FirstService
RESIDENTIAL

8 Secrets to
A Better Association Budget Process

Unlock the mysteries behind successful budget process management.

When your board first sets out to draft a budget, it can seem like a daunting task. How do you balance your community's needs with its wish list? How do you know what items to plan for and when? And how can you ensure you'll have enough money to cover planned or unplanned expenditures when the time comes?

In this guide, we will let you in on some of the secrets to decoding your community's budget process. We'll outline how your association's annual operating budget should be created and managed, beginning with identifying short and long-term goals and assessing where your community is right now relative to where you want it to be in the future. This starting point is important because the decisions your board makes today will most certainly impact the financial situation you will find yourself in tomorrow.

We will also review the benefits of conducting a reserve study as it serves as the very foundation of effective long-term financial planning. And to ensure your budget process is a comprehensive one, we will lay out the components and considerations of both short-term budgeting and long-term financial planning along with the steps a board should take to ensure well-informed decision-making.

The successful development and management of your community's operating budget is dependent on two important things: board alignment and resident buy-in. In this helpful guide we will detail how to achieve both. Finally, we will outline what you, as a board member, should not only look for — but expect— in terms of property management support throughout the budgeting process.

While all these best practices are important elements of association budgeting, the real secret is to work with an experienced property management company that truly understands their importance and has them firmly embedded into its process. FirstService Residential, by virtue of our North American footprint and depth of resources, is uniquely qualified to speak to these best practices because they are part of our budget process DNA. We deliver on them consistently, no matter the market or property type.

Short- *and* Long-Term Financial Plans: Why you need both

An annual operating budget is the very foundation of your community's financial management and operation. It's the tool that enables you to estimate your expenses and revenues, and helps you measure and monitor your association's financial activities.

Annual operating budgets also help board members gauge spending and foster sound decision-making – while serving as a means to establishing sufficient, regular assessments. But what some associations don't appreciate is that having a longer-term financial plan (3-5-10 years) is just as important as having a short-term (1-2 year) operating budget.

By identifying and planning for your community's needs farther out in time, your association can better defend itself against significant, unexpected expenses and position itself to thrive well into the future.

SECRET #1:

By developing a long-term financial plan, you will be able to:

- Avoid financial surprises, uncertainty and special assessments.
- Maintain and improve your community cost-effectively over time.
- Sustain property values within your community.
- Proactively address residents' concerns, expectations and understanding of their community's financials.

Budget Process Components

There are three main components of the budgeting process: operating costs, a reserve fund/reserve study and revenue.

1. Operating Costs

These include “line items” or expenses that are necessary to keep your association functioning. For easy reference, they are typically categorized as follows:

» **Vendor/Contractor services –** Costs for services rendered contractually may include landscaping, snow removal, painting, pest control, trash removal, window cleaning, pool maintenance, mechanical/technological systems, laundry services, etc.

» **Professional services & administration –** Money paid for professional services such as bookkeepers, reserve specialists, attorneys, etc., should be accounted for here. Other administrative costs to consider are subscriptions, banking fees, professional member organization dues and event registration fees.

» **Insurance –** Associations need both property and liability insurance. If you haven’t had your community’s insurance needs audited recently, ask your property management company to conduct one to ensure you have the proper protection (coverage levels and endorsements)e. FirstService Residential has vast resources to assist you with this.

» **Utilities –** Make sure the money you budget for electricity and water is based on the previous year’s average consumption (kilowatts and gallons) instead of how much you paid because rates fluctuate regularly.

» **Maintenance –** Money allocated for maintenance is earmarked for the ongoing care and upkeep of common-area components. This category is an important one and should be one of the top line items you fund because maintaining or improving your community’s physical property is one of your board’s main responsibilities. Another factor you should consider is when and how often maintenance must be performed on the assets in your community. Developing a maintenance schedule will help with this task.

» **Office expenses –** This line item represents the cost of doing business and should include things such as rent, office equipment and supplies, office cleaning services, furniture, phone and internet service and postage.

» **Collection costs/Bad debt –** Delinquencies, overdue refunds or any money owed that is unlikely to be paid should be estimated and factored into your budget.

» **Miscellaneous expenses –** This line item would include things like higher-than-projected snow removal costs, hidden mold, a lawsuit, taxes, transportation costs, etc.

SECRET #2:

A good property management company will be able to leverage its purchasing power to negotiate contracts with vendors on your behalf.

2. Reserve Fund/Reserve Study

Your reserve fund is a budgetary component that is designed to grow over time to pay for big ticket items such as the replacement of certain community components, such as balconies, mechanical equipment and roofs, or the construction of a new community feature that will take place in the future, such as additional roads, gate houses or amenity beautification.

Your reserves' annual funding contribution is determined by a reserve study, which is a comprehensive analysis of the current condition of your community's physical assets and what it will cost in the future to replace them. Both your reserve fund and reserve study are essential undertakings that ensure the long-term financial health of your association.

3. Revenues

The primary source of revenue for most associations is regular assessments, and one of the main reasons your association establishes an annual budget is to determine the amount of that assessment. Your community's governing documents will outline the payment frequency (monthly, quarterly or yearly) and how the assessment should be allocated to the units in your community (divided equally or on an ownership basis).

There are other revenue sources that can help augment regular assessments and offset operating costs:

» Fees charged for advertising or sponsorships.

» Leased units, parking spaces and storage facilities.

» Recreational facility memberships.

» Miscellaneous fees (lost keys, guest parking, insufficient funds, etc.).

» Interest from investment accounts.

A last resort for revenue that's often fraught with issues is a special assessment — an extra fee charged to residents that is over and above their regular annual dues. There are several reasons why your association may need to impose a special assessment:

» Underfunded reserves that were earmarked for a capital project.

» Unanticipated repairs caused by a natural disaster that your insurance does not cover.

» A budget deficit resulting from residents defaulting on their regular assessments.

Because they cover special needs instead of day-to-day expenses, special assessments occur only when they are needed. The goal for you as a board member is to avoid special assessments as much as possible given the financial strain it can cause the residents of your community. Other alternatives include a line of credit or a loan.

Jack Boselli, president of FirstService Residential in Pennsylvania, shares this perspective: "I think one of the biggest components that drives a special assessment is really the reserve fund and the reserve fund balance. From my experience, the most common reason for special assessments is that reserves have been underfunded."

SECRET #3:

It's better to increase annual assessments annually and minimally to match the evolving needs of your community and keep in step with inflation — as opposed to increasing assessments every several years by larger amounts. The goal is to spread increases out over the time of ownership.

Budget Planning Considerations

As you embark on the budget planning process, remember that the decisions you make should be *informed* ones — meaning you should give consideration to a number of factors that will directly or indirectly impact the amount of money flowing into your association and the amount going out.

First it is important to review trends in costs over time. This can be accomplished by conducting an expense-to-budget analysis to identify areas where costs and revenues have been steadily increasing or decreasing.

"One thing we implemented last year during the pandemic was to perform a monthly analysis of trends to see where there was emerging change," said Bobet Bennett, senior vice president for financial services at FirstService Residential. "For example, if over a 30 day period, 10% of an association's population pays their monthly dues late, then over the next 30 days you see that number going up to 20% — that's an indicator you need to pay closer attention to that issue."

The next step is to look forward to projected increases/decreases in revenue and expenses. Speak with your contractors and utility providers about any anticipated changes in rates. And factor in how the economy is performing as well. Is unemployment rising? Are interest rates falling? Are oil prices stable? Is inflation a concern?

Your reserve study should also be closely reviewed to ensure that you are on target with funding your reserves as community replacement and enhancement projects draw nearer or are added.

The budgetary decisions you make must also weigh how your community will be financially impacted. What has your history been regarding regular assessments? Have you raised them, and if so, by how much and why? Have you had to make special assessments in recent years? Be cognizant of the fact that your residents will have a clear memory of recent community investments and the reasons for them, so be mindful of how they will be affected as you move through the process.

In addition, give consideration to the composition of your community. "Seniors, for example, may only want to look at plans that go five rather than 15 years out, said Isadora Goh, director of finance with FirstService Residential. "Similarly, owner occupants tend to be more vested in longer-term community expenditures whereas owners that rent might not be as committed to the upkeep of their properties for the next 10-20 years. They are just looking at what income they're going to receive in the current year. I think it comes down to balancing the demographics of the ownership."

SECRET #4:

Start your annual budgeting process with a kickoff meeting six months in advance of the actual budget taking effect. It's important to honor the time that's required to budget properly.

How to Prepare for the Budgeting Process

The key to your budgeting success is upfront planning. If you gather the data, documents and insights you need early in the process, you'll enjoy greater efficiency and experience fewer pain points.

Identify goals and objectives. Ideally, the budgeting process should begin with a goal-setting meeting that is attended by your board, property manager and committee chairs. The objective of the meeting is to determine what expenses must be covered by the association for the budget's allotted timeframe, and what expenses might be covered to please residents and enhance the community. Consider whether the demographics in the community have shifted to warrant changes, think about what assets might be due for an upgrade, if the complaints you regularly receive tend to revolve around the same issue(s), etc.

Create a budgeting schedule. Your governing documents likely outline when budgets must be shared with association members and when approvals must be secured. Simply work backwards from the start of your upcoming fiscal year, allowing time for each step in the budgeting process. Eventually you will land on when you should begin.

Review governing documents. Your association's governing documents will offer detailed guidance on assessment payments and increases, reserve contribution amounts, whether the budget must be presented to and/or ratified by residents, etc.

Examine previous budgets. This exercise is helpful in spotting line items that are consistently over or under budget. And while you review them, think about line items that could be eliminated or added. Past budgets are a good starting point, but do not depend on them exclusively.

Review financial statements. These documents should be provided to you by your property management company and include your association's income statement, the statement of cash flows and balance sheet.

Investigate legal requirements. These vary from state to state and are constantly changing which is why it is important to refresh yourself with your association's legal obligations — especially as they relate to conducting reserve studies and establishing or maintaining reserve accounts.

Conduct a community survey. Involve residents in the budget planning process by formally asking them to prioritize additions and improvements to the community, such as a dog park, better street lighting, speed bumps and landscaping. The results of the survey will help you, in turn, prioritize items under consideration and incorporate them into the budget.

SECRET #5:

A great way to foster a better understanding of financial matters within your community and secure budget buy-in from your residents is by forming a finance committee that is comprised of association members who are not active board members.

Long-Term Financial Health Hinges on Two Things: Reserve Funds & Reserve Study

Consistently funding reserves over time will go a long way to protecting the fiscal health of your community. However, it can be challenging for boards to identify all the items in their communities that will eventually need the support of this funding, when those items will need to be developed, upgraded or replaced and how much it will cost in the future.

One of the primary advantages of establishing and maintaining reserves is that it is an equitable way to ensure all residents who are using and enjoying community assets while those assets are fully functioning are participating in their costs.

Without reserve funds, only those residents who are living in your community at the time an asset needs to be replaced will have to shoulder the burden of replacement costs via a special assessment. What's more, reserves will give your association members peace of mind knowing the money will be there when it is needed.

And, the market value of properties within a community is better preserved when reserves exist to support its shared assets.

The importance of conducting a reserve study cannot be overstated. It is the crux upon which sound long-term financial plans are built. The study assesses the condition of significant, shared assets within a community (like pools, mechanical equipment and workout areas) and provides a financial analysis of future replacement costs, including a recommended dollar amount the association should contribute to its reserve fund each year.

Your governing documents will outline for you if a reserve fund must be created and how you should maintain it over time. They should also dictate the procedures you should follow for funding your reserves and whether it can be delayed or bypassed all together if consensus among most of your residents is achieved.

SECRET #6:

Remember, you can only use reserves for large, longer-term expenditures. That's why long-term planning is so important. The reserve study will be your roadmap to future financial success.

Maintenance or Reserve Components?

A tricky aspect of managing your reserves is determining how to categorize your community's common area components. Some will just require ongoing maintenance; others will need eventual replacement and still others will need both. Your association must allocate for maintenance each year so community components will last until the time they are due to be replaced.

Failing to do so could result in having to replace them long before the reserve study's replacement due date, resulting in a possible special assessment. At the same time, you must make a reserve contribution each year to be properly prepared for covering replacement costs when they are scheduled to occur.

The decisions you make around whether items are maintenance vs. replacement (or both) will ultimately determine whether they will be listed in your yearly operating budget or in your reserve inventory.

Generally speaking, less expensive items tend to land in the operating budget, and higher-priced items are usually assigned as reserve components so their replacement costs can be funded over a longer period of time.

In addition, it is becoming increasingly common for associations to begin addressing infrastructure components as part of their long-term planning process — especially for communities that are decades old. Infrastructure components are generally out-of-sight, such as storm water systems and sewers, and last a very long time (some as long as 50 years). As such, they are often not thought of until they begin deteriorating or failing. It's a good rule of thumb to consider adding infrastructure items to your regular list of reserve components when they reach the halfway mark of their expected life spans.

SECRET #7:

Seek the advice of your auditor or property management company if you need help determining whether an item is a reserve or operating budget component.

Who should conduct your reserve study, why and how often?

We strongly suggest that your association's reserve study be conducted by a third-party professional such as a reserve specialist. These professionals will not only have a solid working knowledge of your state's requirements with regard to reserve funds and studies, but they will also have a thorough understanding of the components that should be considered and when they should be added to your reserve inventory. They will also offer your board an unbiased voice to your budgeting process. FirstService Residential can help you identify a reserve specialist in your area.

Finally, keep in mind that your reserve study is a living, breathing document that should be regularly reviewed and updated. But treat it is a guide, not gospel. "Just because your reserve study says you need to replaster your pool in 2022, doesn't mean you have to. Check with your pool vendor and have him give you an opinion as to whether it really needs to be replastered in 2022 or if you can push it to 2023," said Tina McWilliams, senior community manager with FirstService Residential.

In the early years, reserve study updates are recommended every three years. After a decade of existence, communities should consider updates every other year and detailed reviews of the study should occur annually.

Again, your state may dictate the cadence schedule of reserve studies/updates. Consult your property manager for assistance.

Budget Communication Essentials

You and your fellow board members play an important role in making the annual operating budget process a smooth one. The first step is to achieve alignment within your board as to where and how money is allocated. If there are disagreements between members, it will hamper your ability to achieve consensus outside of the board in getting your budget ratified. So, begin from within.

Next, you must secure buy-in among your residents. Start by soliciting their opinions and ideas via a residents' survey at the start of the process. After your operating budget has been drafted, consider holding a town hall with residents to review it. Include several board members in the presentation or better yet, have your finance committee present part of it to demonstrate that the budget was developed by residents of the community who are not currently serving on the board.

"If at all possible, take several board or finance committee members and have them own different parts of the meeting. Avoid a one-person presentation, especially if there's difficult news to deliver, as it can put the messenger in a tough position," added Christina Forbes, senior vice president at First Service Residential.

You should also consider bringing in subject matter experts to address specific areas of your budgeting process, such as an insurance agent or reserve specialist. "We like to promote that we have guest speakers — experts in their fields who will come and present at meetings as part of the budget approval or project funding process. There they can address questions from the entire ownership and help residents better understand what money is going where," said Goh.

Forbes added, "We like to use visuals. Pie charts are especially helpful because they clearly illustrate for residents the amount of fixed expenses versus variable expenses — the costs you have to take on no matter what and the 20 percent where there's some wiggle room."

In addition, look at all the communication vehicles available to you and make good use of them. Trying to justify a big budget increase in a letter or email is no substitute for holding an information session where concerns can be addressed in person or via virtual meeting, in real time.

"We anticipate the questions that we think the membership is going to ask, and then communicate the answers through several different communication channels," said Lauren Starner, regional director with FirstService Residential. "I know personally, if I get mail, I often put it directly in the trash or don't spend much time reading it. Same thing goes for other people with emails and attending meetings. So, we look at all available channels of communication in a particular community and we use as many of them as possible."

Bennett explains further, "Some of the more successful budget meetings I've attended were the ones where board members were able to make community investments relatable by breaking them down. I've actually heard board members say, 'Think about your own personal expenses, like your utility bills. If they are going up for you, they are going up us and the rest of our community too.' It's about articulating financials by putting them back into layman's terms, rather than using the technical terms of association budget management."

SECRET #8:

It's always a good practice for board members to think about their own personal expenses and relate them back to what residents are experiencing. By helping them understand that your board is affected by price increases too, your residents will be more understanding.

Property Management Company Support: What boards should expect

The type and degree of budgetary support associations receive from their property management company depends on the community, its size, and frankly, the depth of expertise and resources the property management company offers. FirstService Residential is the only property management firm that consistently puts into practice these "secrets" to effective association budget management. The fact is, we execute against them each day. We understand the complexities inherent to financial planning for a community and have the expertise on staff to assist you with budget preparation every step of the way.

Some of the budget planning deliverables we routinely provide include:

- Regular, thorough financial reporting.
- Analysis of budgetary discrepancies.
- A budget checklist outlining the necessary steps and resources.
- Assistance with fostering alignment and process buy-in among board members and residents.
- Ongoing guidance such as creating yearly maintenance calendar and offering insights on how to handle things beyond your control (i.e. fire code changes.

At FirstService Residential, our experience is the budgeting process varies from state to state and region to region. However, more often than not, we are at the forefront of budget development for many of our properties, oftentimes completing all of our associations' budgets utilizing our in-house resources and experts and leaving minor adjustments and final approvals to our boards.

"In the New York market, a majority of the operating budgets are prepared by our Finance Department," said Forbes. "We generate a master schedule which states when the property manager can expect to receive a draft. Approximately one week after the property manager receives it and has provided comments, the budget is then sent to the board or finance committee."

Forbes added, "The timing really depends on the board, but the goal is to encourage approval no later than 45 days prior to the effective date of the budget to allow time to prepare the communication to the owners and to update the billing statements.

Starner shares a similar process: "FirstService Residential's management facilitates the creation of the initial budget for our properties and it is reviewed with the board/finance committee for final input and approval." She further explains, "In Nevada, our budget process begins as early as July and concludes in November or December with the annual ratification of the owners."

Throughout the budget development process, your property management company should direct the steps that should be taken, provide the items that should be reviewed and considered and share best practices that will create the best possible budgetary outcomes. At FirstService Residential, we not only deliver these services, we do so with excellence. And by virtue of our size and scale, we are also able to share our buying power with the communities we manage to extend significant time and cost savings.

Even if your community's budget may be developed in large part by an experienced property management company like FirstService Residential, the actual responsibility for it falls squarely with the board. As a board member, you are responsible for unlocking the mysteries behind the budget planning process, understanding what your property management company is doing, and how and why it is doing it relative to your community's finances. Then you must carefully examine, adhere to, and oversee your association's budget. Hopefully, some of the secrets you've learned in this guide will help.

Contact FirstService Residential today to learn more about the secrets to managing your association's budget process more effectively.

FirstService RESIDENTIAL

About FirstService Residential

FirstService Residential is North America's property management leader, partnering with 8,500 communities across the U.S. and Canada. HOAs, community associations, condos and strata corporations rely on our extensive experience, resources and local expertise to maximize their property values and enhance their residents' lifestyles. Dedicated to making a difference, every day, we go above and beyond to deliver exceptional service.

FirstService Residential is a subsidiary of FirstService Corporation (FSV), a North American leader in the property services sector. Find out how we can help your community thrive. Visit www.fsresidential.com.