Budgeting 101: Budgets in the 21st Century

By Sue Nelson, CCAM®

WHAT IS A BUDGET? The budget is: 1) a prediction, using the best information that we have at the time, of how much money an HOA will need to cover the association's outflow of funds for the upcoming year; and 2) a tool to calculate the new year's HOA fees. What is not a budget? It is not an iron-clad set of constraints; it is an estimate of what the HOA will need. This article addresses the nuts-and-bolts of the process and will not review the *Civil Code*; the assumption is that the reader is well-versed in the statutory requirements.

The first step is pre-budget preparation. You should begin by coding this year's income and expenses to the correct lines. Some managers try to make the actual expenses match the budget —if an expense will throw that line over budget, they will mask it by reclassifying it to another category. Do not do this. It perpetuates budgeting errors year after year. Instead, code expenses where they belong, even if it goes over budget. After all, the budget is a prediction; the actual expenses are the reality.

About six months into the year, the board should have the reserve study started—a site visit every three years and professional updates on the two off-years. Many reserve study companies will give a discount if the HOA gives them two or three months to complete the study. If you wait until the last minute and want a rush, your HOA will pay a premium for procrastinating.

Keep any notes about proposed budget changes in a file. About eight months into the year, it's time to dust off your Excel skills. Set up your budget like this:

XYZ HOA Budget	2009 Budget Monthly	2008 Actual 7 MO AV	2007 Actual 12 MO AV	2006 Actual 12 MO AV	2008 Budget Monthly	Budget Change2009 Unit/Month
Follow with Income & Expense Categories Underneath						

Each year, build on this form and add the next year's information to have a true historical picture of budgets and actual data.

In formulating the new budget, first and foremost, skip the cell for the HOA fees —that's for later. For the rest of the receipts and disbursements, look at the three columns of actual expenses and estimate from there. Of course, take into consideration known changes, like utility increases or insurance or contract changes, and any new items that your board is anticipating. It is important to budget as close as possible to what you expect the actual expenses of the new year to be—without being overly optimistic.

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OTHER CONSIDERATIONS IN YOUR BUDGET ARE:

- **Bad debt expense.** Review your current delinquencies. If you have serious delinquency problems that you anticipate will continue, budget for it.
- **Contingency.** This is where you get the cushion for unplanned expenses or for planned expense(s) that have increased more than have been budgeted.
- **Taxes.** If your non-member income (like interest income) is higher this year, you need to budget more for taxes next year.
- **Expenses that don't occur every year**. Examples are five-year elevator load, fire system tests or the reserve study site visit every three years.
- **Prior year's loss/gain.** Calculate one month's HOA fees minus the monthly reserve transfer. If the HOA has less than that amount in the operating fund (including operating cash, prepaid insurance and collectable accounts receivable minus operating liabilities), then add a budget line to increase your operating cash by the difference. Conversely, if the HOA has substantially more than that amount in the operating fund, add a budget line to reduce operating cash by the difference.
- **Insurance deductible**. Some lenders are now requiring that HOAs have adequate cash to pay insurance deductibles.
- **Loans.** Budget for both the interest (expense) and principal pay down (reduction of the liability).
- **Legal.** Expenses may be updating governing documents? Lawsuits?
- **Board education.** Encourage the board members to take the CAI Essentials Workshop—It could be the best spent money in the budget.
- **Annual costs not yet incurred this year.** Examples are bonuses, fire extinguisher recharge, pool or elevator licenses.
- **Staffing.** This includes changes in levels of staffing or changes in pay/benefits.
- **Insurance.** Check with your agent to get a sense of next year's premiums; be sure to factor in finance charges, if any.
- **Utilities**. Check with the utility providers; also, take into consideration if the current year's utilities were affected by weather that was unseasonably hot, cold, wet or dry.
- **Reserve transfers.** Look to your approved reserve study.
- **Reserve interest.** If shown as a receipt, be sure to back it out with the reserve transfer, as the reserve interest is not to be used to offset operating expenses.

After all of the new budget amounts are entered into the cells, take a look at the bottom line variance between receipts and disbursements. This is the amount that you will need

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for your HOA fees, and it should be entered in the empty cell at the top of the second column. Hopefully this amount is under the 20% statutory requirement. If not, you'll have to go back through to see where to cut or go to the membership for a vote to approve.

COMMON ERRORS

- Some boards do not want an HOA assessment increase and tell their managers to make the budget fit. This is a common but glaring mistake, as it doesn't address the reality of the expenses and almost always results in HOA fees that are inadequate. If the HOA fees are not high enough and there isn't enough operating cash, what happens? Usually, reserves are underfunded and/or maintenance is deferred, which results in higher costs somewhere down the line.
- Funding reserves less than the amount recommended in the reserve study. We've all heard board members say they don't want to make future owners rich with their reserve contributions Suffice it to say, for example, that if all of the reserve components in the community had a ten-year useful life, then every year the owners should be putting 1/10th of the replacement cost into reserves. Those who received the benefit of the use need to pay for the replacement. Underfunding reserves gives present and past owners a break and makes future owners pay more than their fair share.
- Calling interest income part of the reserve transfer. Most reserve studies calculate the reserve transfer as an amount over and above the reserve interest, not inclusive of the interest

In summary, effective budgeting is a combination of skill and research combined with art and science. The board has a fiduciary duty to the membership to budget adequately for anticipated costs and proper reserve transfers. With historical data and logical reasoning, you can make the best possible predictions of future expenses and end up with the most accurate budget for your HOA.

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