



BUDGETS, RESERVE FUNDS AND FINANCIAL PLANNING 101:

**A Guide to Building a Powerful Financial Future for
Your New York City Cooperative or Condominium**

INTRODUCTION

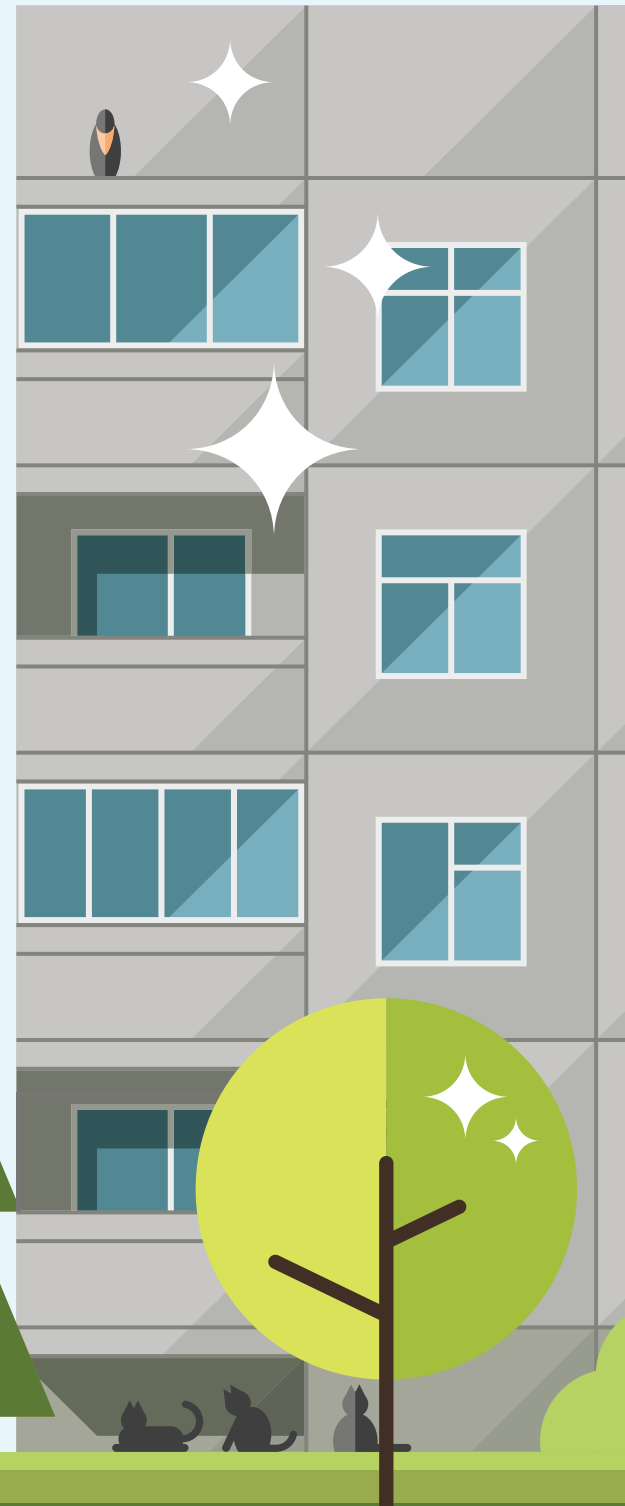
If you are on the board of a condominium or cooperative in New York City, you know that the value of your property and the satisfaction of fellow homeowners are directly tied to the financial strength and stability of your association. Well-managed, financially healthy communities can consistently deliver essential quality services while strategically pursuing long-term capital improvements that allow them to compete in a changing landscape—one that increasingly features amenity-rich buildings.

Fiscally sound properties are also notable for what they do not provide: surprises. Their **annual budgets** reflect the importance of efficient operational approaches and ongoing preventative maintenance designed with cost effectiveness in mind. And their **financial planning** methods are engineered to maximize investment benefits, simplify complex banking processes and deliver financial security.

By minimizing unexpected expenses, controlling operating costs and safeguarding investments, you are helping to preserve not just the value of your property, but the lifestyle that you and your fellow owners expect. Getting your financial house in order takes time and a commitment to understanding the smallest details of your association's accounting and management policies.

Fortunately, you need not approach the challenge alone. A strong and experienced professional management company can provide the foundation for superior financial performance. With the right management and technical support, your community can thrive now and into the future.

In the following pages we will review specific steps that your board can take to achieve successful financial management.



PART ONE

GETTING YOUR ANNUAL BUDGET OFF THE GROUND—AND RIGHT ON THE MONEY

A TIME TO REFLECT

Preparing your association's annual budget is not just a financial necessity, but an opportunity to assess your overall management strategy and gauge its relative success.

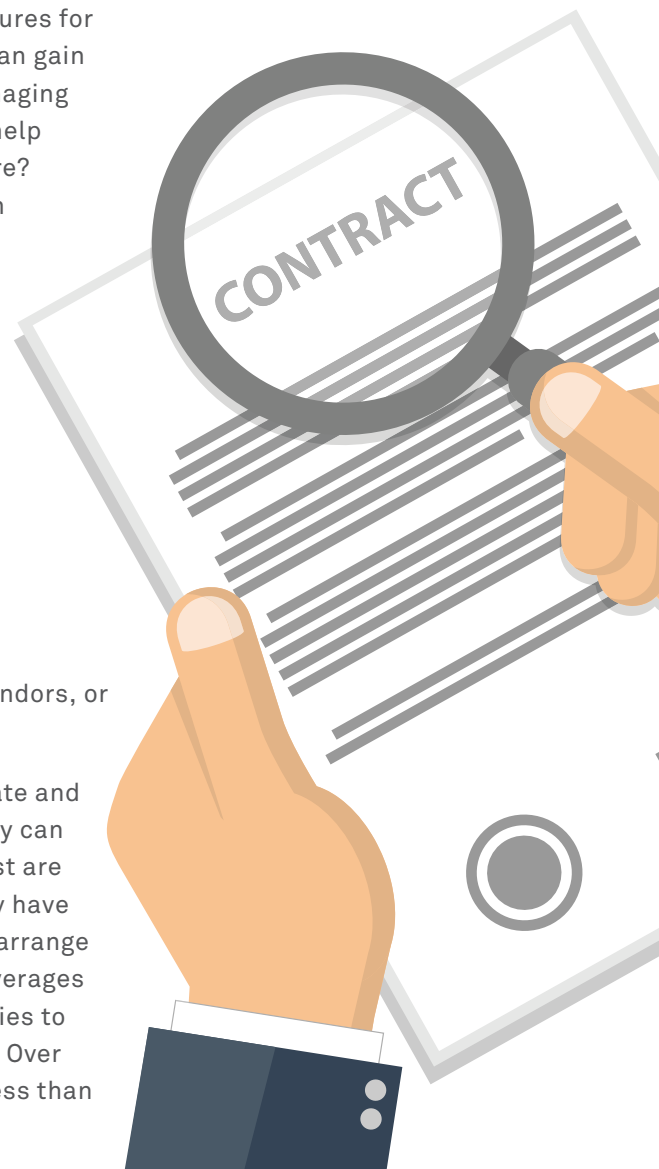
For instance, when analyzing current and past operational expenditures for maintenance and repairs—and projecting next year's needs—you can gain insight into the effectiveness of your association's approach to managing these critical functions. Is your maintenance program adequate to help prevent costly infrastructure issues, such as HVAC equipment failure? If the previous spending and projected budget reveal large swings in infrastructure costs, it is time to look at how your infrastructure is actually managed and how it can be improved.

During the budgeting process, you should also review current vendor lists and determine which among them are planning fee increases or service changes in the year ahead. This is an excellent chance to appraise the status of working with your current vendors:

- » Are they reliably providing quality service?
- » Are their fees and terms reasonable?
- » Do they offer new capabilities that you can bundle in?

Depending on the answers, you may want to shop around for new vendors, or at the very least, renegotiate for better fees and service terms.

With a vast network of vendor relationships and the ability to evaluate and negotiate for quality services, an experienced management company can help. At FirstService Residential we understand that quality and cost are equally critical factors in the vendor selection equation. We not only have access to top vendors, but the purchasing power and knowledge to arrange more favorable contracts. For example, FirstService Residential leverages the combined energy utilization of hundreds of its managed properties to negotiate lower-than-standard rates for natural gas and electricity. Over the last five years, clients have paid, on average, up to 12 percent less than rates charged by Con Edison and National Grid.





BUDGET WITH THE FUTURE IN MIND

While it is technically an “annual” budget, the process should drive you to think long-term and to consider how planned expenditures in the coming year can actually help you save money down the road.

A budget is meant to optimize the revenue stream from monthly maintenance fees or common charges toward the overall operation of the community. Quite simply, it tracks how, when and where the money coming in is going to be flowing out. Strategic budgeting, on the other hand, should form the basis for longer term financial decisions and your annual budget should reflect your long-term financial planning. It should also anticipate any large projects that cannot be funded from your reserves or which may require levying special assessments.

To make sure your approach to budgeting is on track, here are some key considerations:

1. Prepare and Plan

The budget process is, at times, arduous and time-consuming. In order to meet the challenge and ease the burden, you must be prepared. An experienced property management company, such as FirstService Residential, can help you through the process and diligently follow the budget throughout the year. Members of our financial management team often attend board meetings to present draft budgets, address questions and provide insights on how to improve the operating budget. Our goal is to provide the highest level of financial guidance to board members and to the association’s finance committee.

PAY ATTENTION TO THE DETAILS

When unforeseen shortfalls occur during the year, your reserve funds and your long-term capital improvement plans may pay the price. Keep your eyes open in these areas that are often overlooked when planning the budget:

» **Accounts payable.** A building or community that carries accounts payable on a month-to-month basis requires special care to understand how this element impacts the budget. When properties are facing cash-flow challenges, they will often recommend new annual budgets that deliver only modest increases in spending. But in the quest to minimize increases, these budgets sometimes overlook the need to carry accounts payable into the new year.

Failing to consider year-end accounts payable will prevent the annual budget from generating enough revenue to pay all invoices, leaving your community in the position of having to use reserves or levy a special assessment. Similarly, if there is a deficit in the current year, this must be carried forward in the budget for the subsequent year.

» **Bad debt.** Budgets generally anticipate 100 percent collections of fees and dues from owners. The reality is that some owners will carry arrears balances, and the difference between the ideal budget and this reality can cause cash-flow problems. A bad debt expense line item in your budget can help anticipate this issue.



2. Approach Conventional Operating Costs from an Unconventional Perspective

Understandably, the routine number-crunching nature of budgeting and accounting exercises can lead to routine decision making. The “if it ain’t broke, don’t fix it” justification springs to mind. But this can also lead to missed opportunities to find new solutions that can positively enhance your property.

Many homeowners look for inspiration and ingenious ways to make their household income stretch further. The same should hold true for associations. Boards, working closely with their management team, should challenge themselves to look beyond just the numbers and reconsider how objectives can be achieved, not just how much it will cost to do so.

At FirstService Residential, our team of management experts has developed innovative cost-saving methods to help lower operating expenses. Some of it starts with what we can do to deliver results and reduce costs, such as adopting new management practices, improving strategies for hiring staff, and offering energy use and cost management solutions, just to name a few.

3. Understand the Role of Reserve Funds in Order to Budget Properly

An annual budget for a cooperative or condominium is prepared with the intent to break even. As a result, any unfavorable variances created throughout the course of a year will generate an operating deficit. It’s at this point that many associations may be tempted to dip into their reserve funds to cover the shortfall.

The fact is that reserve funds should be designed to save for future repair, replacement or additions to major components or infrastructure of your community. Variances in your budget will either put your capital plan at risk or require you to seek a special assessment. While you may not be able to avoid the financial impact of a natural disaster, there are steps you can take to minimize unexpected costs and avoid accessing reserve funds for anything other than their intended use.

The most important step to protect reserve funds is to adequately budget for maintenance costs. Your repairs and maintenance budget should provide sufficient funds for routine and preventative maintenance of equipment and infrastructure from HVAC systems to roofs. The goal is to prevent deterioration and allow your infrastructure to meet or exceed its “useful life,” or the expected lifespan of a system, piece of equipment, paint job or other component.



To ensure that your infrastructure is being properly cared for, you must invest now to save later. At the same time, your reserve funds must account for the fact that at various points some elements of your infrastructure will need replacement. Your reserve funds and capital plan should integrate with your approach to annual repairs and maintenance budgeting.

4. Stay Engaged All Year Long

If there is only one caveat that every association board and property manager must recognize in order to wisely manage funds, anticipate costs and achieve efficiency, it's this: *the budgeting process is non-stop.*

Although the annual budget has a start and end date, the process does not end once there is an approved document. You need to stay on top of how expenditures are being managed month-to-month to truly assess if your budget is working effectively. If the board and property management team do not operate within the confines of the budget, the document becomes meaningless. Of equal importance is to document variances, expected or unexpected, to better understand why operations vary from the budget.

On the financial management side, you must also have strong internal controls in place. Separating duties like recording receipts and making deposits will help to guard against financial misappropriation, which will ultimately help protect your budget as the year progresses.

Your approach to budgeting and day-to-day management are closely intertwined. To make your budget work, you must ensure your management is in top form. A deep and ongoing awareness of your community's current and past finances will help you greatly when creating the new budget for the year ahead. A professional property management organization will bring resources and experience into the equation, offering oversight and budget-conscious strategies for success.



PART TWO

MAKING SMART FINANCIAL PLANNING A PRIORITY

As a board member, you have a fiduciary duty to protect the financial interests of both the association and your fellow homeowners. That includes ensuring that operating and reserve funds are properly managed, invested and protected to achieve ongoing financial health and stability.

The opportunities to maintain or grow account funds, or even create new revenue streams, are varied and plentiful. Whether investing association funds, accessing or refinancing loans, restructuring insurance policies and premiums or securing investments that accrue interest, your financial decisions as a board member have far-reaching implications for your association's bottom line now and into the future.

Association treasurers must understand the right vehicles to invest in, how to increase yield while maintaining liquidity and minimizing risk, what the optimal allocation of funds should be, and more.

Consequently, rather than managing their financial planning themselves, many community associations opt to partner with financial management companies—especially those with deep experience with co-op and condo associations and strong banking relationships. FirstService Financial, the financial services arm of FirstService Residential, will work closely with the treasurer and board to review the association's investments and craft tailored solutions to help it achieve its goals.

This hands-on, dedicated approach to helping communities maximize their finances is what sets FirstService Residential apart. Our highly trained in-house team of financial professionals provides a full range of cash management, treasury and investment solutions designed to help you navigate the complex association banking landscape.



With billions in administered funds across North America, FirstService Financial leverages its scale to eliminate unnecessary bank fees while providing increased interest yields. With an integrated approach to long-term reserve fund management, FirstService Financial provides multiple investment options through various institutions and products to ensure that FirstService Residential's clients' liquidity needs are met while maximizing interest yield and protecting principal.

Whether you choose to work with a financial services company or go it alone, it is important to understand some of the fundamental principles of good financial planning. By keeping these tenets in mind throughout the year, board members can ensure they are fulfilling their responsibilities and improving the financial outlook of their building or community.

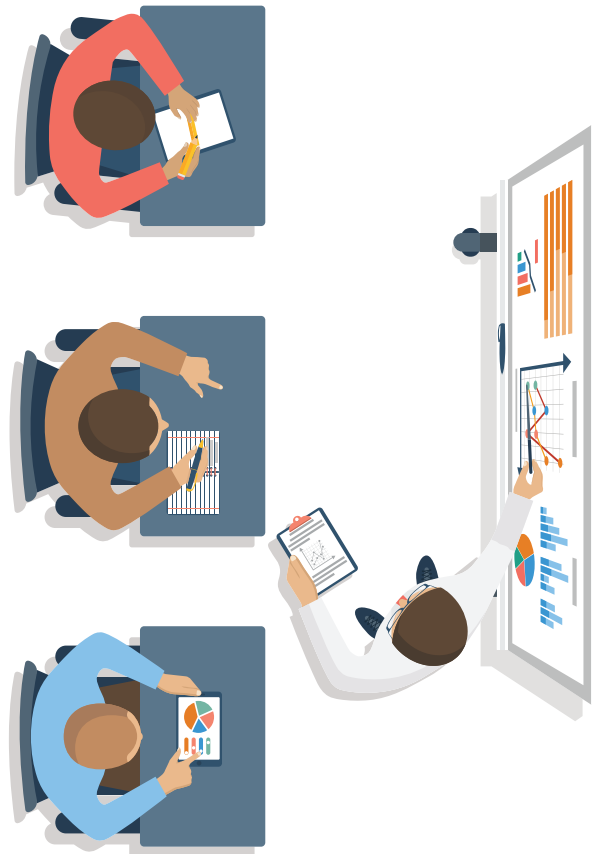
Here are some key considerations for your financial planning strategy:

1. Understand the Basics for Investing

Operating funds and reserve investments are analyzed differently, therefore your strategy for managing each will differ accordingly.

For your **operating funds**, consider maintaining three months of budgeted expenses in a checking account and investing the excess in interest-bearing accounts. If there is more than one year's worth of budgeted expenses, then the excess over that amount can be invested in longer term vehicles. Typically, anything less than one year of budgeted expenses should be kept liquid.

For **reserve investments**, the board should develop an investment policy if one is not already in place. Based on this policy, as well as a reserve study and any anticipated capital improvements or replacements, the board can determine the ideal amount of liquidity that should be maintained as reserves. Liquid funds should be set aside for one year's worth of projected expenses, along with a 10 percent cushion to account for cost variances. The remainder should be invested in longer term vehicles.



2. Know Your Options and Obligations

Since board members have a fiduciary duty to safeguard the assets of the association, most invest conservatively in money market accounts for liquid funds, and CDs for longer term funds. A financial services partner can help you choose the right investment products based on your investment policy and your reserve fund expenditure requirements.

3. Choose Your Bank Wisely

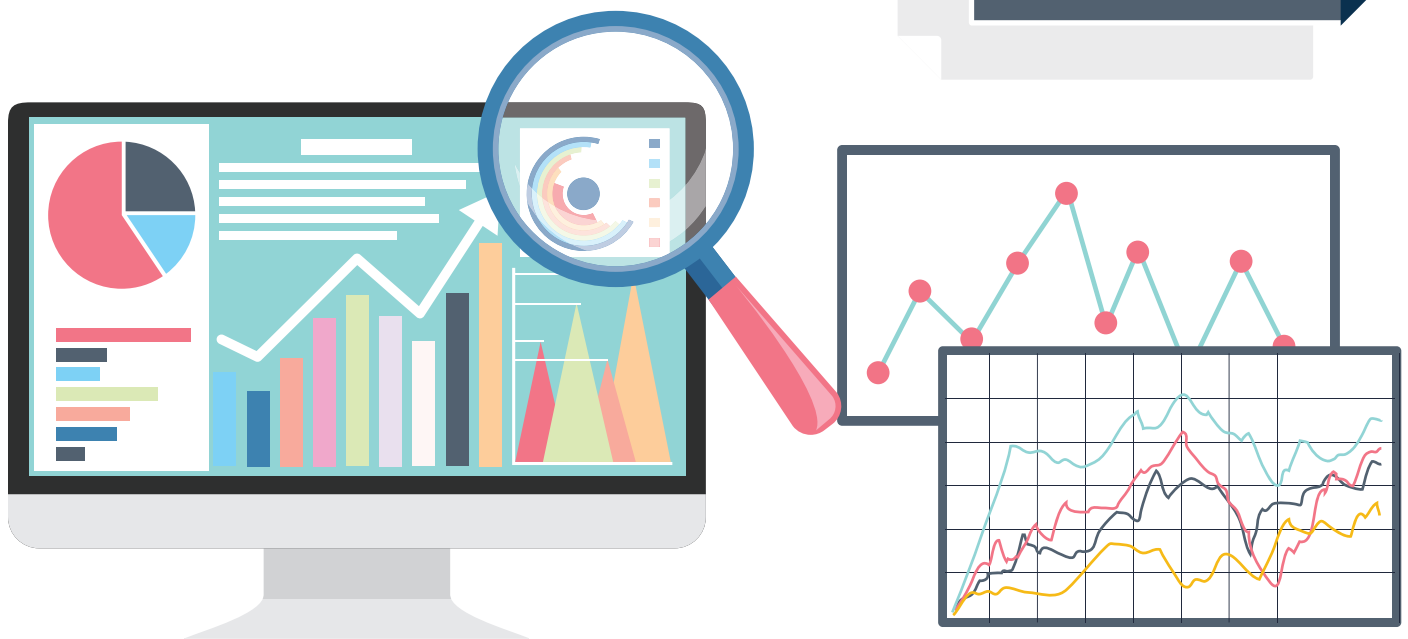
Finding the right banking partner can make the entire process of managing your finances easier and safer. Below are some factors that boards should consider when selecting a financial institution:

- » **Stability:** By examining a bank's ratings from multiple sources, you can determine just how predictable and stable its offered rates will be.
- » **Experience with community associations:** Institutions that have worked regularly with condo and co-op associations will be familiar with your needs and will be able to easily work with your professional management company.

4. Review Regularly

One of the best ways to ensure that your financial planning strategy is on track is to review your investments regularly. At least once a year, conduct a thorough examination of returns and assess your investment strategy. The best time to conduct your review is prior to your annual budget preparation.

Ultimately, your association's financial planning strategy should align closely with your annual budget and should reflect the health of your operating funds. Finally, consider all of your capital improvement plans and the strength of your reserve funds.



FINANCIAL PLANNING THAT DELIVERS RESULTS

At 201 West 21st Street, a 130-unit co-op in Manhattan, FirstService Financial delivered powerful results in the form of a comprehensive mortgage refinancing strategy. Guiding the association's board through the process, FirstService Financial developed specific steps to help achieve the association's key financial end-goal: to fund significant capital improvement projects on the horizon.

After analyzing its mortgage situation, FirstService Financial was able to identify a hybrid loan product that would offer the co-op a way to avoid short-term cost increases with a new loan, gain access to significant loan proceeds, and switch from an interest-only to an amortizing loan—all without having to raise maintenance fees or impose a special assessment. In the end, the association locked in a lower interest rate, along with net proceeds in excess of \$1.2 million to fund capital needs.

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FirstService Financial's professional guidance throughout the process was a fantastic benefit offered through FirstService Residential as our management company. We were able to meet our refinancing objective and achieve favorable new loan terms.

—Greg Reed, 201 West 21st Street Tenant Association President

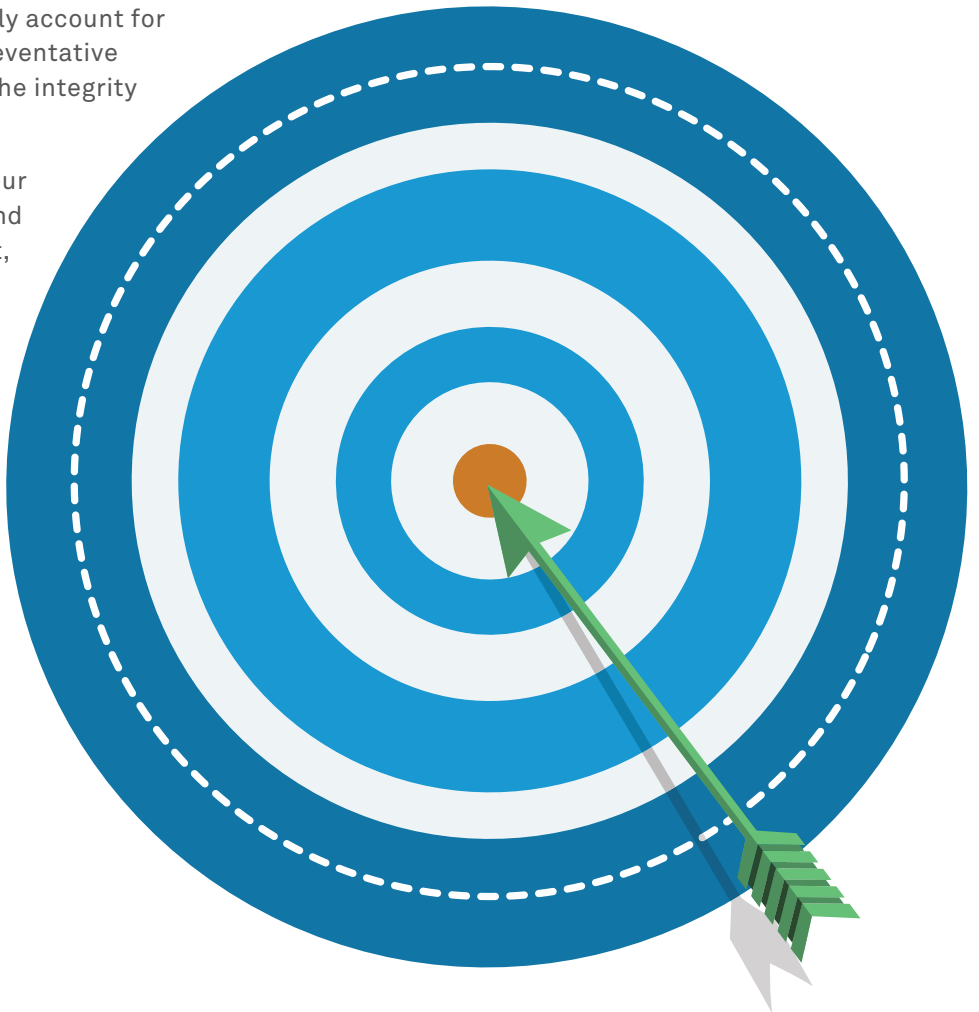
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SUMMING IT ALL UP

Stability within any managed property or community requires that every aspect of the association's finances work toward a united goal. Your annual budget and your approach to financial planning and investing must all be in sync. So remember:

- » Your annual budget must adequately account for daily operational management and preventative maintenance, which will help ensure the integrity of your reserve funds.
- » Your annual operating funds and your reserve funds provide opportunity—and responsibility—for careful investment, which can enhance your community's overall operational health.
- » Strong financial planning will ensure that you are making the most of your funds, your insurance plans, and your assets.



The best way to get your integrated financial program on track is by talking to the experts at FirstService Residential. For more information about our exceptional services and solutions, visit us at www.fsresidential.com today.

About FirstService Residential

For nearly 30 years, FirstService Residential's dedicated team of professionals has worked hard to become New York City's premier residential management company – a trusted partner representing buildings of every type and size.

Every day, we work hard to make a difference for the board members, residents and properties we serve. Our team is committed to delivering outstanding service and proven solutions that maximize property values, lower operating costs and provide an exceptional quality of life for every resident.

Only FirstService Residential offers the best of both worlds: The personalized attention of a boutique property management company backed by the exclusive, cost-savings programs of a national industry leader.

In New York City, FirstService Residential manages more than 500 properties – from pre-war landmark cooperatives and newly-constructed condominiums to luxury rental towers and sprawling apartment complexes. The company's portfolio includes many of the city's most prestigious buildings such as The Plaza Residences, 432 Park Avenue, New York by Gehry, and Cipriani Club Residences at 55 Wall Street.

FirstService Residential, a subsidiary of FirstService Corporation, oversees more than 7,000 properties and 1.5 million residential units across North America. For more information, visit www.fsresidential.com.

Let us help you develop your community's comprehensive financial plan. To get started, please contact us today!



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