Association Budgeting in “Tough Economic Times”

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Every person should have a budget…and few do. A budget helps smooth out the ups and downs of short term and long term financial goals. However, we, as individuals, have options when financial upheavals strike – options such as taking on another job, changing our lifestyle, increasing credit card debt or even walking away from financial obligations through bankruptcy and foreclosure. Most of these options are not available to an Association

Associations are communities of individuals who are pooling their financial resources to protect their real estate investment, maintain a lifestyle and share maintenance and other obligations. These are the same individuals that may not have a budget in their own life. Thus, when it comes to preparing a budget for their Association it is a difficult process. Unlike individuals or government entities, there is not a lot of credit out there for an Association. It is often difficult to borrow money. The Association cannot walk away from its debt by filing bankruptcy. Thus, the Association is left finding ways to pay bills and keep the place maintained. Here are five budget suggestions in what is often termed (and albeit the oft overused phrase) “tough economic times” –

1. **Don’t expect to collect all budgeted assessments (and associated costs)**

   The reality is that most Associations will encounter bad debt write-offs. The budget must reflect the fact that some of the unit owners won’t pay their assessments. Because the banks will not quickly foreclose on the units there may be a long period of time where the association does not receive assessments. How to estimate the amount to budget for noncollection of assessments is very subjective and specific to each situation – but it is important not to underestimate this amount. It is better to assume the worst and then collect more than what you expected.

   Along with the bad debt budget line item there needs to be consideration for payment of collection measures on those past due assessments. While the costs can be passed along to the unit owner, if the unit owner ends up walking away from the unit, the Association may not collect the monies they expended trying to get the unit owner to pay. However, the Association must have a collection policy and uniformly enact it. It also may be necessary at times to force a foreclosure to get the unit back and get someone in that will pay rent or will purchase the unit and pay assessments. The Board must understand that a portion of their bad debt allowance must include not only the assessment that isn’t collected but the unreimbursed legal costs that are expended to try and collect that debt.

2. **Focus on long-term as well as short term**

   The Board is charged with protecting, maintaining and enhancing the assets of the association. The decisions made today affect future as well as current owners. If the decision is made not to maintain the buildings or not to set aside monies for future major repairs and replacement of common area components, the value of the investment may decrease and the costs will be born disproportionately by future owners.

Lack of focus on longer term goals often means that a special assessment is needed. Special assessments are not popular in that future owners are generally paying for past mistakes and that is not well received by those owners. Plus, special assessments make it difficult for the owner to budget for that expense personally. When they purchased the unit in the Association they were aware of the monthly obligation and they should have been aware that it would go up as inflation occurred. But, a large one-time assessment (even with a payment plan option) was not in their budget and may considerably impact on their financial situation adversely.

All too often the Board wants to stop funding reserves or borrow from reserves (with no realistic payback). That is not a good answer. The deterioration of the common areas will continue. Instead, this is the time to have a reserve study and come up with a realistic reserve funding plan. With the advice of the reserve professional in collaboration with the Board and management, a plan may be developed that will adequately fund reserves with the minimal amount of monthly obligation. But, once that plan is determined the Association needs to fund that plan. Funding reserves (the replacement fund) is an important obligation of the Association.

3. Have a plan when there is a deficit

The Association is an ongoing entity that doesn't operate in the vacuum of just the current year. Thus, when the Board works on the budget they need to look to the past as well as the future.

If there was a shortfall last year and there was no contingency fund, the Board needs to budget for that shortfall in the current year's budget. It will not go away on its own. One recommendation is to include a budget line item – Prior Year Operating Deficit. This makes the issue very visible.

Alternately, if the Association is lucky enough to have an operating fund that has built up during the past years, then a current year budget could include usage of some that prior year excess. But, be sure that it is not all used up in one year and that there still remains a balance for future years. Most recommendations are to have ½ to 3 months of operating expenses as a balance in the operating fund for contingencies.

4. Evaluate expectations

Possibly there are previous expectations that can be reduced when money is tight. There may be large projects that were deemed important in prior years that can be delayed until a future year. There may be nonessential services that can be reduced without a large impact on the unit owners or with the agreement of the unit owners.

However, if the unit owners bought into the Association because of certain features – 24 hour concierge service, gated and patrolled community, clubhouse amenities – the Board needs to evaluate those expectations and not eliminate them if quality of life would be adversely affected. Determining expectations may be a difficult process and not everyone's expectations are the same. This requires good communication skills and an understanding of the community.

CAUTION - eliminating a budget line item that reduces the budget a minuscule amount while not meeting unit owners expectations may be counterproductive to developing a community where people want to live. So, carefully evaluate the <u>benefit</u> of the reduction to the <u>cost</u> of the reduced expectation.

5. Operate with a business-like attitude

Operate the Association as a business. Take the time necessary to really review and understand the financial statements of the Association. Learn from historical financial statements as to where the monies come from and where they are spent. The Board should ask questions if they do not understand. Financial matters are a vital part of running this business.

The Board is not expected to know everything about running the Association. Thus, as with any business owner, they should bring in professionals to assist and advise them. This is never more true than in the budgeting process. There may be cost saving tools out there of which the Board is unaware. The most amount of time should be spent on the largest dollar items on the budget. Get input from those vendors or companies about how to save money without sacrificing service or product quality.

Ultimately, the Board must determine the correct assessment that it takes to operate the Association. This is not the assessment amount that will make them popular with the current group of unit owners. This is the amount that it takes to meet the Association's obligations as well as the needs and expectations of the majority of the unit owners. The Board needs to make the decision to increase assessments and/or decrease costs as needed. The Board needs to be willing to be tough in order to ensure the Association's financial well-being in these "tough economic times".