# FIND YOUR WAY

## *to a better budget*

Your association's long-term financial health should be the driving force behind your budget process.

**How realistically do you develop your association's budget?** If your approach is simply to duplicate your current year's budget or if your primary goal is to avoid raising association assessments, you may be doing your community a disservice and neglecting your fiduciary duty.

Of course, no one (including board members) wants their assessments to go up, but it's more important to be realistic when forecasting what you'll need next year.

In this guide, you'll learn how to plan a realistic budget and avoid some common mistakes. You'll also get tips on creatively reducing costs and generating revenue, and guidance on the best way to tell residents if it's necessary to increase assessments.

# Planning: The Secret to Healthy Budgeting

A realistic and robust annual budget starts with a strong vision. Before anything else, make sure that you and fellow board members agree on the vision for your community and priorities for the next 3 to 5 years. Then, work with your board to set goals for the coming year, giving yourself enough time to plan your budget around meeting those goals.

Next, compare current spending against the budgeted amount. If they don't match, tweak your year-end projection so it's more accurate. "Getting your current year's forecast right is crucial because it's the basis for next year's budget," explains Roy Almeida, vice president of finance at FirstService Residential. "You're really looking at a 16-month period — for example, September of this year through December of next year — when you develop your budget."

Also, review 3 to 5 years of historical data to get a more accurate picture of your spending and of what you need annually.

## Avoiding Costly Mistakes

It's not unusual for an association to go over budget if it doesn't plan well, especially in a self-managed community. This can result in postponing needed work or levying a special assessment. Here are some of the most common budgeting mistakes you'll avoid with a little planning:

» **Overlooking or underfunding reserves.** Approximately 72% of associations fail to adequately fund their reserves. That's because future capital improvements are often the first thing to get shortchanged when the goal is to avoid increasing dues. "If you aren't budgeting for the future, you'll end up with a loan or special assessment, says David Jandak, vice president of finance at FirstService Residential, "and in some associations — especially in fixed-income communities — residents can't afford a special assessment." Always contribute the amount recommended in your reserve study and make sure you are accounting for inflation (approximately 2% per year).

» **Increasing last year's budget by a set percentage.** A formulary approach doesn't account for variations in your community's needs year to year. For example, landscaping may seem like a fixed cost, but if your property requires significant re-sodding or tree removal next year, that predetermined increase to your budget may not adequately account for the cost.

» **Miscalculating variable expenses.** Expenses you can't anticipate are the most difficult to properly estimate. According to Dylan Murray, director of finance at FirstService Residential, "Nine times out of 10, associations go over budget because of unfixed expenses" like repairs and maintenance. He recommends that you "look at the past 3 years and add some cushion." A good rule of thumb is to add 10% to the average.

» **Underestimating cost increases or prevailing market pricing.** Partner with your management company to ensure you are assessing vendor costs and increases in the year ahead. If you don't do your research, you may wind up estimating costs inaccurately or overlooking price increases among your vendors and contractors. Although it's not necessary to get bids on every contract each year, it's a good idea to reevaluate whether you're getting the most value and whether market prices have changed.

# Reducing Costs and Generating Revenue

Your board has crunched some numbers, and your preliminary findings are that you will need more money to fund next year's expenses. However, before you reach deeper into residents' pockets, see if you have other options. "There isn't a silver bullet," notes Bill Worrall, vice president at FirstService Residential. "It has to be holistic, but you may be able to cut costs and generate revenue in ways you hadn't considered before." Be sure to get residents' input before applying any of the suggestions below.

## Sensible Cost Cutting

Residents appreciate even small cost-cutting measures. You will certainly gain their support if you shave off enough to offset other rising costs and prevent an increase in their assessments. Here are some ways you may be able to do just that:

» **Take advantage of bulk buying.** You may be able to negotiate better rates for products and services by combining forces with other associations. The simplest way to do that is through a well-established management company with extensive buying power.

» **Perform a cost-benefit analysis.** Ask your management company to review current services to determine if there may be a less expensive way to get the work done. For example, if you currently outsource pool maintenance or engineering, you may find that adding in-house staff costs you less. Make sure that whatever you decide to change won't create a bigger burden for board members.

» **Get an energy audit.** Utility companies are usually willing to examine your association's power usage and make recommendations for reducing your energy expenses. Many companies and cities also offer rebates to offset the cost of replacing existing lighting or heating and cooling systems with high-efficiency options. A good association management company should be able to help with your audit or make recommendations to lower your energy costs.

» **Renegotiate contracts.** Your existing vendors may be willing to give you a price break if you sign a multi-year contract. They may also be willing to beat competitors' prices if you present them with lower bids you've received from other vendors. If they aren't willing to come down in price, it may be time to hire a less expensive vendor. Just make sure you aren't sacrificing quality for price.

## Creative Revenue Sources

When seeking ways to generate revenue, set your sights on a long-term solution rather than focusing on a quick, one-time money-making opportunity. This way, you'll have a source of income you can depend on year after year. Talk to prominent accounting firms that work with associations in the area about revenue-generating activities they see other communities implementing or with your association's auditor. You should also ensure that any extra income your association generates complies with tax laws and is properly accounted for.

- **Reinvest funds.** How much interest does your reserve account earn — if any? Your association can increase its income by thousands of dollars a year simply by reallocating your reserve fund to one or more interest-bearing accounts. Be sure any investment doesn't put your association's finances at risk. Seek guidance from your association's investment advisor.
- **Lease space.** Whether you just have a meeting room or a more elaborate clubhouse, leasing the space to residents or to the public for parties and other events can yield regular income.
- **Hold vendor fairs.** Sell booth space to local vendors and contractors, such as pet groomers, hairdressers and painters. Businesses in the area will appreciate an opportunity to present their products and services to residents in the community.
- **Sell ad space.** Do you have a community newsletter or magazine? In a large community, this is an ideal way for local businesses to get their name in front of potential customers in the area.
- **Rent out unused space.** Converting parts of your building or community to office space will provide you with a steady stream of income. However, you'll want to make sure your governing documents, local laws and your insurance policy allow the association to become a landlord.
- **Sponsor an event.** Although most associations hold events for residents, it may be lucrative to charge a fee for nonresidents to participate in holiday parties, barbeques or festivals.
- **Sell air rights.** If you're in a high-rise building, look into the possibility of selling your "air rights." Many cities have maximum density limits, so adjacent lot owners that exceed their limits may want to purchase your unused portion.
- **Charge a fee for certain amenities.** Sometimes, a particular amenity or service may be the primary reason the board needs to raise assessments. Instead, you can tack on an extra fee for using those amenities. As Jandak points out, "If an increase only affects the people who are creating the additional expense, you may not have to raise dues on everyone." For example, it's common for associations to charge an additional fee to residents who use the golf course. You could also charge an extra fee to pet owners, especially if costs associated with pet stations or dog parks are increasing.
- **Make amenities available to the public.** If residents are willing to share, invite nonresidents to use your pool, tennis courts or other facilities for a fee. Residents should get a significant discount or pay nothing at all. Otherwise, they may feel like there are no advantages to living in the community.
- **Make room for a cell tower.** Wireless carriers that want to expand their service are often eager to find new sites on which to build cell towers. Your association could lease the space if residents are willing, and you may even be able to sell leasing rights to another company for a limited time.
- **Provide public parking.** A community with unused parking spaces — especially one that is located in an area where parking is scarce — can offer its extra spaces to the public. "Gather data up and down the street so you can benchmark the parking rates," suggests Worrall.

# The Right Way to Raise Assessments

Even the most financially savvy board can't avoid raising assessments forever — nor should it. At the very least, your budget needs to keep up with inflation and rising costs. Maintaining artificially low dues may appease residents in the short run, but cutting corners will catch up with your association eventually. "The association that doesn't have any increases for 10 years doesn't have a responsible board," says Jandak. At some point, it will have to hit residents with a major assessment increase, a special assessment or both to make up for years of inadequate funding.

Today's buyers know this because they are more knowledgeable about association finances. They see a flat budget as a red flag — an indication that the prospective community is inadequately funding its reserves or is deferring maintenance. And they are probably right. A better approach is to implement small increases each year. This is much more likely to have a positive effect on property values than no increase at all because it shows prospective buyers that the association is planning ahead.

Even though some residents may balk at seeing their association assessments go up incrementally each year, small increases will be easier to swallow than a large, unexpected hike. They also will be easier to implement than a large increase because they generally don't require approval by residents. (What constitutes a "small" increase depends on your association's governing documents and state or provincial laws.)

If a large increase is needed and residents vote against it, you'll be unable to fully fund your operations and/or your reserves. This will leave you with no option but to take out a loan, levy a special assessment or both, which may present an even greater hardship. "Residents in some associations can't afford special assessments," Jandak says, "especially those who live on fixed incomes."

### Communication Matters: Are You Doing Enough?

Hopefully, your board has made a practice of communicating regularly and transparently with residents. (See our guide, How to Improve Communication in Your Community: A Recipe for Association Success.) Communication is especially critical when it comes to raising assessments. Use the following checklist to be sure you're communicating an increase appropriately.

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# Communicating an Increase in Assessments

## *A Checklist for Association Boards*

- [ ] We have communicated with residents about the community's finances all year long.
- [ ] Residents have had an opportunity to tell the board what is important to them, and we've incorporated their feedback into our financial decision making.
- [ ] We have a plan for notifying residents of the assessment increase in writing 30 days before it takes effect.
- [ ] We have communicated about the assessment increase as early and as often as possible and have shared the reason(s) behind the change.
- [ ] Besides providing written notice, we will announce the assessment increase through other communication channels (e.g., emails, flyers, newsletter, website, open meetings, etc.).
- [ ] We are being completely transparent about why the increase is necessary and beneficial.
- [ ] Our communications emphasize how residents will benefit from the increase (e.g., higher property values, a more attractive property or better/more amenities).
- [ ] We can support the need for an assessment increase with facts and numbers, and we have shared these with residents.
- [ ] We have worked with our management company to come up with a realistic budget and to effectively communicate the increase to residents.

A healthy association budget doesn't happen overnight. It starts with a solid vision and set of goals, supported by your board. You'll also want to work with management to come up with ways to reduce costs and generate revenue. Most importantly, it takes a realistic approach to assessments, with slow and gradual increases to account for rising expenses, inflation and unexpected maintenance costs. By implementing these strategies and effectively communicating them to residents, you'll help preserve property values and enhance resident lifestyles for years to come.

For additional tips and helpful budget strategies, go here: **http://bit.ly/AZ-HOA-Articles**

FirstService RESIDENTIAL

## About FirstService Residential

FirstService Residential is North America's largest manager of residential communities and the preferred partner of HOAs, community associations and strata corporations in the U.S. and Canada. FirstService Residential's managed communities include low-, mid- and high-rise condominiums and cooperatives; single-family homes; master-planned, lifestyle and active adult communities; and rental and commercial properties.

With an unmatched combination of deep industry experience, local market expertise and personalized attention, FirstService Residential delivers proven solutions and exceptional service that add value, enhance lifestyles and make a difference, every day, for every resident and community it manages. FirstService Residential is a subsidiary of FirstService Corporation, a North American leader in the property services sector. For more information, visit www.fsresidential.com/arizona.