someone being out of town or an answer taking longer than expected.
- 4) Have a multi-yr plan. Be aware of the past. See the changes in the community, the ownership, and the economic environment. If the necessary changes are too large, create a five-year plan (such as the “\$10 solution”, a multi-yr plan to start adequately funding your Reserves). Even during your short term as a boardmember, see yourself as a successful link in the chain.
- 5) Deal with the truth. Someone needs to be the “grownup” or “designated driver” for the association, seeing its financial needs, speaking the truth, with the courage to create a budget that gives the board the cash it needs to “preserve, protect, maintain, and enhance” the assets of the association.
- 6) Budget for the majority. Your job as a boardmember is to care for the needs of the association, not cater to the whims of the vocal minority.



**Boardmembers** – you are a corporate officer and you have a duty to run the association towards a successful future.

**Managers** – it is your professional duty to provide wise counsel to your association clients. Know what you are trying to accomplish (keep your eye on the goal), have a good process, avoid common mistakes, and take advantage of hints from those who have done it successfully many, many times before!

**For additional Resources see:**

[www.ReserveStudy.com](http://www.ReserveStudy.com)

[www.Adamen-Inc.com](http://www.Adamen-Inc.com)



**You can view the recorded webinar by clicking on this link:**

<https://www.youtube.com/watch?v=vUBATolzclc>

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## AUDIENCE QUESTIONS

**Q: Can tree replacement, xeroscape, and other greenscape or landscape projects be funded through Reserves?**

Yes. Projects passing the National Reserve Study Standards four-part test (Common Area maintenance responsibility, with a limited Useful Life, a predictable Remaining Useful Life, and above a minimum threshold cost of significance) should be funded through Reserves. Landscape-related projects often pass this four-part test.

**Q: My association's annual budget is around \$45K. We keep about \$20K balance to ensure that we have adequate funds to cover unexpected expenses and larger annual expenses. Is this too much, too little or about right? Is there a "typical" operating fund balance an association should have as a cushion for unexpected costs?**

Best practice for balance in your checking (Operating) bank account is commonly recommended to be three months of income. With a \$45k budget (\$3750/mo), that means \$11,250. So \$20k is above typical best practice.

**Q: If an item is budgeted, is it recommended to spend it just because it is budgeted, even if it not needed for that year?**

With respect to the operating budget, the answer is no, your association is not the federal government. Having money left over in one category allows you to budget better for the following year, and it gives you more institutional knowledge when forecasting; i.e., it wasn't needed in the past year makes it more likely in the next – or maybe not needed at all, or may be over-budgeted. Regardless, one line item being over-budgeted will likely cover that other line item which was under-budgeted.

**Q: What is the ideal percentage of Reserve Fund?**

Ideal is the 100% level, where the Reserve Fund is equal to the value of Reserve component deterioration at the association. In general, associations above 70% Funded enjoy the benefits of a strong Reserve Fund (absence of special assessments and deferred maintenance), while those Reserve cash-flow problems are common among associations under 30% Funded.

**Q: You state that most communities are underfunded. Is it possible that the standard of 70-130% funded is too high, and not realistic?**

No. It is responsible to pay your bills. Associations that are 100% Funded demonstrate that they have responsibly set aside funds to offset ongoing deterioration. In addition, the data clearly shows that special assessments (clear evidence that the association had been collecting inadequate Reserves) are rare among associations above 70% Funded, while they are frequent among associations under 30% Funded. Approximately 30% of associations are in the 70-130% Funded range, enjoying the ability to execute their Reserve projects in a timely manner and maximized property values. More associations should join them!

**Q: What is your opinion on moving monies within a budget from one line item to another during that budget year? Moving the budgeted money from one line item to another would not result in any change to the bottom line of the total budget. And if this is acceptable, does it not affect any variance analyses that would take place?**

Moving an item around once in the FY may be workable, provided it is clearly documented (to promote that corporate memory); however, moving many line items around during the year I wouldn't typically recommend: Even if the action(s) are on the up and up, the \*appearance\* is not. Also, once you start doing that, you have set a precedent in where subsequent Boards or Board members may feel free to blur all those lines for purposes which may be nefarious – not saying there could be theft (though, there could) but it may be a convenient “shell game” to hide the financial truth of the community from the membership.

**Q: Should a Statement of Appropriated Retained Earnings be used to secure funding for Reserve components?**

Not necessary. It is much simpler than that. Regular Reserve contributions are expected in community associations to prepare the association for large, irregular Reserve expenses.

**Q: I'm the brand new treasurer of our community. We're planning to repave our roads this fiscal year. Was it OK that we didn't add anything to reserves last year knowing this expense was coming?**

Best practice, as it is fairest and results in the lowest cost to the homeowners, is to make appropriately sized contributions on an ongoing basis that offset the ongoing rate (cost) of deterioration. Whenever you stop making Reserve contributions, you fall behind.

**Q: Accrual v. Cash basis thoughts given the volunteer board members?**

Typically in the HOA business we see a modified accrual system of accounting: Accrual Income, Cash Expenses. This seems to be a workable way that most people can understand. If not, Cash based is the simplest to understand for Board having a tough time.

**Q: How often should you do an YTD budget, if you are already doing a monthly budget?**

It's an ongoing process. YTD figures should be available monthly (or quarterly, depending on how often financial statements are produced) for the board to review.

**Q: How often should you have a reserve study updated?**

While state laws may have lower standards (update your Reserve Study every 3<sup>rd</sup> or 5<sup>th</sup> year), best practice is to update your Reserve Study on an annual basis. Reserve contributions are typically 15-40% of an association's total budget, worthy of annual review. In addition, statistics show that associations performing (inexpensive) annual Reserve Study updates have a 35% lower rate of special assessments than associations neglecting to update their Reserve Study information for three or five years at a time. Reserve contributions get out of balance surprisingly easily and quickly!

**Q: My association recently had a reserve study conducted. They had two alternative funding options. The straight-line which was only \$60 more than our current monthly transfer and a recommended that is \$400 less. The recommended amount increases at 3% a year. At the end of the 30 year projection, that's increase of almost 270%. I favor the straight line method because everyone pays their fair share of the costs, but how do I inconvenience the homeowners?**

You haven't provided enough information for me to evaluate the specifics of your association. I agree that everyone should pay their fair share of costs. That is one of the Funding Principles found in National Reserve Study Standards. Because inflation is real, you should expect your Reserve contributions to increase into the future. A 270% increase over 30 years is not surprising at all. See a webinar dedicated to Reserve Funding by clicking [here](#).

**Q: Typically what is the cost for an updated study?**

Reserve Studies prepared by a credentialed, independent professional regularly cost in the range of 1% or less of an association's total annual budget. Note that both types of update Reserve Studies (Update With-Site-Visit and Update No-Site-Visit) are significantly less expensive than a "Full" Reserve Study, which typically only needs to be done once.

**Q: Are Directors obligated to follow a reserve study?**

They are not directly obligated, but they incur liability exposure if they retain an independent and credentialed Reserve Study professional, and then ignore that counsel.

**Q: What's a good come back for board members that want to minimize maintenance payments on the grounds that the poorer owners won't be able to afford more and if we increase maintenance it will simply throw those folks into delinquency and we'll be in worse shape.**

Express compassion for their situation as their friend and neighbor, but remind them that your job as a board member is to run the affairs of the association, and an increase is necessary. Your legal responsibility as a board member is to the association: to preserve, protect, maintain, and enhance its assets. Your responsibility therefore is to budget for the true costs of the association, so that it is financially healthy during your tenure as a board member. If some people are giving you pressure expressing their personal financial concerns, it is their responsibility to either adjust their spending habits so they can continue to live in the association, or move to a more affordable home (selling to someone who can afford the true cost of living in your association). I know it sounds harsh, but the association is not a charitable organization. The Board has a fiduciary duty to manage the association, not cater to the few who can no longer afford to live there.

**Q: I understand that keeping assessments artificially low is not desirable. However, many households in our over-55 community operate on fixed household budgets. Even small increases in the assessment could be a hardship for some residents. I feel that it is also important to keep assessments from getting out of control. If there is not some attempt to manage the increase in assessments, they could quickly get high enough to drive some people out of our community.**

See above. I applaud your compassion. But board members need to control their feelings and act in light of their responsibilities. Board members are like the "designated drivers" for the association, making sober decisions to bring the association safely to the

future. You have no responsibility to keep current residents in your association or to pursue elusive “affordability”. Due to ever-changing circumstances, some homes become too expensive for people, and they need to move to a home that fits their budget.

**Q: What do you do if your community is over funded?**

Our recommendation is to continue to make Reserve contributions, but at a rate slightly below what is needed by the association. In this way owners remain in the habit of making contributions, and that rate can be increased slightly without much disruption to the budget after a few years when the association’s Reserve Fund has dropped down to the 100% level.

**Q: Our HOA will be coming into a large capital infusion from the sale of a communal asset. There will be great pressure to apply these funds to a large infrastructure project for which we already have a loan. Can you suggest a percentage split between reserves and this large project?**

Loans are expensive. Pay it off as soon as possible.

**Q: We are seeing issues in a Developer Turnover budget year, when build-out was stalled for several years as has happened in many communities. Now with more homeowners the community needs are increasing, this should be the time when reserves should grow too.**

Correct. Adequate Reserves need to be collected, no matter who is in control (the Developer or homeowner board members). In newer associations, the Reserve Fund typically grows rapidly in preparation for significant expenses that will inevitably occur.

**Q: Can you talk a little bit about what the best process is for budgeting and planning to expend reserve funds ... we approve the budget for operating expenses and how much to put into reserves each year but we don't do a good job of discussing and approving what reserve expenses we will incur in a given year.**

At the beginning of each year, look to see what Reserve projects are scheduled to occur (hopefully you have a current-year Reserve Study for this purpose!). There are different failure or “end of life” modes. See an article on “do on schedule” or “wait” by clicking [here](#). If the Board is uncomfortable with evaluating the projects scheduled to occur, or making these types of (BIG) decisions, you can appoint a committee of owners, preferably those with some construction, financial, or general business backgrounds, to review the issues and make recommendation. This committee could be allowed to talk

with the reserve preparer and other experts (and pay them – the experts, I mean) as needed to give real time input and recommend a plan for actual work to commence. I like this approach because it brings more stakeholders (owners) in to the process and allows them to take ownership, along with the Board, in the eventual outcome. However, Board, make sure you give the committee specific goals, deadlines and parameters, and ensure they report to the Board periodically while in process. The end result is still your responsibility!

**Q: What are key questions to ask a Reserve Study company when asking for bids?**

As with any potential business partner for the association, check their references and experience, view a sample product (make sure you find it clear and informative) and look for professional credentials: either the “RS” (Reserve Specialist) or “PRA” (Professional Reserve Analyst).

**Q: What is the best method to put together a budget?**

Take real income and expenses, add 3% for inflation and adjust for real cost increases and anticipated projects on the horizon. The key word here is: REAL

**Q: What is the most efficient way to budget for multiple maintenance projects? Our condo association provides exterior maintenance on all of our units.**

See above: it's the same

**Q: What's the best way to project or anticipate increases necessary due to inflation when preparing the annual budget?**

Check (Google) the Consumer Price Index (CPI) for your region.

**Q: Where can I go to learn more about Reserve Studies (online training)?**

*We have a deep resource of materials in our online [Library](#) or in our [list of recorded webinars and webinar outlines](#).*

**Q: How do I go about getting a Reserve Study proposal?**

*Easy! Click [here](#) and enter some brief information about your association and were you'd like us to send/email the proposal.*

**Q: Did you say \$10/mo/owner should be a good Reserve Funding plan?**

No. For many underfunded associations we've proposed what we call the "\$10 solution". It likely took many years for your association to develop the habit and problems associated with Reserve underfunding. So we propose building the size of your Reserve contributions with a \$10 assessment increase this year (all of it going towards Reserves). Typically it will only take 3-5 years of annual \$10 increases before an association finds itself making responsibly sized Reserve contributions. Read more about it [here](#).

**Q: If we have an existing (for a prior year) Reserve Study, do we need to start over with a new one, or can we update it?**

If the prior Reserve Study was prepared by a credentialed Reserve Study professional according to National Reserve Study Standards, the same or a different Reserve Study professional can update it either with or without a site inspection (depending on your needs and time that has lapsed since the last Reserve Study). If you don't have such a reliably prepared Reserve Study, you'll need to start over with a "Full" Reserve Study responsibly prepared according to National Reserve Study Standards.