# Condo Insights

**#*36* - Budget preparation for condo and homeowner associations**

This column is an update of column #3 that appeared October 2021.

With less than 3 months until the start of a new year, it's time for condo and homeowner association board members to prepare the operating budget for their association for the coming year. While budget preparation can be a daunting task, a few simple steps can make this an effective and valuable planning exercise.

Budgeting is not a one-size-fits-all exercise. The scope of common elements including the number of floors, amenities, recreational facilities and age of the building and assets all affect annual operating costs. How do you determine how much labor your association will need in the coming year? Are there any anticipated changes to expected and/or required service levels? Are there any upcoming regular or periodic maintenance projects planned for the coming year? Board members should consider all of these factors to develop a meaningful and realistic budget.

The annual operating budget for a homeowner or condominium association is broken down into two major components: income and expenses. Going one step further, the income and expenses are broken down into a few categories. Identifying these categories is the first step to developing an effective budget for your association.

**Income**
For most associations, the primary and most significant source of income includes HOA (homeowner association or condo fees). Also known as maintenance fees, these fees are paid by the association members. Most associations require members to pay monthly or quarterly.

Associations also generate non-fee income from other sources such as leases, easements, commissions, capital contributions, amenity usage fees and resale transaction fees. Every little bit helps.

**Expenses**
These are the primary expense categories in the annual operating budget for an association: insurance, operating expenses, utilities, administration, and the reserve contribution.

For many associations, insurance has now become the single largest expense category. An association typically will have insurance policies for: property protection, liability protection, coverage for board members, flood insurance, fidelity and crime, workers compensation and perhaps an umbrella liability policy. Insurance is often the single largest expense in an association's annual operating budget. The Board's primary objective is NOT to save money but to protect the assets of the community with the best coverage money can buy, within reason.

An entire column can be dedicated to a discussion of insurance, but for budget planning purposes, it's important that board members speak with their agent on a regular basis to stay aware of trends affecting insurance coverages and premiums. Make sure you account for all the policies and premiums when preparing the insurance allowance in the budget. Start at zero and add up the expected premiums for each policy when preparing this budget category. Insurance can often account for 35% of an associations annual budget.

Operating expenses typically include the cost to take care of the day-to-day activity for the association including operation and maintenance of the building, all association common areas, and all association recreational amenities. Factor in the expected and required service levels. Each association may have service contracts for fire protection systems, elevators, domestic water pumps, landscaping, and other similar services. Don't forget to include allowances for general maintenance and custodial and cleaning supplies. If your association has a swimming pool, include opening & closing costs along with in-season operating and chemical costs. Don't forget to include the cost for the pool testing service.
Many associations employ property maintenance services to put out the trash, keep the common areas clean, and handle any maintenance needs.

If your association employs its own staff, don't forget to include payroll, wage taxes and any other forms of compensation for employees.

Many associations fail to include an allowance for recurring non-recurring items, and this leads to underbudgeting. Prudent board members include an allowance in the budget for unexpected operating expenses that arise from time to time. Some operating expense line items such as service contracts are straightforward. Other operating expense line items may require review of recent past year expenses to determine the amount to include in the budget.

Utilities include electric, gas, water, sewer, telephone, internet, and cable tv. Budgeting for these expense line items will require a review of recent past year expenses to determine the amount to include in the budget. Utility expenses are predictable in that they typically follow seasonal peaks and valleys throughout the course of the year. For many associations in Cape May County, utility expenses will be higher during the busier summer months. If available, record and analyze information from the utility bills for the past 24-36 months to identify trends in preparing the utility allowances in the budget. Utilities typically account for 15% of an association's annual operating budget.

Administrative expenses include items such as annual licenses, permits and inspections; postage, copying and meeting expenses; and fees for accountants, lawyers, and engineers. While administrative expenses usually comprise the smallest percent of the annual budget, often around 10-15%, failing to account for these costs can have a significantly adverse effect on the association cash position over time.

The reserve contribution represents funds allocated in the annual operating budget dedicated to long term replacement and maintenance of the association common elements. Many associations have capital reserve studies, component asset schedules or deferred maintenance schedules to identify the items for which the association needs to set aside funds. Smaller associations may perform a similar exercise to list the major items the association has to replace or maintain (such as a roof, HVAC system, swimming pool, parking lot or sidewalks; or painting the building) identify the expected service life and expected replacement cost. Preparing such a schedule over a long-term basis will identify these expected expenses. The total costs can then be allocated over a period of years to develop an annual reserve contribution to support this budget line item. FHA requirements for lending require at least 10% of an association annual operating budget be allocated to long term reserve contributions.

This column just scratches the surface on budget preparation and planning for condominium and homeowner associations but hopefully will be helpful to make sure the budget for your association is realistic and reflects the actual costs to operate your association.

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