



FirstService
RESIDENTIAL

8 Secrets to A Better Association Budget Process

Unlock the
mysteries
behind
successful
financial
management.

In this guide, we'll let you in on some of the secrets to decoding your community's budget process. We'll outline how your budget should be created and managed, starting with short and long-term goals, assessing where your community is now and where you want it to be in the future. This starting point is important because your board's decisions will certainly impact the financial circumstances you may find yourself in.

When your board sets out to draft a budget, it can seem like putting together a Rubik's Cube. How do you balance your community's needs and wishes? Do you know what items to plan for and when? Most of all, are you confident there's enough money to cover planned *and* unplanned expenses?

We'll also review the benefits of conducting reserve studies, outline the components and considerations of both short- and long-term budget planning, along with steps boards should take to make informed decisions.

The successful development and management of your community's budget depend on two important things: board alignment and resident buy-in. Throughout this guide, we'll detail how to achieve both! Finally, we'll uncover what you should not only look for — but expect — in terms of property management support.

Some of these best practices may not seem so mysterious since many are important association budget planning elements. The real secret is working with an experienced property management company that truly understands their importance and firmly embeds them into its process. FirstService Residential, by virtue of our Texas-sized expertise and resources, is uniquely qualified to speak to these practices because they make up the very DNA of the overall budgeting process. We deliver on them. Consistently. No matter the market or property type.



Short- and Long-Term Financial Plans: Why you need both

Budgets are the foundation of your community's financial management and operation. It's a tool that enables you to estimate your expenses and revenues, and helps you measure and monitor your association's financial activities.

They also greatly help board members gauge their spending, foster sound decision-making and serve as a tool for establishing adequate assessments. Some associations don't recognize that having a longer-term budget plan (3-5-10 years) is just as important as having a short-term (1-2 year) budget.

By identifying and planning your community's needs, your association can defend itself against unexpected costs while continuing to move the community in the right direction.

SECRET #1:

By developing a long-term budget, you'll:

- ▶ Avoid financial surprises, uncertainty and special assessments.
- ▶ Maintain and improve your community cost-effectively over time.
- ▶ Proactively address resident concerns, expectations and an understanding of their community's financials.

Budget Planning Components

There are three main components of the budget planning process: operating costs, a reserve fund/reserve study and revenue.

1. Operating Costs

These include “line items” or expenses that are necessary to keep your association functioning. **For a quick reference, they’re typically categorized into several groups, including:**

- » **Contractual expenses:** These are line items your association is required by law or contract to pay. Funds should be allocated to these line items first.
- » **Taxes:** Consider what your association might owe in taxes and include non-assessment revenues, such as interest earnings, income from the sale of goods and services, facility rental income, payroll, real estate and personal property taxes (for associations with vehicles).
- » **Administrative:** Money paid for professional services like bookkeepers, reserve specialists, attorneys, etc., should be accounted for. Other administrative costs to consider are subscriptions, banking fees, professional member organization dues and event registration fees.
- » **Insurance:** Associations need property and liability insurance. If your community’s insurance needs auditing, ask your management company to conduct one to ensure your protection (coverage levels and endorsements). We have vast resources to assist you with this.
- » **Utilities:** Make sure your electricity and water budget is based on last year’s average consumption (kilowatts and gallons) instead of how much you paid because rates fluctuate regularly.
- » **Maintenance:** Money allocated for maintenance is earmarked for the upkeep of common-area components. This category should be at the top of your line items because maintaining or improving your community’s physical property is one of your board’s main responsibilities. Another factor you should consider is when and how often maintenance must be performed on your community’s assets. Developing a maintenance schedule will help with this task.
- » **Overhead:** Represents business costs and should include rent, office equipment and supplies, office cleaning services, furniture, phone and internet service, and postage.
- » **Contingency funds:** Allocated for unexpected or overlooked expenses, such as higher-than-projected water leak damage costs, hidden mold, a lawsuit, etc.
- » **Capital improvements:** These are large, expensive projects such as a new community feature that sometimes require residents’ approval (your governing documents will dictate this). Determine the amount needed, if you have the essential funds and whether a special assessment is necessary.
- » **Debt:** Delinquencies or any money owed that’s unlikely to be paid should be estimated and factored into your budget.
- » **Vendor/Contractor services:** May include landscaping, snow removal, painting, pest control, trash removal, window cleaning, pool maintenance, mechanical/technological systems, laundry services, etc.
- » **Transportation:** Be sure to allocate for car leases, fuel, insurance, inspections, registration and maintenance.

SECRET #2:

A good property management company will be able to leverage its purchasing power to negotiate contracts with vendors on your behalf.

2. Reserve Fund/Reserve Study

Your reserve fund is a budgetary component designed to grow over time and pay for big-ticket items, like new community features. Its annual funding contribution is determined by a reserve study, which is a comprehensive analysis of the current condition of your community's assets and replacement costs. Your reserve fund and reserve study are essential undertakings that ensure your association's short- and long-term financial health.

3. Revenue

The primary source of revenue for most associations is regular assessments. One of the main reasons your association establishes a budget is to determine the amount of the annual assessment. Your community's governing documents will outline the payment frequency (monthly, quarterly or yearly) and how the assessment should be allocated to your community's units (divided equally or on an ownership basis). **Other revenue sources that can help augment regular assessments:**

- » Interest from investment accounts.
- » Fees for advertising or sponsorships.
- » Leased units, parking spaces and storage facilities.
- » Recreational facility memberships.
- » Miscellaneous fees (lost keys, guest parking, insufficient funds, etc.).

The last source of revenue at your disposal is a special assessment — an extra fee charged to residents when reserve funds are insufficient. **There are several reasons why your association may need to impose a special assessment:**

- » Unanticipated repairs caused by natural disasters that your insurance does cover.
- » Community assets that need to be replaced or upgraded.
- » New amenities.
- » A deficit resulting from residents defaulting on regular assessments.
- » Failure to accurately calculate monthly expenses.

Because they cover special needs instead of day-to-day expenses, special assessments happen on an “as-needed” basis. As a board member, the goal for you is to avoid special assessments as much as possible, given the financial strain it can cause residents. Consider opening a line of credit as an alternative.

Jack Boselli, president of FirstService Residential in Pennsylvania, shares this perspective: “I think one of the biggest components that drives a special assessment is really the reserve fund and the reserve fund balance. From my experience, what we've seen is that the biggest reasons for special assessments — except for maybe insurance — is that reserves have been underfunded.”

SECRET #3:

It's better to increase annual assessments annually and minimally — keeping in step with inflation (2% to 5% per year) as opposed to increasing assessments every several years by larger amounts (10% to 15%). The goal is to spread increases out over the time of ownership.

Budget Planning Considerations

As you embark on the budget planning process, remember that the decisions you make should be informed ones — meaning you should consider a number of factors that may impact the amount of money flowing in and out of your association.

First, it is important to review trends in costs over time. This can be accomplished by conducting an expense-to-budget analysis to identify areas where costs and revenues have been steadily increasing or decreasing.

“One thing we implemented last year during the pandemic was to perform a monthly analysis of trends to see where there was emerging change,” said Bobet Bennett, senior vice president for financial services at FirstService Residential. “For example, if over a 30-day period, 10% of an association’s population pays their monthly fees late, then over the next 30 days you see that number going up to 20% — that’s an indicator you need to pay closer attention to that issue.”

The next step is to look forward to projected increases/decreases in revenue and expenses. Speak with contractors and utility providers about anticipated rate changes and consider how the economy is performing, too. Is unemployment rising? Are interest rates falling? Is inflation a concern?

Your reserve study should also be closely reviewed to ensure that you’re on target with funding your reserves as community replacement and enhancement projects draw nearer or are added.

The budgetary decisions you make must also weigh how residents will be affected. When did you last increase the number of regular assessments? By how much and why? Have you had to make special assessments in recent years? Be aware that residents will have a clear memory of recent price hikes and their reasons, so be mindful of how they will be affected as you move through the process. Also, consider the makeup of your community.

“Seniors, for example, may only want to look at plans that go five rather than 15 years out, said Isadora Goh, director of finance with FirstService Financial. “Similarly, owner-occupants tend to be more vested in longer-term community expenditures whereas owners that rent might not be as committed to the upkeep of their properties for the next 10-20 years. They are just looking at what income they’re going to receive in the current year. I think it comes down to balancing the demographics of the ownership.”

SECRET #4:

Start your budget process with a kickoff meeting six months in advance of the budget taking effect. It’s important to honor the time that’s required to budget properly.

How to Prepare for the Budgeting Process

The key to your budgeting success is upfront planning. If you gather the data, documents and insights you need early on, you'll see greater efficiency and experience fewer pain points.

Identify goals and objectives. Ideally, the budgeting process should begin with a goal-setting meeting attended by your board, property manager and committee chairs. The meeting's objective is to determine what expenses must be covered by the association for the budget's allotted timeframe and what costs might be covered to please residents and enhance the community. Consider whether the community demographics have shifted to warrant changes, think about what assets might be due for an upgrade and if the complaints you get tend to revolve around the same issue(s).

Create a budgeting schedule. Your governing documents likely outline when budgets must be shared with association members and when approvals must be secured. Simply work backward from the start of your upcoming fiscal year, allowing time for each step in the budgeting process (see chart below). Eventually, you will land on when you should begin.

Review governing documents. Your association's governing documents will offer detailed guidance on assessment payments and increases, reserve contribution amounts, whether the budget must be presented to and/or ratified by residents, etc.

Examine previous budgets. This exercise helps spot line items that are consistently over or under budget. And while you review them, think about line items that could

be eliminated or added. Past budgets are a good starting point but don't depend on them exclusively.

Review financial statements. These documents should be provided to you by your property management company and include your association's income statement, the statement of cash flows and balance sheets.

Investigate legal requirements. These vary from state to state and are constantly changing, which is why it is important to refresh yourself with your association's legal obligations — especially as they relate to conducting reserve studies and establishing or maintaining reserve accounts.

Conduct a community survey. Involve residents in the budget planning process by formally asking them to prioritize additions and improvements to the community, such as a dog park, better street lighting, speed bumps and landscaping. The results of the survey will help you, in turn, prioritize items under consideration and incorporate them into the budget.

Consider establishing a finance committee. A smart way to divide and conquer the budgeting process tasks is by forming a finance committee comprised of association members who are not currently serving on your board. This committee would be responsible for many of the activities listed above, including drafting the budget and presenting it to the board and residents. This committee could also monitor the budget and the association's various financial activities throughout the year.

SECRET #5:

A great way to foster a better understanding of financial matters within your community and secure budget buy-in from your residents is by forming a finance committee comprised of association members who are not active board members.



Budgeting Success Hinges on Two Things: Reserve Funds & Reserve Study

Consistently funding reserves over time will go a long way to protecting the fiscal health of your community. However, it can be challenging for boards to identify all the items that will eventually need funding, when those items will be developed, upgraded or replaced, and how much it will cost.

One of the primary advantages of establishing and maintaining reserves is that it is an equitable way to ensure all residents who are using and enjoying community assets while those assets are fully functioning participate in their costs.

Without reserve funds, only those living in your community at the time an asset needs to be replaced will have to shoulder the burden of replacement costs via a special assessment. What's more, reserves will give your association members peace of mind knowing the money will be there when it is needed. The market value of

properties within a community is better preserved when reserves exist to support its shared assets.

The importance of conducting a reserve study cannot be overstated. It is the crux upon which sound budgets are built. The study assesses the condition of significant, shared assets within a community (like pools, irrigation systems and roadways) and provides a financial analysis of future replacement costs, including a recommended dollar amount the association should contribute to its reserve fund each year.

Your governing documents will outline for you if a reserve fund must be created and how you should maintain it over time. They should also dictate the procedures you should follow for funding your reserves and whether it can be delayed or bypassed altogether if consensus among most of your residents is achieved.

SECRET #6:

Remember, reserve funds cannot be used to fund a capital improvement unless the capital improvement was identified as one of the inventory items for which the reserve fund was established.

Maintenance or Reserve Components?

A tricky aspect of managing your reserves is determining how to categorize your community's common area components. Some will require ongoing maintenance, others will need eventual replacement, and still, others will need both. Your association must allocate for maintenance each year so community components will last until the time they are due to be replaced.

Failing to do so could result in replacing them long before the reserve study's replacement due date, resulting in a possible special assessment. At the same time, you must make a reserve contribution each year to be prepared for replacement costs.

The decisions you make around whether items are maintenance vs. replacement (or both) will ultimately determine whether they will be listed in your yearly operating budget or in your reserve inventory.

Generally speaking, less expensive items tend to land in the operating budget, and higher-priced items are usually assigned as reserve components so their replacement costs can be financed over a longer period.

Plus, it is becoming increasingly common for associations to begin addressing infrastructure components as part of their budget planning process — especially for communities that are decades old. Infrastructure components are generally out-of-sight, such as stormwater systems and sewers, and last a very long time (some as long as 50 years). As such, they are often not thought of until they begin deteriorating or failing. It's a good rule of thumb to consider adding infrastructure items to your regular list of reserve components when they reach the halfway mark of their expected life spans.

SECRET #7:

Keep an eye out for duplicate items that end up on both your reserve inventory and your operating budget. These are usually items that can be replaced at relatively low price points (such as fences and sidewalks). If you find a duplicate entry, simply assign it only to the budget category that makes the most sense. Seek the advice of an advisor if you need help.



Who should conduct your reserve study, why and how often?

We strongly suggest that your association's reserve study be conducted by a third-party professional such as a reserve specialist. These professionals have a solid working knowledge of your state requirements about reserve funds and studies and a thorough understanding of the components that should be considered and when they should be added to your reserve inventory. They will also offer your board an unbiased voice to your budgeting process. FirstService Residential can help you identify a reserve specialist in your area.

Finally, keep in mind that your reserve study is a living, breathing document that should be regularly reviewed and updated. But treat it as a guide, not gospel.

“Just because your reserve study says you need to replaster your pool in 2022, doesn't mean you have to. Check with your pool vendor and have him give you an opinion as to whether it really needs to be replastered in 2022 or if you can push it to 2023,” said Tina McWilliams, senior community manager with FirstService Residential.

In the early years, reserve study updates are recommended every three years. After a decade of existence, communities should consider updates every other year and detailed reviews of the study should occur annually. Again, your state may dictate the cadence schedule of reserve studies/updates. Consult your property manager for assistance.



Budget Communication Essentials

You and your fellow board members play an important role in making the budget process a smooth one. The first step is to achieve alignment within your board as to where and how money is allocated. If there are disagreements between members, it will hamper your ability to achieve consensus outside of the board in getting your budget ratified. So, begin from within.

Next, you must secure buy-in among your residents. This begins by soliciting their opinions and ideas via the residents' survey at the start of the process. After your budget has been drafted, consider holding a town hall with residents to review it. Include several board members in the presentation or, better yet, have your finance committee present part of it to demonstrate that the budget was developed by residents of the community who are not currently serving on the board.

"If at all possible, take several board or finance committee members and have them own different parts of the meeting. Avoid a one-person presentation, especially if there's bad news to deliver, as it can unfairly foster a mob mentality against the messenger," added Christina Forbes, senior vice president at First Service Residential.

You should also consider bringing in subject matter experts to address your budget's specific areas, such as an insurance agent or reserve specialist. "We like to promote that we have guest speakers — experts in their fields who will come and present at meetings as part of the budget approval or project funding. There they can address questions from the entire ownership and help residents better understand what money is going where," said Goh.

Forbes added, "We like to use visuals. Pie charts are especially helpful because they clearly illustrate for residents the number of fixed expenses versus variable expenses — the costs you have to take on no matter what and the 20 percent where there's some wiggle room."

Also, look at all the communication vehicles available to you and make good use of them. Trying to justify a big budget increase in a



8 Secrets to a Better Association Budget Process

letter or email is no substitute for holding an information session where concerns can be addressed in person or via virtual meeting in real-time.

“We anticipate the questions that we think the membership is going to ask and then communicate the answers through several different communication channels,” said Lauren Starner, regional director with FirstService Residential. “I know personally, if I get mail, I often put it directly in the trash or don’t spend much time reading it. The same thing goes for other people with emails and attending meetings. So, we look at all available channels of communication in a particular community, and we use as many of them as possible.”

Bennet explains further, “Some of the more successful budget meetings I’ve attended were the ones where board members were able to make price increases relatable by breaking them down. I’ve actually heard board members say, ‘Think about your personal expenses, like your utility bills. If they are going up for you, they are going up for us and the rest of our community too.’ It’s about articulating financials by putting them back into layman’s terms, rather than using the technical terms of association budget management.”

SECRET #8:

It’s always a good practice for board members to think about their own personal expenses and relate them back to what residents are experiencing. By helping them understand that your board is affected by price increases too, your residents will be more accepting.



Property Management Company Support: What boards should expect

The type and degree of budgetary support associations receive from their property management company depends on the community, its size, and frankly, the depth of expertise and resources the property management company offers. FirstService Residential is the only property management firm that consistently puts these “secrets” into effective association budget management. The fact is, we execute against them each day. We understand the complexities inherent to financial planning for a community and have the staff’s expertise to assist you with budget preparation every step of the way.

Some of the budget planning deliverables we routinely provide include:

- » Regular, thorough financial reporting. Analysis of budgetary discrepancies.
- » A budget checklist outlining the necessary steps and resources.
- » Assistance with fostering alignment and process buy-in among board members and residents.
- » Ongoing guidance such as creating a yearly maintenance calendar and offering insights on handling things beyond your control (i.e. fire code changes).

At FirstService Residential, the budget process varies from state to state and region to region. However, more often than not, we are at the forefront of budget development for many of our properties, oftentimes completing 95% of our associations’ budgets utilizing our in-house resources and experts and leaving the remaining 5% for the boards to flush out.

“In the New York market, a majority of the operating budgets are prepared by our Finance Department,” said Forbes. “We generate a master schedule which states when the property manager can expect to receive a draft. Approximately one week after the property manager receives it and has provided comments, the budget is then sent to the board or finance committee.”

Forbes added, “The timing really depends on the board, but the goal is to encourage approval no later than 45 days before the effective date of the budget to allow time to prepare the communication to the owners and to update the billing statements. Starnier shares a similar process: “FirstService Residential’s management facilitates the creation of the initial budget for our properties and it is reviewed with the board/finance committee for final input and approval.” She further explains, “In Nevada, our budget process begins as early as July and concludes in November or December with the annual ratification of the owners.”

8 Secrets to a Better Association Budget Process

Throughout the budget development process, your property management company should direct the steps that should be taken, provide the items that should be reviewed and considered and share best practices that will create the best possible budgetary outcomes. At FirstService Residential, we not only deliver these services, we do so with excellence. And by virtue of our size and scale, we can also share our buying power with the communities we manage to extend significant time and cost savings.

Even if your community's budget may be developed in large part by an experienced property management company like FirstService Residential, the actual responsibility for it falls squarely with the board. As a board member, you are responsible for unlocking the mysteries behind the budget planning process, understanding what your property management company is doing, and how and why it is doing it relative to your community's finances. Then you must carefully examine, adhere to, and oversee your association's budget. Hopefully, some of the secrets you've learned in this guide will help.



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Contact FirstService Residential today to learn more about the secrets to managing your association's budget process more effectively.





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About FirstService Residential

FirstService Residential is North America's property management leader, partnering with 8,500 communities across the U.S. and Canada. HOAs, community associations, condos and strata corporations rely on our extensive experience, resources and local expertise to maximize their property values and enhance their residents' lifestyles. Dedicated to making a difference, every day, we go above and beyond to deliver exceptional service.

FirstService Residential is a subsidiary of FirstService Corporation (FSV), a North American leader in the property services sector. Find out how we can help your community thrive. Visit www.fsresidential.com.

