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Budgeting for Community Associations

MULCAHY

Community Association Cheat Sheet©

BRINGING ANSWERS TO COMMUNITY ASSOCIATIONS

This publication discusses significant points of law as they apply to community associations and is not intended to offer specific legal advice or responses to individual circumstances or problems.

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THE COMMUNITY ASSOCIATION BUDGET PROCESS

A community association budget is an itemized summary based on the anticipated income and expenses for each fiscal year. Most community association documents require that the board of directors adopt a budget for each fiscal year. Most associations' fiscal year is the calendar, and thus, the board will start work on the budget in the late summer/early fall. Each association should check its governing documents to determine the requirements for preparing the annual budget and whether the members are required to participate in the budgeting procedure, or whether the board is solely responsible for preparing and approving the budget.

WHO PREPARES THE BUDGET

If the association is managed by a management company, the management company typically prepares the budget for board approval since the management company typically pays the bills for the association and has the back-up information from which the budget is prepared. However, the treasurer, an association's finance committee or a special budget committee can also assist the board with that process. In a self-managed association, the treasurer and budget/finance committee typically complete the budgeting process. Whether the manager, an officer of the association, or a committee is responsible for developing the budget, it takes time and planning to complete the process.

STEPS TO COMPLETE THE BUDGETING PROCESS

The budgeting process begins by reviewing the association documents to determine whether there are any specific requirements for preparing the budget. A good rule of thumb is to have the budget completed and ready for approval at least 45 days prior to date required by the association documents, or by the beginning of the fiscal year, if no date is stated in the association documents. Typically, if the association's fiscal year is the calendar year, the budget should be ready for approval at the November regular board meeting.

1. Review last year's budget and records and compare the differences between what was budgeted and what was actually spent. Review each line item in the budget. Is there a difference between what was budgeted and what was expended? Determine reasons for any differences?

2. Evaluate the needs of the community for the upcoming year. Does the annual assessment need to be raised because of an increase in delinquencies and increased costs of operating the association? Is it anticipated that the board will need to make new expenditures that will benefit the community? Do estimated expenses exceed estimated revenue?

3. Assess the needs of the community for the future. What long term or capital projects need to be addressed in the reserve budget? When was the last reserve study conducted? Considering increases in the operating expenses, should a new reserve study be conducted? Does a larger percentage of the annual assessment need to be directed to the reserve budget?

4. Ask questions of the association's vendors. Are there potential cost increases or added services a vendor might deem necessary for the association? Are proposed cost increases necessary?

5. Review and analyze the association's contracts. Are there changes in services that may require an increase or decrease in the contract amount? Is the association required to obtain three bids from outside vendors to determine value received? Should existing contracts be put out to bid with other vendors?

6. Receive and analyze information obtained from the vendors to determine the amount to be included in the budget.

7. Plan for the unexpected and miscellaneous expenses. While the Board should not expect surprises, it is prudent to include a line item for contingencies, which would include unanticipated expenses.

8. Budget the amount to be placed in each line item after concluding the research.

9. Analyze estimated expenses. If expenses exceed estimated revenue, then the board needs to decide whether to reduce expenses, increase assessments or impose a special assessment.

Present the Budget/Adoption process

The budget should be reviewed and approved by the board of directors. If required in the association documents, the homeowners would then approve the budget once adopted by the board.

1. Present backup information on how the line items were determined and how estimates were obtained.
2. Provide accurate and simple information that is easily understood.
3. Discuss the most important line items, i.e., those items in which the membership is most interested.
4. Address trends that will help show the future of the association's expenditures.
5. Be open and ready to answer all questions.

Planned Community Budget: In a planned community the budget must be adopted by the board, but there is no requirement in the Planned Community Act mandating that the budget be approved by the membership. While the association documents could require membership approval, it is the experience of this firm that this requirement would be unusual.

Condominium Budget: The Arizona Condominium Act (A.R.S. Section 33-1243) requires that the board of directors provide (typically by mail) a summary of the proposed condominium budget to all unit owners within 30 days after adoption. The unit owners are required to ratify the budget or any amendments to the budget, unless the board of directors is expressly authorized in the declaration to adopt and amend budgets. If ratification is required, the board of directors is required to notice a meeting of the unit owners (not less than 14 nor more than 30 days after mailing the summary) to ratify the budget. The budget is ratified whether or not a quorum is present, unless a majority or any larger vote of the unit owners as specified in the declaration rejects it at that meeting. If the proposed budget is rejected, the budget that was previously ratified by the unit owners will continue to be in effect until the unit owners subsequently ratify the budget proposed by the board of directors. Note that there is no requirement of membership approval if the declaration expressly states that the unit owners' approval is not necessary.

Operations and Reserves

The association budget should consist of an operating and a reserve budget. The operating budget consists of the usual and customary expenses incurred by the association on a regular basis, such as management fees, landscape (and pool) maintenance, insurance, legal fees, water, social programs, etc. The reserve budget consists of those funds necessary for large capital expenditures such as painting, paving private streets, roofs (if required in the declaration), common area improvements, etc. Both operating and reserve needs should be addressed annually and budgeted appropriately.

The budget consists of various line items reflecting the anticipated income from assessments, special assessments, late charges, fines and penalties, interest income and reimbursements for attorney fees and costs incurred by the association in enforcing the association documents. In addition to the line items reflecting various sources of income, the budget will include the anticipated expenses for the next fiscal year. The association documents usually set out the association's responsibilities and the costs of all of these expenses should be reflected in the budget. This would include recurring repairs, utilities, landscaping, pool maintenance, maintenance of private streets and/or parking areas, gate maintenance if the community has controlled access, management fees, legal and accounting expenses, etc.

Reserve Study and Funding

It is best practices for a board to plan for and have a reserve study completed and updated every 3-5 years depending upon the extent of the capital items in the planned community for which the association is responsible. The costs of the reserve study would be reflected in the operating budget. The reserve account should be adequately funded in accordance with the study. A reserve fund: 1. provides for the planned replacement of major community assets; 2. distributes the monetary contributions of old and new owners; 3. reduces or eliminates special assessments; and 4. enhances the resale value of the homes because reserve funding policies must be disclosed to new purchasers.

The Reserve Study identifies the common area components (like roofs, painting, siding, paving, etc.) for which the association has maintenance responsibility, assigns a useful life and replacement or repair cost to each component, and a long range funding plan so that future maintenance occurs without the need for special assessments. It is the single most important piece of the budget because it provides a long term plan for the board to follow, even though the specific members of the board change with each election. It also helps relieve the board from pressure to not raise fees since "The Reserve Plan" dictates a prudent course of action that considers all owners' interests, not a particular individual's. More importantly, associations with a Reserve Plan are more inclined to maintain the property in accordance with that plan, which has a positive effect on the resale values.

The Treasurer

The community association treasurer is typically responsible for assuring that a draft budget is prepared and reviewed. With a managed association, the duty of drafting the budget is usually delegated by the board to the manager, although it is the board's duty to approve that budget once prepared by the manager. Once management has prepared the draft of the budget, the treasurer will usually review it with the board of directors.