Monetizing an HOA

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Money is the grease that makes a homeowner association's wheels turn. Having enough of it in all the right places ensures the common elements are maintained and member property values sustained. While HOAs have their own governmental system, they have the ability to draw the members into the budget process in a way big government can't. With a bit of planning, the budget can be a harmonizing exercise instead of a battleground of discontent.

Philosophically, it's important for the board to adopt a "we're one of you" attitude because, frankly, it's true. All HOA members, including directors, pay their share of the HOA freight. Even if the board has the power to unilaterally adopt the budget, approaching it as a consensus building exercise will work wonders in how the message is received.

Form a Budget Committee. It is often difficult to get members to volunteer for board positions but getting some to serve on a Budget Committee is not so tough. There are always a certain number of bean counters out there that would make time for a 4-6 week stint crunching numbers. Targeting CPA or bookkeeper members is logical but there are others that can provide valuable service, particularly if they are long time residents who know the HOA's history or have served on a past board.

Update the Reserve Study Annually. This 30 year plan to perform periodic repairs and replacements on common elements has a *profound* impact on the annual budget. A typical common wall HOA needs to put around 1/3 of the monthly assessments into reserves each year. The reserve study needs to be updated annually so that the projections and assumptions remain as accurate as possible. Aspects of the study that will need to be adjusted annually include:

> **1. Starting Balance.** The amount of money held in reserves at the beginning of the fiscal year. It changes ever year and is the platform upon which the Funding Plan is built.
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> **2. Inflation Rate.** Inflation has a profound effect on future dollar needs roughly tripling the dollars needed over the 30 year projection period. The average inflation rate changes every year so the reserve study needs to reflect that too. Historical inflation rates are available at www.inflationdata.com. Since inflation rates can be volatile from year to year, it makes sense to use a 15-30 previous year average.
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> **3. Investment Return.** Many HOAs let reserve funds languish in money market or savings accounts which produce the lowest yields available (close to 0%). However, investing reserves strategically can yield impressive revenue over 30

years, revenue which offsets member contributions. Using the reserve study renovation event schedule as a guide, decisions can be made on how much reserve money can be invested in, say, Certificate of Deposits (CDS) and for how long. In many cases, most reserves could be invested for 3-5 years at higher yielding CD rates. Using a technique known as "laddering", CDs are purchased in varying terms like 1, 2, 3, 5 and 10 years. Those terms should be lined up with amounts and years where liquid cash is needed for renovation. Laddering can produce an average yield in the 1-2% range common in 2016. While this doesn't sound like much, over the 30 year projection period, it can yield tens, even hundreds of thousands of interest review. Since interest earnings offset member contributions, this is good news indeed.

4. Component Cost Changes. The reserve study predicts future costs based on current actual expenses or area average costs adjusted by inflation. Average costs can vary from year to year. Roofing, for example, took a dramatic increase in 2015. If the reserve study was not adjusted to reflect this increase, the fund would fall short on one the study's most expensive components.

5. Component Life Changes. The useful life of a component assumes quality material, proper installation plus regular and adequate maintenance. For example, if a roof is not kept clean and repaired regularly, the predicted useful life of, say, 25 years, might need to be reduced to 20 years. Periodic site inspections (recommended every three years) will reveal if components are aging as predicted. If they are not, useful lives are shortened which means reserves will need to be accumulated faster to meet the new schedule. In some cases, a component life can be extended but it usually not advisable when it comes to high priority components like roofs, paint, siding and decks.

6. Adding or Removing Components. Sometimes, it makes sense to add or subtract. For example, since insurance deductibles are now $10,000 and up, it makes sense to build an Insurance Deductible reserve. Since hot tubs are maintenance and utility intensive (expensive), it might make sense to shut it down permanently and remove all related components from the reserve study.

Reserve studies are living documents with many moving parts. Preparing and updating one takes specialized skills. A **Professional Reserve Analyst (PRA)** is a credentialed member of **Association of Professional Reserve Analysts (APRA)**, the reserve study industry's trade association. PRAs have a minimum of 5 years of full time experience preparing reserve studies. Third party expertise provides the board with the expert and objective analysis it needs to make informed decisions. For a list of PRAs, go to www.apra-usa.com Members section.

Poll the HOA Members. Asking the members for budget suggestions is largely symbolic, like raising the flag and see if anyone salutes. There may be a couple who do but most don't even notice. But the mere fact that all are asked goes a long way toward building support. Those that respond may be thoughtful or total flakes but the board doesn't need to commit to including the suggestions, only to consider them. Gather this information the month prior to Budget Committee meetings so it can be included for consideration.

Budget Review Meeting. Once the Draft Budget has been compiled, a Budget Review Meeting should be scheduled. This could be part of a regular board meeting if the budget is simple or a part of a special meeting if the budget is complex or contentious. All members should be invited and encouraged to attend. A formal presentation should be made and presenters prepared to answer questions or justify line items.

Budget Approval. After the review is held, formal approval of the budget should take place. If this requires a quorum of members to vote, sending out formal announcements, ballots, etc. are in order. If the board has the authority to approve the budget, it's still a good idea to inform the members when and where that approval will take place. It should happen at least 30 days prior to the start of the new fiscal year. Assuming the budget has increased (and it usually should due to inflation alone), the board should give members at least 30 days notice of any homeowner fee change.

Circulate Approved Budget. Once the budget has been formally adopted, a copy of it along with detailed notes explaining each line item and a side by side comparison of the past and future budgets should be sent to each member. A cover letter should explain what the new homeowner fee will be if equal or include a matrix showing the different fee levels if prorated by percentage or fraction. This would be the perfect time to distribute payment envelopes and coupons if you use them.

The whole budget process generally takes 4 to 12 weeks from start to finish depending on complexity and the requirements for approval. There are few exercises that have a more profound effect on the HOA's destiny so don't downplay it. The budget is a chance for a new beginning, improvement and team building. Don't miss the opportunity to engage the members.