International Edition

The Quintet Chronicles

November 19, 2021

A Special Three Page Edition Focusing on Our Financial Health

It's Budget Season

This is a busy time of year for all the cool people involved in crafting the Quintet's budget for 2022.

There are two sides to a condo budget – the *annual operating budget* (utilities, salaries, landscaping, etc) and the *Reserves fund* for the long-term, predictable, sometimes costly expenses involved in maintaining our complex property.

A member of the Finance committee reports that it's challenging and interesting – responsibly spending $1.3 million of (mostly) other people's money.

Much of it is fairly simple math, but it can involve a lot of zeros and commas so you have to act responsibly.

Finance Committee on their recent HOA funded retreat

As an official Quintet volunteer accountant you become adept at dividing by 206, as that is the number of units here at The Q.

There aren't (or at least shouldn't be) many surprises in drafting the annual operating budget. We have years of data on our annual expenses for electrical, water, sewer and other utilities……throw in professional management, salaries and benefits for our Quintet staff, office and admin fees, landscaping, insurance, post-it notes and clubhouse coffee – and boom! You've got a million bucks. Add to that the contributions to our Reserves account – and you're at $1.3 million.

Digging into the details is what separates your "really cool" from your "wannabe cool" volunteer accountants.

Kin Living certainly provides assistance, but it's largely volunteers who put it all together.

Not to worry, though – Maria provides the adult supervision – and doesn't hesitate to tell us if we're doing it wrong.

The Quintet's *annual budget* and 30 year *Reserves and Maintenance Plan* can be found here [Quintet Financials]

Doing The Math

Homeowners are concerned primarily about the dues for *their* particular floor plan, but we're going to focus on the *average* cost per unit per month. Simply pick any expense category, divide by 206 and there's your answer.

Dividing 2021's $1.3 million budget by the 206 Quintet units averages out to $6500/year/unit, or $540/month.

For a *Floorplan B* 1 BR unit (there are 91) it's actually $396. A *Plan A* 2 BR (59 units) is $600. A *Plan F* 3 BR (11 units) is $823.

A few examples of how the *average* monthly dues break out in 2021.

-Insurance - $46/month
-Kin Living Management - $26
-Staff salaries & benefits - $84
-Water/sewer - $65
-Electricity - $34
-Cable/internet - $62
-Landscaping - $40
-Clubhouse, pool, fitness room and tennis courts- $4
-Clubhouse coffee – $0.26

Utilities make up 46% of The Quintet's annual operating budget

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The Reserves Fund

Our Savings Plan For the Future

Managing and funding the Reserves account is not as simple as the annual operating budget. Reserves involves a paid consultant - a Reserve Study Specialist - using sophisticated computers, calculators and perhaps a big crystal ball.

We're not sure what goes on behind the curtain

With all those tools at his/her disposal, the Reserve Specialist peers into the future to estimate the deterioration of buildings and other property components over 30 years.

They use well-established regional and national standards to determine the "useful life" of the 128 different components included in The Q's 30 year Maintenance Plan.

Using those standards for expected wear and tear (deterioration) a maintenance schedule is developed - intended to repair and maintain our property components so as to "keep pace with deterioration."

From that, 30 years of expenses can be calculated.

And a contributions plan can then be adopted to ensure adequate funding through the years.

It's hard to underfund the annual operating budget - staff wouldn't get paid, utilities get turned off, the lawn wouldn't get cut, doors would break and stay broken. The chaos would be immediate.

But it's quite easy, and often tempting, to underfund the Reserves account.

State law requires a condo to establish and maintain a Reserves Fund in order to avoid just that – but there's no requirement on what bank balance must be maintained.

For that, we can turn to HOA Trade Associations that have tracked HOA's and their Reserves data for decades.

One prominent trade association is Community Associations Institute (CAI.)

Because we have a Reserve Study (prepared annually since 2008 by Schwindt & Co Reserve Specialists) we *know* what our forecast expenses are.

Knowing how much we need to be saving can then be calculated.

Ideally, the Reserves account is funded sufficiently to "keep pace with property deterioration" and if so, is considered to be "100% fully funded."

Few HOA's are 100% funded. But statistics show that if the account balance falls below 30% funded, the HOA becomes exposed to special assessments and bank loans.

Accordingly, a balance below 30% is considered a sign of weak financial health for an HOA. 70% and better is considered strong.

The Quintet's Reserves account balance is 12%.

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Ideally, a Homeowner's Association determines their tolerance of special assessments, and funds their Reserves to provide the chosen risk level - the lower the bank balance, the higher the risk of an assessment.

There's no record that The Quintet has ever made a decision on what bank balance we want to keep and maintain in Reserve. We don't have a funding goal on which to base our Reserve contributions.

Exactly what *is* our tolerance of special assessments?

If you compare our 2021 Reserve expenses against Reserve contributions, you'll see that, for this year, we're into deficit spending.

One year of that is no cause for alarm - as long as the annual contributions are adequate, absorbing the occasional peak year for expenses shouldn't pose a problem.

But if you look at the last 10 years of our Reserve account expenses and contributions, you'll see that over that 10 year span, *we've averaged a deficit of $40,000 per year.*

That's not sustainable - and is one reason that by HOA Trade Association standards, our Reserves account is underfunded. *Substantially underfunded.* And forecast to stay that way for 15 years, based on the current plan for Reserves contributions.

The Reserves and Finance committees have done a good job in making our Reserves dollars go as far as possible – shifting projects around, moving unspent funds from the annual budget into the Reserves account, searching for less expensive maintenance options.

But that can only go so far.

The bottom line is - there's just not enough money in the Reserves account. We've not been contributing enough.

What are our options?

Should the Board head to the casino, adopting the Fibonacci method at the roulette table?

Another option is to begin a gradual but continued increase in our Reserves contributions over (five?) years to get us out of the danger zone for special assessments. And for those five years, hope like heck that nothing unexpected arises that would require additional funding.

Instead of spreading "the fix" over five years, a one-time assessment could be levied (about $4,000/unit) that would immediately get us to 30% funded. Out of the "weak" category - important to a condo-savvy buyer.

Another option is to delay any increase in contributions in the hopes that our future maintenance costs will be lower than expected (an unlikely scenario – the 2021 cost of our rolling 30 year maintenance plan is 273% greater than it was forecast to be 10 years ago.)

Another option (too often used by HOA's) is simply do nothing - defer maintenance, push the crisis down the road onto future owners – and be willing to accept more frequent assessments.

It's a big decision - having long term ripple effects on the financial security and property values of our Homeowner's Association.

The Board of Directors is scheduled to discuss and vote on this at Monday's meeting (Nov 22.)

A more wonky brief, the same one sent to the Board from the Quintet's Reserves Committee, will be posted tomorrow on the KL portal.