STRATEGIES FOR EFFECTIVELY
MANAGING YOUR HOA'S FINANCES

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INTRODUCTION

Making and enforcing community rules and guidelines, is just one role Homeowners Associations (HOAs) play in community management. HOAs must also manage the community's finances, collect dues, hire contractors, pay bills, and administer the reserve fund, which puts aside funds for major, unanticipated expenses.

While the HOA boards are made up of community members, it's not necessarily made up of financial experts, which can be challenging for properly and effectively managing association funds.

We put together this guide to help you make the most of your community's funds and administer them responsibly and successfully.

There are over 351,000 homeowners associations in the United States, representing over 40 million households.

~ hoa-usa.com

START WITH THE BASICS

When you begin serving on an HOA board, it's vital that you fully understand what laws or governing documents you must adhere to, what accounting system your HOA is currently using, what processes are in place, and where exactly your finances stand. This will help ensure that any plans you make follow regulations, are done properly, and are within your means.

- **Know the law** – Check to see what state and local laws apply to your HOA. For example, some states limit the kinds of investments allowed for HOA reserve funds, or you may be required to keep reserve funds separate from operating accounts. Learn what laws are applicable to your organization to prevent any violations.
- **Review the HOA's governing documents** – Take time as a board to review your governing documents to ensure your community is in compliance with those documents, or to consider making any necessary amendments. If your governing documents do not outline your investment policy, it's time to create one. This policy should include how funds are to be invested, what insurances are required, who is responsible for making investment decisions, and any other special considerations.
- **Determine what accounting system your HOA is using** – Check to see what accounting method — cash or accrual — your association uses. With a cash accounting method, you record income as you receive it and expenses as you pay for them. With an accrual method, you record expenses when you incur them (even if you haven't made the payments yet) and you record income when you've earned it (even if you haven't received the money yet). Understanding your accounting method will give you a better sense of the current state of your HOA's finances.
- **Learn where your finances stand** – To plan a budget or put together an investment strategy, you need to know what your HOA's monthly income is, what regular expenses you incur, any upcoming projects or expenses to consider, and how much money you have in reserve.

BE READY FOR THE FUTURE

To make a plan that works for your community, it's a good idea to consult with financial advisors/professionals, vet and hire reliable vendors, budget for upcoming capital improvement projects and contingencies, and fund your reserve.

- **Consult with experts** – Ideally, you should have someone on your HOA board who has financial experience to serve as your treasurer and help advise your organization. But don't hesitate to also enlist an accountant/CPA, investment advisor, financial advisor, broker or banker to provide your HOA with professional guidance. You'll also want to partner with a bank that specializes in HOA management.
- **Hire reliable vendors** – HOAs are dependent upon a number of vendors, such as landscapers, painters, electricians, plumbers, builders, maintenance people and more. Make sure you take your time properly vetting vendors to ensure you hire competent and reliable workers so you don't blow the budget on botched jobs or work that has to be redone.
- **Budget for upcoming projects** – Just like any business, it's important to create a budget that accounts for your regular income (via dues), fixed expenses (such as monthly landscaping work), variable expenses (such as unanticipated repairs), and capital improvement projects that may require saving for (such as remodeling your community's clubhouse).
- **Fund your reserve** – Your HOA's reserve is your association's long-term savings account for emergencies like major repairs or replacements of amenities and structures. It's important that you actively fund the reserve to ensure you have the money you need when you need it. Additionally, you want to consider low-risk, prudent ways to invest and grow your reserves instead of simply letting the money stagnate. Read on for more information on strategies for making the most of your reserve fund.

MANAGE RESERVE FUNDS

As a member of your HOA board, it's your responsibility to effectively manage and regulate your reserve funds to ensure your community has access to funds when they need it most. It's important to understand when to use your reserves, how much money you should keep in reserve, and to conduct regular reserve studies.

- **Understand when to use reserves** – The HOA's reserve fund is intended as a community safety net and should not be used for things like regular maintenance. Instead, it should be used for major repairs, replacements, and unforeseen circumstances like damage from a natural disaster. The best interests of the community must always be considered when dipping into the reserve fund. Using it for unnecessary expenses can be considered a misuse of funds and can even be legally held against you. When you are considering using your reserve, ask yourself if the expense is regularly occurring or a capital improvement. If the answer to either of those questions is yes, you should not be using your reserve.
- **Know how much reserve you need** – Many HOAs simply do not have enough money in their reserve funds, and a shortfall could be dire for a community in an emergency. Determine how much money you need to have in reserve by assessing the life of the community's capital systems, properties and facilities and estimating how long they will last before deteriorating. Then, estimate how much repairs or replacements for those assets would cost over their lifespan. Once you have that amount – and don't panic, it will likely be high – figure out how much your HOA will need to save annually to cover those costs. Having a realistic view of how much you need in your reserve can protect your community into the future.
- **Conduct a reserve study** – A reserve study is essentially a planning tool designed to help your HOA board anticipate and prepare for major repair and replacement projects. Ideally updated annually, it can help you assess the current state of your HOA reserve funds, and to plot a course of action for better funding going forward. Seek the help of a professional, whether a financial advisor or HOA management company, to perform this essential function to ensure your reserve is healthy.

EXPLORE FINANCIAL STRATEGIES FOR YOUR RESERVE FUNDS

It's important to keep your reserve fund safe and accessible, but you also want it to grow over time with interest. That's why you'll need to consider your HOA's investment goals, understand FDIC limit coverage options, and review account types that keep your community's best interests in mind.

- **Set strategic investment goals –** When investing your reserve funds, you need to first and foremost protect your principal against loss with insurance and low risk investment funds. However, you'll still want to invest where you can get a reasonable ROI. While your fund may be sufficient now, inflation or other factors could cause your estimated expenses to grow in the future. Finally, you need to ensure that you can access your reserve funds when you need them without paying a penalty or additional taxes.
- **Review different account types** – Consider different HOA deposit accounts to determine which best meets the specific needs of your association. You'll likely need a checking account for regular operational expenses, but you may want to put your capital improvement funds and/or reserve funds in HOA Money Market accounts or CDs to generate more interest than a standard savings account. A sweep account is a bank or brokerage account that automatically transfers amounts that exceed, or fall short of, a certain level into a higher interest-earning investment option (typically, a money market fund) at the close of each business day. Be sure to choose a bank that has a wealth of experience in helping HOAs, and they can help you determine what accounts will maximize your returns while minimizing risk.
- **Understand FDIC limit coverage options** – FDIC insurance covers all standard deposit accounts such as checking, savings, money markets, CDs, etc. However, HOAs should understand that there is an FDIC limit of $250,000 per tax ID number, which means, to ensure full FDIC coverage, an HOA should not have more than $250,000 in any one FDIC insured bank. This presents challenges for HOAs who have significantly larger reserve funds; it's inconvenient and more difficult to manage your reserves when they are spread across multiple banks and multiple accounts. You can work around this limitation by exploring options such as:
    - **HOA CDARS®** – the Certificate of Deposit Account Registry Service®, which allows you to access multi-million-dollar FDIC insurance coverage by working directly with one bank.
    - **Money Market Sweep Service** – secure large deposits while maintaining access to funds placed into money market accounts, earning interest, and retaining multi-million-dollar FDIC insurance coverage. Again, this option offers the convenience of working with one financial institution.

BE ACCOUNTABLE

Managing your HOA's finances is a big responsibility, and you want to do all that you can to ensure that the association does everything by the book. This includes tracking and documenting income and expenses, filing taxes, getting proper insurance, signing and updating contracts, and participating in regular audits.

- **Track and document everything** – Have an accounting system in place that lets you clearly track income and expenses in specific categories or projects. If legal issues should ever arise, you want to easily be able to produce a detailed ledger.
- **File tax returns** – Even though HOAs are non-profit entities, they must file state and federal tax returns like other businesses. Get an experienced CPA or tax professional who can prevent you from paying taxes on tax-exempt revenue.
- **Have adequate insurance coverage** – Be sure you get insurance coverage to cover damage and theft, auto insurance for those who drive on HOA business, and directors' and officers' insurance to cover board liability.
- **Sign and update contracts** – Avoid handshake agreements. Have written contracts with all vendors and suppliers, make sure they are signed, and keep them up-to-date.
- **Audit every two years** – Regular audits will reassure the board, property management company and the community that the HOA is financially healthy and being fiscally responsible, and they can also alert the board to problems that may need to be addressed.

CONNECT WITH US

By following the strategies we've outlined here to effectively manage your HOA's finances, you can help ensure your association's health, wealth and long-term prosperity. Valley has years of experience helping HOAs like yours with the financial services and expertise you need to keep your community thriving for years to come.

For more information about how Valley Bank can help you manage your HOA's finances, reach out to one of our dedicated HOA banking associates.

Call **877-850-7625**

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Learn more at **HOAValley.com**

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