

Condo Insights

#47 – New economic realities for southern New Jersey condominium associations

Southern New Jersey condominium associations have experienced unpredictable economic conditions during the past few years. Last year this column identified trends and offered explanations for the current economic environment for community and condominium associations and forecast that seashore condominium associations could expect higher prices for goods & services and as a result, condo fees would increase for the near future.

Across a representative portion of area condominium communities, associations of all types and sizes are experiencing similar budgetary pressures. Components of an association budget that are less controllable such as insurance, reserve contributions, wages and utilities are becoming an increasingly larger percentage of the annual operating budget for most associations. As a result, items an association can control such as operating and administrative expenses have become a smaller percentage of an association's annual operating budget.

Insurance - Insurance is the largest expense for most associations, often between 25% and 35% of the annual budget. Depending on proximity to the water and loss history, some associations are realizing total insurance premiums exceed 50% of their annual budget. Insurance has been in a very hard market in recent years, the result of several factors including: additional and more severe named storms, some insurers pulling out or reducing capacity in coastal markets, some insurers excluding certain types of construction; and increases in the number of claims at condos that have a high percentage of rentals, as is frequently found in shore condominiums. Some insurers are also declining to offer coverage for condominium buildings with significant deferred maintenance, aging infrastructure and older roofs.

Further complicating an already challenging insurance environment, property insurers are requiring updated insurance valuation appraisals because reconstruction costs have increased significantly, therefore the value of property being insured increases. When reconstruction costs increase, the amount of property insurance coverage increases resulting in higher insurance premiums. Double digit percentage increases for property insurance have been the norm for many associations in the past few years. Spikes in windstorm coverage premiums have forced some associations to increase deductibles or forego windstorm and hurricane coverage. The new economic reality includes higher insurance premiums and reduced coverage for coastal condominium associations.

Reserve funding - Condominium associations are required to set aside funds for replacement of assets as part of the annual operating budget. These funds are known as reserve contributions. The amount of annual reserve contributions is determined by qualified engineers that prepare a capital reserve study ("CRS") for the association.

New legislation signed into law in early 2024 ("Structural Integrity Act") requires all condominium associations to conduct regular periodic structural integrity inspections, regular reserve studies and maintain adequate reserve funding. The new law also expands the scope of reserve studies to require additional information related to preventive maintenance schedules including periodic inspections, maintenance schedules, timing and costs.

Prior to this new law, associations were not required to fully fund reserves. Some associations opted to keep condo fees low by underfunding reserve contributions and relying on special assessments to finance asset replacement projects. The new legislation requires that all associations undertake a capital reserve study and include adequate reserve funding in the annual operating budget. The CRS must include a 30-year funding plan to ensure the association has adequate reserve funds available to repair or replace the association's capital assets, common elements and facilities without the need for special assessments or loans (with a few exceptions).

The new economic reality includes mandated periodic structural inspections, mandated current capital reserve studies and increasing reserve contributions to ensure an association has adequate funds available to maintain and replace association assets when and as needed.

Changing labor market - In recent years, especially in the tourism-based areas of Cape May County, the labor market has changed dramatically. These changes have mostly favored the employee and resulted in higher payroll costs for employers. The single largest change is State-mandated increases in minimum hourly pay rates since 2019. These minimum wage mandates result in substantially higher wages for seasonal positions in tourism areas which are mostly filled by students or entry-level service workers.

The long-term effect of this labor-wage spiral is that payroll and related costs won't be going down. When an employer's overall wage costs increase, payroll taxes and worker's compensation insurance premiums also increase. Employers are passing along these increased expenses through increases in the cost of their goods and services. The more an association relies on services provided by seasonal and service workers, the more likely costs will continue to increase.

An additional consideration: transient and seasonal workers need somewhere to live. Real estate values increased significantly, making it attractive for investors. Landlords that used to accommodate seasonal student housing converted to higher revenue short term tourist rentals or sold their properties. Some large employers purchased rooming houses to ensure some of their workers were able to find local housing. Some of the aging housing inventory was demolished and replaced with new, eliminating options for seasonal and service workers. The new economic reality is that the area has far fewer seasonal and year-round rental housing options available compared to pre-pandemic seasons.

Higher operating costs are caused by an inflationary cycle that continues to drive up material and supply costs. Lumber, concrete, building supplies, cleaning products and swimming pool chemicals have increased in price at a rate more than twice that of just a few years ago. Associations need cleaning supplies, pool chemicals and general maintenance materials to operate and maintain their buildings, so use of these products cannot just be eliminated. Associations have to pay close attention to supply usage and cost control efforts.

Administrative costs for licenses, inspections, office supplies and professional fees are also on the rise. Municipalities looking for ways to increase revenues are raising fees for municipal services, increasing inspection fees on Associations and imposing new fees such as transient occupancy taxes on property owners that rent their condos. Professionals such as accountants, attorneys, engineers and property managers serving community associations are also passing along their higher operating costs through increased rates and fees.

The new economic reality for coastal condominium owners is that the cost of ownership is significantly higher now compared to just a few years ago. Associations that have adequately funded their long-term reserves and maintained their facilities and infrastructure are in a significantly better financial position compared to associations that have not.

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