

HOA FEES—To Increase or Not to Increase?

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The budget is used to calculate the HOA fees. Budgets should take into consideration:

- Known operating costs
- Anticipated changes
- A contingency for unexpected expenses
- The prior years' cumulative shortfall or overage, and
- Reserve transfers per the reserve study.

If this is properly done, HOA fees may stay the same, increase, or decrease slightly or occasionally increase substantially.

TRAPS TO AVOID

Some boards do not raise HOA fees enough because

- Some owners are on fixed incomes.
- Board members don't want to look like bad guys.
- The board does not agree with the reserve study.
- If their HOA fees are higher than those of comparable properties, the marketability of their units could be affected.
- A board member convinces the board to keep the fees artificially low.

For any of the above reasons, the board might set the HOA fees without regard to actual expenses. However, operating costs are still as high as they would have been if the budget were formulated correctly. When reality hits, the owners have to pay more to make it up—sometimes much more. Each year that HOA fees are kept at an artificially low level compounds on the prior year, making the association's cash position exponentially worse over time. The resulting cash shortfall is often covered by underfunding the reserves, deferring maintenance and/or aging accounts payable. **When there isn't money to pay for some big-ticket reserve or repair item, the fallback position is a special assessment.**

The problem with any of these philosophies is that owners buy and sell. If the budget has been shortchanged, the past owners did not pay their fair share. The reserve transfers should offset the depreciation of the capital components. When a special assessment is imposed to cover reserve shortfalls or deferred maintenance, the financial burden shifts to the people who own "now." **The prior owners were given a pass, and the current owners are stuck footing the bills.**

RESERVE FUNDING

Reserve funding is a lot like retirement planning. If Complex A starts funding appropriately early on and continues to fund reserves completely, it should have lower reserve transfers at

property age 20 than Complex B that underfunded reserves for the first 20 years and then realized they need cash now to cover capital replacements. Since the Complex B owners were underpaying for years, they have to make it up now without the benefit of compound interest enjoyed by Complex A.

The board has a duty to read and understand the reserve study. If it is confusing, they need to get their questions answered. If any of the assumptions are incorrect, the study should be corrected and revised. The recommended reserve transfer should be incorporated into the budget.

WHAT ABOUT CUTTING COSTS?

Most association expenses are not discretionary. Insurance and utility costs have increased substantially over the past five years. An association may be able to increase insurance deductibles or turn down the landscape watering or retrofit to lower wattage bulbs. Associations should not defer maintenance due to budgetary considerations, as this magnifies costs in the long run.

EVERY COMPLEX IS UNIQUE

We often hear the question, “**What are other associations paying for HOA fees?**” **It doesn’t matter, because even similar complexes have different financial requirements** at any period in time. Some have higher insurance premiums due to prior claims. Some have funded their reserves appropriately; some have started late and are catching up; and some haven’t started yet. Some take care of repairs on a proactive basis, and some have deferred maintenance that may not be readily noticeable. Some have earthquake insurance, cable TV, guards, and some don’t. **In other words the “HOA fee” doesn’t include the same costs in all complexes.** It isn’t really one fee—it is all sorts of costs that are lumped together for the convenience of the homeowners. Maybe there is some gossip value in what the other owners pay for HOA fees, but that should not influence the level of HOA fees for any other association. **The HOA fees should be based on a complex’s specific needs, not the neighbor’s needs.**

KEEP THE ASSOCIATION’S BEST INTEREST IN MIND

Boards must be strong and take a position in the best interest of the association, despite its possible unpopularity. **The board has the fiduciary duty to the membership to set the HOA fees at a level that is adequate to cover operating expenses and reserve transfers as recommended by the reserve study.** Not wanting to raise the HOA fees is no defense for not properly funding the reserves and not fixing deferred maintenance. Usually, if a board takes the care to explain the reasons an increase is needed, the membership respects the decision and understands and concurs, even though they may not be thrilled with the prospect of the increase.