

# OVER VIEW OF BUDGETS AND RESERVES

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Initial Budgets and Reserve Studies are prepared by the developer of a project. In Nevada, there has been no requirement for the developer to prepare a reserve study, but some have minimally estimated some of the items which should be on a reserve study or thrown excess funds into a category called Reserves.

## BUDGETS

The annual operating budget is a formal written plan for the Association expressed in financial terms and is required by Nevada law to be presented to the owners and a formal vote taken to “ratify” the same. The budget should reflect the needs, policies and goals of the Association by expense groupings for a certain period of time, typically a year. It also sets for the plan for funding the costs of those expenses.

### A. Purposes Served by the Budget

1. Sets the expense level for the Association to carry out its functions and the assessment fee level to fund those activities.
2. A method to determine and plan for future needs and requirements and to set specific goals for future operations.
3. A process that forces the Board to study problems, needs, and quality of existing services and activities.
4. A management tool against which performance can be monitored throughout the budget period to help identify adjustments needed.
5. An information and communications tool which provides owners, leaders and management, insight into the Board’s plan for the coming year.

### B. Common Budget Mistakes

1. Failure to conduct adequate research, not only on past performance but on anticipated future needs.
2. Basing the budget on political considerations. (This means that the Board “thinks” that they should just keep assessments low because owners resent increases, board doesn’t believe owners will accept an increase, and board wished to keep the assessment low to protect those on fixed incomes or with inadequate incomes.)

When budgets are prepared and adopted based on political considerations, inadequate service, maintenance and under funding occurs, leading to shortfall, deferred maintenance, inadequate and unresponsive contractors, and less than adequate staff.

### Steps in Preparing the Budget

1. Determine Needs – Review the legal documents to determine what has to be done, such as: 1) Maintain the common property, 2) Provide Insurance, 3) Replace and repair facilities and equipment, and 4) Delineate those items that need to be done in order to fulfill the legal obligations, i.e., establish a process for funding replacement such as reserve items or acquire landscape supplies and equipment.
2. Set Goals and Objectives Regarding the Level of Service Desired – For each required service or activity, set the standard of performance desired. For instance, determine what level of roving patrol, courtesy staff for minimal protection or the appearance of the lawns is desired. Is this an upscale community or one that is just getting by and it looks like it.
3. Determine Additional Services or Activities Desired and Set Levels of Service. – Many Associations carry out activities and programs and offer services to help develop a sense of community which are not “required” under their legal documents, but which have cost implications, such as newsletters, recreational programs, social activities, etc.
4. Setting Goals and Standards – In examining the current goals and objectives, the Board can identify activities which will help them be achieved and help heighten the levels of satisfaction with those activities. Seeking input from Committees, Management and the community through public hearings or surveys will also help the Board determine what levels of services are desired.

5. Formal Evaluation of Current Services and Programs - Questions to be asked to help evaluate the current programs are:
  - a. What are the objectives of the service activity and how well are they being met?
  - b. How well is the party responsible for delivering the service performing in comparison to the goals and objectives set?
  - c. What changes to the goals and objectives need to be made in light of this experience?
  - d. What problems have developed in the process which need to be dealt with?
  
6. Preparing the First Draft - Whoever has the responsibility of preparing the first draft of the budget (Treasurer, Manager, Budget Committee), should consider the following factors:
  - a. The goals and objectives as established
  - b. The required services, level of service and desired services indicated.
  - c. A review of historical operating costs and unit consumption data as well as patterns of extraordinary costs.
  - d. Consideration of proposed or know significant changes to past costs based on rising prices for fees, changing circumstances and workload, and the impact of new goals and objectives. Revisions made to reserves or repair budget based on a physical inspection of the property and revisions to the schedule of work that resulted.
  
7. Review of the First Draft – The key to successful common interest community budget process is the opportunity for community leaders and owners to have involvement in budget decisions. Obviously many of our suggestions will not work for every one, but we are including those processes which have worked successfully for other common interest communities.
  - a. Committee Review – Key leaders form budget and other committee should review and submit recommendations for revisions.
  - b. Public Hearings – The owners should have the chance to participate in a public hearing to discuss budget goals and objectives for the coming year and the preliminary budget drafts. The owners will have a further opportunity for review of the final budget document, however, involvement now may diffuse problems later. This is critical with proposed assessment increased.
  - c. Board of Directors’ Review – The Board of Directors normally has the ultimate responsibility for budget adoption and thus, must assure itself that the document is well researched and substantiated and has had adequate review and input from committees and the community. The Board should assure that the necessary research, assumptions and justifications for levels within the budget are submitted and maintained in written documentation as a narrative to the budget numbers.
  - d. Member Ratification Meeting - Proxies or written ballots do not need to be sent for this meeting, in Nevada, but rather owners need to show up to vote this down by 50% plus 1. Our legislators understand apathy and if owners are upset at proposed increases enough to show up and vote it down, the budget reverts to the previous budget.
  
8. Notes of Various Income and Expense Categories in Association Budgets – Notes accompanying the budget will clarify expenses which may seem unreasonable to any owner who has not been able to be a part of the budget process. Examples are:
  - a. Increased legal fees for anticipated litigation.
  - b. Aging facilities and resulting increased costs.
  - c. Increases in employee costs.
  - d. Increased service requests from contractors.
  - e. Anticipated increased in utilities.
  - f. Payment of taxes on interest income on increased reserve funds.

## **RESERVES**

Many Associations are now in excess of ten to 20 years of age and are likely to have minimal reserve accounts containing only the traditional replacement and repair items such as roofs and painting. Incomplete or limited line items include, for example, water heaters. While saving to replace this item will fund reserves for the water heater itself, it ignores the

possibility of other plumbing problems association with the heater, such as corrosion of pipes. Corrosion of pipes is a problem which can cost hundreds of thousands, or even millions, of dollars to repair, depending on the size of the project. Obviously, budgeting for water heaters alone will not provide the Association with long-term financial protection against failure of the piping system, an expense beyond the ability of most Associations to fund.

The following is a check list of items that often have a service life less than that of buildings but that rarely appear in association budgets (regular or reserves). All managers and directors of common interest communities should review it to determine whether their project has potential hidden liabilities:

- Balconies
- Carports Posts
- Concrete Walkways, Driveways, Curbs and Gutters
- Decks
- Drainage Systems
- Fences
- Gutters (If any)
- Interior and Exterior Plumbing
- Iron Railings and Gates
- Lakes, Waterways
- Landscaping, especially Trees and Irrigation Systems (Valves and Timers can be very expensive)
- Patio Covers
- Pool Decks
- Planter Boxes and Trellises
- Stairs and Railings
- Tennis Courts
- Trim
- Wooden Lampposts
- Wood Siding

If eventual repair and replacement of these items is anticipated at an early stage of the project's development, a sufficient reserve can be accumulated by the time the work is actually necessary. If the reserve budget is used for unforeseen expenses (for which reserve categories should have been set) the alternative is usually a large special assessment.

Contracting with a reserve company (a specialist in this field and who has registered with the Division to get a license number, not just a contractor friend) will take a giant step toward preserving the financial health of your community. Many reserve companies perform reserve studies with the specific goal of identifying unfunded liabilities, but some do not. Determining the scope of the Association's contract with the reserve preparer is extremely important. It becomes even more so if the Association's current study or budget has failed to identify or provide for hidden liabilities as described above.

The Association is required to have a full reserve study every 5 years, but your documents may required more frequent studies to be updated. The Board is required to review the study annually and make any necessary adjustment to the study. Care should be taken in doing the adjustments as you will assume liability if you make changes to the study itself, which will limit the liability then of the reserve study preparer.