HOA BOARD OVERVIEW:

Strategies, Budgets, Reserves

KEYSTONE

An overview of successful HOA management strategies, budgeting tips, and reserve studies.

Contents

An HOA Strategy for the Future **3**

What many communities overlook 4

Every HOA needs a clear vision 4

Beware of sacrificing long-term success for short-term "wins" 5

Evaluate your reserve study 6

Communication is key 6

HOA Management Budget Considerations **7**

How does your board approach budgeting? 8

Protecting property values should drive all decision-making 9

Evaluate line-by-line 10

Artificially suppressing dues creates problems down the line 11

Invest in reserves 12

Planning — Budgeting - Reserves **14**

An HOA Strategy for the Future

HOA management is similar to car ownership in that as the association ages, boards must pay more attention to significant maintenance and upgrades – and must budget and plan accordingly. The board must consider these costs and anticipate the true scope of dues required to meet future financial needs.

What many communities overlook

As a community reaches the 20-year milestone (and onward), regular maintenance is no longer enough. Unfortunately, too many reserve studies greatly underestimate the actual, current cost of replacement. Instead of patching potholes in the streets, HOAs might be facing an entire repaving project. Instead of trimming trees, it might be time to replace them or even undertake a full landscaping changeover.

Every HOA needs a clear vision

What is the long-term vision for the community? What can the board do today – and over the coming years – to drive resale and to elevate property values? The answers to these questions drive decision-making and ultimately influence the collection and allocation of dues and assessments.

Your HOA's strategic plan should be a concise, bulleted list of the types of actions the board will take to protect property values and promote the community as a quality place to live. Your HOA management company may be able to provide examples of strategic plans from other similar communities in your area for reference. Limiting your plan to a few pages will make it easy for incoming board members to read and internalize.

Beware of sacrificing long-term success for short-term “wins”

When it comes to community dues, we see two distinct philosophies:

- Boards that understand the necessity of financial foresight, accurately estimating the reserve amounts required to responsibly maintain an association long-term
- Boards that attempt to hold down association dues at an artificial ceiling, ultimately creating a gap between operational capital and the HOA’s true financial needs

The issue with the second approach is that the financial shortfall always becomes apparent when major upgrades are required, resulting in relatively large hikes on dues or unexpected special assessments. It’s always more advisable to take a realistic look at the association’s current and future financial needs and allow dues to track incrementally alongside the cost of maintaining property values.

We understand that promising low dues can be a political win, but this strategy can often come back to haunt board members as they are forced to react to the realities of maintaining aging communities.

Evaluate your reserve study

You don't need to wait for your state-mandated reserve study to take a closer look at your reserves. Your HOA management company can help you draft your strategic plan and begin comparing it to your current reserve study. Keep in mind that not only should your HOA collect enough reserves to fund your community's vision, but you must also have the working capital to respond to legislative changes and code requirements as they arise.

Communication is key

Reserve studies, strategic plans, and other financial considerations are usually not top-of-mind for the average homeowner. Therefore, HOA boards should explicitly communicate these objectives to the membership in clear, easy-to-understand terms. When homeowners understand the significant value they receive in exchange for their HOA dues, they are more likely to support increases.

Maintaining a strong position for your community into the future requires vigilant attention to the HOA's unique vision and the financial support necessary to ensure that vision becomes reality.

HOA Management Budget Considerations

Navigating the budgetary needs for an HOA is one of the trickiest elements of serving on the board. The board must build a responsible budget that hits the sweet spot between keeping fees manageable while achieving high service levels.

How does your board approach budgeting?

HOA boards usually adopt one of two long-term financial planning philosophies:

- **Focusing on a fixed dollar amount that is wanted for monthly dues and finding a way to manage to that.**
- **Determining the upkeep necessary to maintain property values and service level that is desired from our HOA. Discovering what that costs, then value engineering around it.**

We understand that keeping dues as low as possible is a noble cause and is also a political win among homeowners. Unfortunately, freezing dues or selecting an arbitrary number that "sounds good" doesn't align with the realities of successful long-term HOA management.

Instead, we recommend beginning with the end in mind. That is, envision the type of community that will maintain or better yet, elevate property values over time, determine the association-controlled factors that contribute to achieving that vision, then start building a financial plan that enables the association to meet those objectives in both the short- and long-term.

Protecting property values should drive all decision-making

The first steps of planning your budget have nothing to do with numbers. The true beginning of the budget conversation starts with the board answering these crucial questions:

What aspects of the community drive property values?

Think about everything in the community that has the potential to impact property values in the future. Every community is different, but here are some of the most common considerations:

- Entrance
- Landscaping
- Amenities (pool, clubhouse, sports complex, recreational areas, etc.)
- Perimeter fencing & walls
- Aesthetic of homes
- Sidewalks
- Street maintenance
- Community events

What are the association's documented responsibilities under the Covenants, Conditions & Restrictions (CC&Rs)?

These include obvious things like the pool, sports centers, common area buildings, gate/entrance, as well as less obvious things like electrical work for common areas, in-wall plumbing in condos, structural support for perimeter retaining walls, etc.

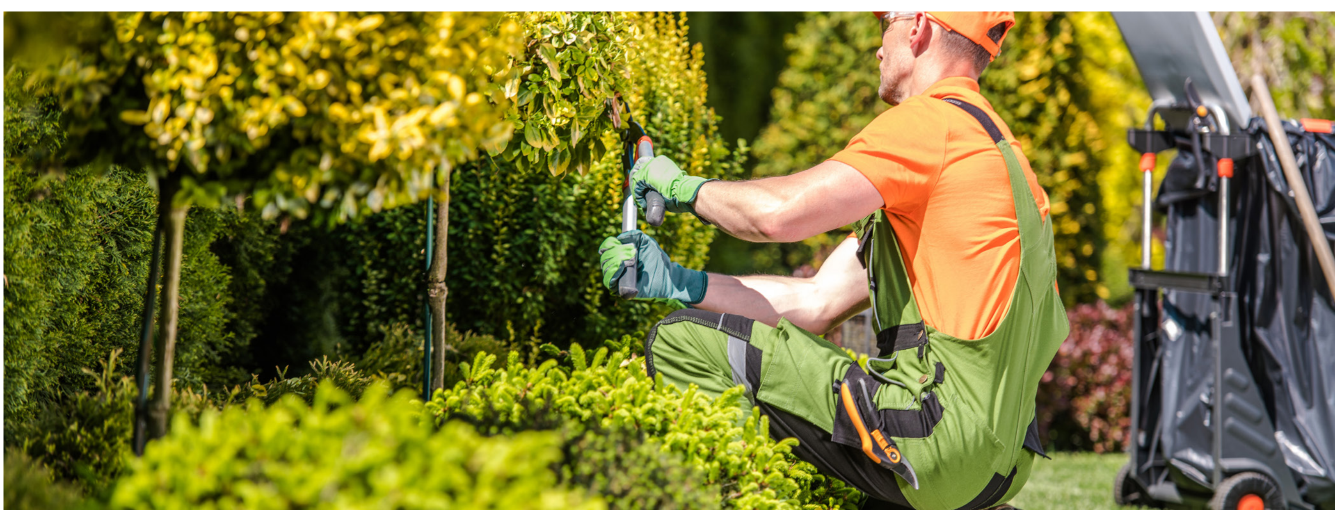
Pay attention to the connection between the things that make your community a great place to live and the obvious and unseen responsibilities your association is tasked with managing.

Evaluate line-by-line

After reviewing community aspects that preserve and promote property values, go through your budget, line by line, and discuss the cost of services. Think beyond maintaining the status quo. Assess the realities of a major overhaul or full replacement of amenities that no longer serve the needs of members.

This ‘zero-based budgeting’ approach requires all expenses to be justified for each period. By evaluating the property-value-drivers in your HOA and what your association is legally responsible to provide, you can build your budget around your true financial needs for the upcoming period. This approach requires rethinking what you may have paid in the past for certain services and asks you to look closely at the service levels you receive to determine if they truly match your community’s needs.

When associations try to retrofit service levels into a hard number, they often end up with no choice but to slash service levels to fit into their budgetary parameters. The association cuts corners and suffers in the end: either by foregoing necessary updates and upgrades or by instituting surprise special assessments on the membership to cover avoidable financial shortfalls.



Artificially suppressing dues creates problems down the line

Holding dues steady year-over-year might initially please the membership, but it sets the association up for unseen challenges that lay ahead. Operational costs tend to rise 1-2% annually in every industry and HOA management is no exception. If dues do not track with this increase, the association is falling behind. At some point, a huge increase (15-20%) could be required, which will likely upset the membership more than a steady increase.

Communicating the 'why' behind the dues will help homeowners better understand and eliminate much of the grievances.

Suppressing dues may also create a budgetary shortfall, forcing the association to levy special assessments. Special assessments must be shared publicly on real estate disclosures and can therefore adversely affect property values.

The smartest course of action is to ensure dues align with true, current, and expected costs of maintaining the association, then letting the membership know where their dues are allocated and the justification behind any increases. Communicating the 'why' behind the dues will help homeowners better understand and eliminate much of the grievances.

Invest in reserves

HOA management is not the place to be penny-wise and pound-foolish. As a non-profit entity, the funds in an HOA are there to be used – either spent on operations or held in reserves. Every budgetary decision you make has the potential to increase or sustain property values.

The backbone of budgetary decisions rests on the association's reserve study, a legally mandated review of the association's assets. A comprehensive reserve study equips board members with more information about where the association stands today in relationship to future HOA expenditures. However, if the reserve study fails to paint a complete picture, associations may end up with a serious budgetary shortfall.

What is a reserve study?

Your community's reserve study is a detailed analysis of your association's assets and includes an analysis of your community's physical assets (common areas), as well as a financial analysis that outlines the association's financial health (expenses, income, and reserve fund balance).

This report helps to ensure that the HOA is on solid financial footing to implement the board's current and future decisions.

Essentially, your reserve study is a detailed road map outlining how your association plans to spend its funds over 30 years.

Under California law, reserve studies based on a "diligent visual site inspection" must be completed every third year, but your association's board must review the study annually and make updates if necessary. The annual budget report to the HOA membership must include a summary of the reserve study based on the current year.

Areas your reserve study may overlook

Your reserve study aims to provide a comprehensive look at funding requirements for the next few decades. However, unless there are provisions for the "unexpected," your association risks facing budgetary shortages.

Here are some of the issues that unexpectedly drain reserves:

→ **Ancillary repair costs**
Sometimes anticipated upgrades come with unanticipated repair requirements, such as replacing damaged wood before painting.

→ **Surprise amenity-related expenses**
Your association's amenities may be in worse shape than they seem, a fact that can evade discovery until you undertake planned changes (example: weak pool plaster that requires full re-surfacing instead of patch repairs).

→ **Roofing issues**
Roof problems may not be discovered until the damage is serious. Costs for repairs, replacement, or other upgrades can rise quickly.

→ **Emergency damage**
Associations should make provisions in their reserve study to "expect the unexpected." Your association should have sufficient reserves in place to address emergency repairs (example: faulty or failed water or sewage pipes).

→ **Increases in raw materials costs**
Your reserve study must account for price changes to raw materials (ex. lumber) that, in large volumes, can dramatically impact costs.

As a board member, it's important you understand the funding plan for your association's reserves. What is the mechanism that will ensure your association is adequately funded to meet the reserves outlined by your reserve study? How will annual assessments need to change over time?

Ask your HOA management company or reserve analyst to share your existing "percentage funded" for community projects and maintenance, as well as any changes they anticipate over the next five years. This information will help you make more informed decisions today that will protect against significant assessment hikes or emergency special assessments to cover budget gaps.

Planning. Budgeting. Reserves.

Strategic planning, continual budget reviews, and regular reserve studies are crucial elements that ensure your community meets the needs of HOA members. Your HOA board plays a critical role in planning and budgeting for the future to ensure your community thrives.

Looking for an experienced HOA management partner to help your community plan for the future?

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