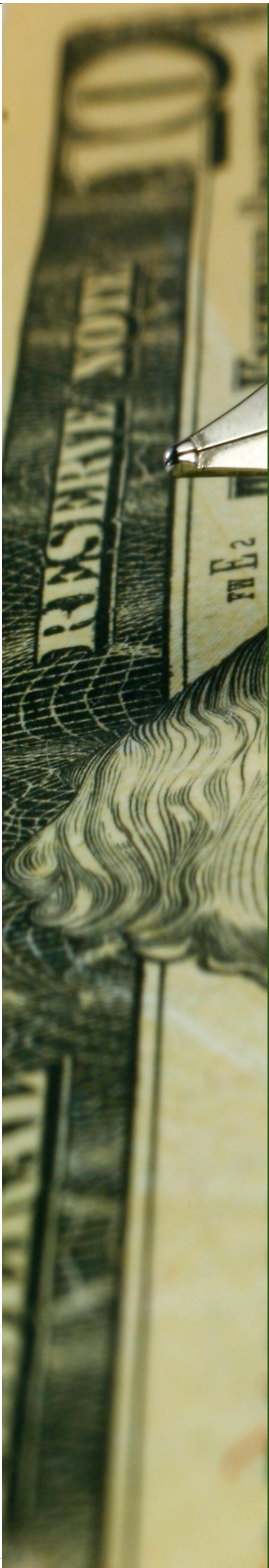

The 2010 Budget: Project Planning Do It Now Or Face Inflation?

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In most corners of the country, 2009 has been a challenging year for associations. Unit owner bankruptcies and foreclosures have eroded a substantial portion of many associations' cash flow. We all have our fingers crossed that 2010 will see a slowing in the pace of foreclosures, where those units that are not paying can be filled with financially healthy, dues paying, happy homeowners.

This financially stressful experience began in the summer of 2007. Typically, community associations have attempted to control their expenditures; during this period, some have been forced to take a riskier approach by tapping their reserves for operating expenses or delaying necessary maintenance. The leaky roof is now rotting the roof sheathing and trusses. The parking lot is chopped up. For Boards wedged between a constrained budget and depleted reserves, there maybe only 2 options to fund a capital maintenance project: special assessment or obtaining a loan.

Recent actions by the federal government have industry analysts concerned about inflation. The large infusion of stimulus cash and other economic factors have poised the country for a sharp increase in interest rates. Analysts estimate that 2011 will be the year inflation will start growing out of control. Ultimately, the concern is not if - but when? What is inflation? Inflation is raising prices. Inflation is increasing interest rates. Inflation is very painful and problematic. Does anyone remember December 1980 when the Prime rate was 21.5% because inflation was around 10%?

2010 is likely the last best year to get your capital maintenance projects completed. The sluggish economy has impacted construction, leaving contractors available and hungry for work. In certain areas, the prices of construction materials are down. Interest rates are low. Should the economy improve, interest rates will rise. Contractors will be busy again. As demand for building materials increases, prices go up. The imbalance of government intervention of the past few years is going exacerbate the extent of price increases: inflation.

Another very important circumstance that has developed over the past couple years is construction defects. If a contractor or sub-contractor was not properly vetted, or was hired because they were "the cheapest game in town," this increases the likelihood that their work may not be on par with competitors. "Cutting corners" on a new construction project or condominium conversion results in defects. Defects will cost the association lots of money. The smartest thing a new association can do is bring in investigative engineers to inspect the property, find any potential construction defects, and deal with them now. Obviously, those defects are not going away. They have the potential of causing more damage. There may be an opportunity for recourse against the developer. The cost of making the repair is going to become very much more expensive after 2010.

Securing a funding source to address these issues is Important. After what your owners have been through these past few years, it will be tough to levy a special assessment. If you plan on obtaining a loan to finance your capital maintenance projects, you will need to present a sound financial position to the bank. Banks are very skittish about taking on any type of borrower showing the smallest degree of weakness. The best thing you can do is plan your 2010 budget to show proper planning and healthy cash flow.

You must have a bad debt expense in your budget. If you have a delinquency level of 15% in you're A/R aging, you need to have at least that level of bad debt expense in your budget. You might not believe it or like it, but you are have to convince a bank that you have enough contingency in your cash flow for all eventualities, so do some aggressive planning. After that large bad debt expense is in your budget, you need to have a healthy Net Excess available for contribution to reserves. This all adds up to the potential of a large amount of cash build up of reserves if the bad debt expense is not as troublesome as the contingency has prepared you for.

Excess funds can be used to reduce the amount of loan that is being requested or allow for loan prepayment. As indicated throughout, you have a small window of opportunity to get capital maintenance projects done inexpensively. Do not squander the opportunity by leaving yourself unable to qualify for a bank loan to fund the projects.

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