Top 12 Budgeting Mistakes *(Part II of the Budgeting Series)*

by Sue Nelson, CCAM®

One of the board's fiduciary duties is to budget realistically and assess HOA fees that will cover the anticipated expenses of the association. Many boards get caught up in the desire to keep HOA fees as low as possible, often unrealistically low. However, this is often to the detriment of the association that they are obligated to guide down a fiscally-responsible path.

Numerous pitfalls and landmines in the budgeting process have the potential to wreak financial havoc for your HOA in the long run. Some of the most common mistakes are listed below:

1. The budgeting process is done backwards. The board decides not to raise the dues (or to raise them "x" dollars or "x" percent) and tells the manager to make the budget work. This often results in HOA fees that cannot support the actual expenses and recommended reserve transfers. The proper way to determine HOA fees is to calculate anticipated expenses first: expenses + reserve transfer - other income = HOA fees.

2. Not raising dues higher than the neighboring HOAs' dues. Budgets need to reflect your association's needs, not the neighbors' budget (who may be making budgeting mistakes).

3. Underbudgeting reserve transfers. If the reserves are less than 100% funded, prior reserve transfers were too low and owners in the past did not contribute their fair share. If next year's reserves are funded at a level lower than recommended, this underfunding will be prolonged, and owners in the future will have to pay even more to catch up.

4. For HOAs with variable dues – not using the HOA fee calculation in the CC&Rs. Often CC&Rs have a formula whereby expenses such as gas, water, water heaters, paint, and insurance are split according to square footage and other costs are evenly divided. If this is the case, even if the overall budget doesn't change, the HOA fees will still need to be re-calculated as the allocation between different sizes of units adjusts, resulting in an uneven increase or decrease in dues for the different sized units. However, if you have such a formula, this is the appropriate method to calculate the variable dues, as opposed to raising all units "x" dollars or "x" percent.

5. Using special assessments to mask HOA fee increases. To not increase the dues but add a special assessment to balance the budget masks reality because those same expenses will occur the following year and reserve transfers will more than likely increase, and what do you do then? Special assessments generally should be used for unanticipated or one-time expenses, and not to keep the monthly dues from appearing to increase.

6. Budgeting without reviewing the current cash position. If there is no money in operating, reserve transfers have not been made and/or there is a large accounts payable, then there is a cash problem. Take these issues into account and budget (or special assess) to also pay off the accounts payable, make the past due reserve transfers and increase your operating cash. HOAs get in this position generally because the HOA fees have historically been unrealistically low, delinquencies have skyrocketed, and/or expenses went way up and the budget wasn't adjusted to reflect the new reality.

7. Budgeting unrealistically high income/not budgeting for next year's bad debt. If there are 2 units in bankruptcy right now and 1 unit in foreclosure, you should probably be budgeting for 2-3 units' worth of bad debt contingency for next year. Also, if delinquencies are an issue, then the HOA will most likely not receive all of the late fees, interest and collection costs charged – be realistic.

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8. Not budgeting for an operating contingency (over and above bad debt contingency). This is for unknown and unbudgeted expenses, for instance, the HOA needs added staffing, pays an insurance deductible or is slapped with a lawsuit and needs legal representation. If the HOA has ample operating cash, this may not be an issue as minor overruns can be absorbed, but not so if the HOA's operating cash is low.

9. Budgeting unrealistically low expenses/not taking into consideration infrequent operating expenses. If, for instance, there are active legal issues this year, unless something changes, legal fees will no doubt be high next year also. Wishing and hoping doesn't change reality – budget for what you can realistically expect, not what you hope. And some expenses are infrequent – be sure track when employee bonuses, 5- and 10-year elevator load tests, major tree trimming, fire/life/safety tests, reserve study site visits, etc. are due and budget accordingly.

10. Not taking into consideration delayed utility bills. If the utility bills are marked "delayed" due to meter issues, be sure to budget for the anticipated cost with all meters working – and for the past unbilled amounts.

11. Using tricks with the reserves. Some boards reduce the transfer by the amount of interest earned – this shorts the reserves. Some boards do their own studies in order to reduce the reserve transfer – this is typically not advisable on many levels. Some HOAs try to keep operating costs lower by paying repair costs from reserves with the justification that the repairs extend the life of the components – this is generally not advisable. Also, most CPAs advise that taxes on reserve interest should be paid from operating, not from reserves.

12. Using reserves to pay off loans. Unless built into the reserve study, payments on loan principal and interest should be over and above the reserve transfer. If an HOA uses reserve money to pay off a loan, the HOA will most likely need another loan or a special assessment when the loan is paid off in order to pay back the reserve deficiency that was created.

By avoiding these pitfalls, you should be able to craft a budget that is realistic, transparent and that properly addresses the association's needs.

Sue Nelson is co-owner of Horizon Management Company in Torrance. She can be reached at sue@horizonmgmt.com.