

OFFENSIVE STRATEGIES FOR BUDGETING AND RESERVES

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Planning for the coming year and for the future is essential. It is something that needs to be planned out carefully and something that should not be left to the huddle or worse yet until the no-huddle offense at the end of the game.

Budgeting is a lot like football. It is a lot easier to be successful when you are making a short quick pass then the long hail Mary pass. In budgeting, you want to plan for expenses each year and keep the future major expenditures also on your coach's clipboard so that you can avoid the Special Assessment, last ditch effort to win the game.

When budgeting you need to keep the current season, (Operating Budget), separate from the long term plans which involve the player drafting and free agents, (Reserve Budgeting). I will list recommendations for each since they should be kept separate and are both unique.

Operating Budget, (Current Season)

Just like in football there are many ways to win a game, there are also many ways to prepare a budget. Does your association prepares budgets by starting with how much the total assessments should be, (ie. same amount as last year or increasing by x percent) and then filling in the expense figures? I would consider that popular budgeting. It may get the Board members re-elected but it may not be what is best for the Association.

A better offensive strategy would be to review each general ledger operating expense category and to plan the expenditures for the next year. Sometimes the service maybe under a contract, such as landscaping and snow removal. Finding out what you want to change for the coming year and also getting other proposals can be a good way to save costs. If your vendor is doing a good job you may want to give them an opportunity to meet the competition. Just like management companies are not all the same, you can apply that to any type of service the association is receiving. Reducing costs is always good but keeping the property in top shape is also very important. If the football team always goes with rookies for their team players, they will save money but the team will lose a lot of games and the seats will not be filled. In that instance the expenses are low but the income also has decreased. Relating that to your condominium, if you

always go with the cheapest vendor, you may find that your property looks shabby and your unit value has decreased accordingly. In that instance what have you really accomplished?

With the struggling economy we have seen unit values plummet. This has caused problems when you are trying to collect assessments. Unit owners in some instances have fallen behind in paying, are attempting short sales or are falling into foreclosure. Increasing the value of the unit is a critical issue. It allows unit owners that have lost their job or fallen behind, an opportunity to get out of trouble by selling their unit.

Budgeting in today's economy requires a fine balance between keeping the assessments as low as possible to avoid having more unit owners getting into trouble and avoiding drastic cost reductions that affect the appearance of the property. The rule of thumb used to be that if your operating budget was not increasing by 3-5% annually to keep up with inflation that your association will eventually need to borrow from the Reserve Funds.

That has been tossed out of the play book now. With not many condominium and housing units coming on the market many contractors that were servicing that industry, are now competing with the other vendors causing extreme pressure on prices to decrease. We have seen actual deflation happening across the entire playing field. Until the economy heats up, which maybe awhile, you can expect level or decreasing prices. That should help you to keep your assessments from increasing or help them decrease.

There is the issue of delinquent owners that should affect your budget. With the assistance of the Association's collection attorney, you will need to estimate your cash flow from delinquent owners. That means you will need to decide how much assessments will be lost or delayed from owners that are currently delinquent and how much will be received in short sales and foreclosures in the coming year. Also, don't forget to do some predicting on what will not be received from unit owners that are current now but fall behind next year. You can look at the trends on how many unit owners are newly delinquent each month and project that out. It will be extremely difficult to be accurate. You should err on the side of being conservative. Your estimate of funds that will not be collected in the coming year can either be shown as a bad debt expense on your budget in the administrative section or you can show it as a reduction of income right under the budget for assessments, (my favorite way). Either way, if you do a good job of estimating unpaid assessments your team will be more successful.

Utilities for 2011-Bill from Lower Electric, an independent energy broker has given us an outlook for 2011 below:

Electric-For customers with electric bills that are less than \$2,500 a month, they will see their ComEd rates increase by 15-20% in 2011. That is because ComEd

has increased their rate from .075 a kilowatt hour to .090. For larger customers that are not with a 3rd party electric supplier, they will be on the "hourly rate" by ComEd. This means that the rate will change by the hour and you will not know what the electric bill will be from month to month. If the Association goes with a 3rd party supplier they can lock in rates. It is a great time for that since rates are at the lowest level since 2006.

Gas-Gas rates change monthly unless a 3rd party supplier is selected. Using a 3rd party supplier and fixing your rate will make the budgeting process much easier since you will be able to predict based on average monthly usage in previous years. What is the industry predicting for 2011?

Salaries and Wages-Due to the economy, we are seeing wages as flat or even reducing in many industries. Increases are much more modest than in past years. 2-3% increases are considered to be a very good even for your veteran offensive line.

Reserves (Long Term Player Development)

Having a Reserve Study is an essential element for any association regardless of size. Without a reserve study it is like not having a quarterback for your team. The reserve study is like your action plan. It will help you plan as your building needs replacements. Most reserve studies will also give you suggested long term maintenance. If you do the maintenance it will prolong the useful lives of your building components.

I have been asked many times for a rule of thumb for how much to have in Reserve Funds. Some say 3-6 months of assessments. The reason that question is difficult to answer is because every building is unique. Buildings were built at different dates and replacements have happened at different times for different buildings. If you were trying to predict how much the medical costs for your linemen were versus another team you would want to take into account the age of each team member and if any have serious medical problems, such as diabetes or cancer. It is the same with predicting the cost for a building. It depends on how old it is, when items were last replaced, whether it is brick or metal exterior, if they use a boiler or gas furnace. There are too many variables to have a rule of thumb.

With all that said, FNMA and the FHA for mortgages require that 10% of your budget must be for additions to your Reserve. For example if your total annual assessments are \$500,000 then your Reserve contribution for that year should be greater than \$50,000.

You will need to strike a delicate balance also with Reserve contributions. Too much and you will push more unit owners into delinquent status. Not enough and

you will need special assessments and or loans to make necessary replacements as they come due. Special assessments can also push unit owners into delinquency.

There are no magic answers. Most Association Boards we see are doing what they feel is most beneficial for their unit owners. What I can tell you is you need to analyze each and every expense category to come up with an accurate budget. If the expenses add up to amounts that are too much of an increase in assessments for the coming year then you will need to go back to the drawing board and decide which projects can be postponed and to be more aggressive in getting alternative bids for services and repairs to be performed in the coming year.

Making the final touchdown to win the game is not easy. As with football, budgeting requires in depth planning and discipline to follow your plan, even in difficult times.