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Revenue or Reduction

Making Tough Decisions

By Liz Lent

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Budgeting is never easy, not for a family of four and certainly not for a co-op or condo community of hundreds or thousands of residents. That fact is made all the more difficult by the lingering effects of the recession, which continues to wreak havoc with our confidence as well as our overall bottom line. For many boards, trying to balance a budget these days requires making difficult choices. If the budget is falling short, what is the solution? Raise more revenue by raising fees? Or reduce costs by cutting back on services and amenities? For residents, neither option is likely to win a popularity contest.

So how does a board determine the best ways to keep their bottom lines in the black? And if unpopular choices must be made, what is the best way to break the news to residents?

What's Flexible, What's Not

For co-op and condo communities of all sizes, a budget is not necessarily a highly flexible entity. In the past, says Richard Apell, a controller at Argo Real Estate, LLC, a Manhattan-based management firm, "I've pointed out to shareholders that up to 93 percent of expenses are non-controllable. Within that 93 percent is the mortgage, insurance, taxes and payroll." For the most part, those prices are fixed from year to year with very little room for maneuvering unless a mortgage is up for refinancing or it is a new contract year for unionized staff. Otherwise, the prices that are locked in at the beginning of the year will still be the same at the end and likely for several years after that, he explains.

Jeff Stillman, CPA, vice president of Stillman Management Inc., based in Mamaroneck, New York, agrees, defining the major pieces of most budgets as "inflexible."

And the pieces that are moveable usually offer very little in the area of control either. Fuel costs are a prime example, says Floyd Brigman, an account executive at Stillman Management. He recalled that the year before they were working on a fuel budget of a little over a dollar a gallon and this year, it's more than three dollars. "That's a $250,000 shortfall," he says. "You can't make that up in the blink of an eye."

The list of items that a board and management team can cut may be relatively small but it still exists. Utilities, for example. Perhaps it is possible to get an energy audit or figure out ways to reduce usage and cut costs. Sometimes with careful review of bills, errors are found as well. Perhaps even looking into grants available from the utility companies for energy conversation and other pilot programs, might just save dollars down the road.

“On insurance, you can raise the deductibles,” Stillman suggests. “Or enter into a master umbrella program,” which is something to which Stillman’s clients have access. He also suggests doing a risk review of the building and seeing if there are any areas that could be repaired or improved to help lower rates and reduce claims.

With supplies, it is possible to cut costs by doing bulk purchases. Management firms can order the winter’s supply of calcium chloride for all of their buildings at one time, earning a volume discount and reducing costs for everyone.

There may be long-term solutions, too. Doing preventative maintenance on major ticket items such as elevators and boilers will reduce repairs during the year and improve efficiency. Training staff to do small contracting jobs could pay off in the long run for a building, saving on outside vendor costs.

Raising Versus Reducing

At times, the search for budgetary salvation may lead boards and management to consider reducing certain amenities or services offered within the building. The experts agree that not a lot can be gained from cutting amenities because they simply do not account for that large a chunk of the budget. “There’s only so much you can do because the majority of your expenses are out of your control,” says Apell. “The things you can control will have little impact.”

There may be legal questions involved with the removal of an amenity or reduction of a service as well. “Before cutting back on amenities, the board needs to review its declaration, offering plan and any amendments, bylaws and house rules to determine whether such a resolution would be permissible,” says attorney **Adam Leitman Bailey** of the Manhattan-based firm **Adam Leitman Bailey, P.C.** “In many cases, completely closing an amenity mentioned as a common element and offered in the offering plan would not fly. A building cannot take away land which they purchased as part of the building without compensation, if at all. However, reducing the hours for using the amenity would most likely be permissible depending on the building’s corporate documents,” **Bailey** says.

So, while it may not be possible to close the pool, for example, it may be possible to reduce the hours it is open. Given the small amount of money that action likely would garner, though, it might not be worth it to anger unit owners and shareholders who look forward to using that pool every weekend.

Time to Raise Those Fees

No matter how much is done to shave dollars off the debit side of the balance sheet, there are times when the issue of raising fees is unavoidable. In these instances, an open and honest dialogue with residents is an absolute must.

“When faced with having to raise maintenance or levy an assessment, education, understanding and sympathy should be the modus operandi,” says **Bailey**. “Owners deserve to know why the increase or assessment is necessary. The residents should receive a memo detailing what caused the increases—for example, an increase in oil costs (or) an increase in taxes and insurance. The memo should start with a statement that the board understands that these are tough times, and that the board has done everything it could to avoid this situation. It should also demonstrate the board’s efforts to avoid the increase.”

The sooner these communications can begin, the better. “The best case scenario would be several updates from the board even before the increase, showing that they are trying to avoid the problem and other ways it has tried to garner revenue or reduce expenses,” **Bailey** adds.

Apell agrees. “Certainly you want to give them information and advance notice if you’re anticipating a maintenance increase. Most shareholders are pretty knowledgeable.” It helps, too, to have accountants on hand to explain budgetary issues at annual meetings, so residents have a solid understanding of where things stand and where financial vulnerabilities may exist.

Fee increases or assessments should be kept as small and reasonable as possible. In rare cases, Apell has seen buildings announce a 25 percent fee increase for their residents. “These were buildings that perhaps were depending on a source of income that eventually became depleted—a commercial tenant perhaps that left and now suddenly there is no commercial income,” he says. These large increases, especially those in the high single or double digits, should be avoided whenever and wherever feasible. “They do not create a good atmosphere,” Apell says.

In some cases, small yearly increases are advisable, providing a budgetary cushion to insulate the community from unexpected and unavoidable shortfalls. “Small increases on an annual basis will hopefully prevent the need for larger increases at some point in time,” says Apell. “It also creates a mindset for shareholders that there will be an increase so it’s not a surprise.”

Small annual fee increases can do more than simply serve as an umbrella for rainy days. They can help build the long-term health of the co-op or condo. “I am a big believer in a strong reserve, especially in these days of natural (hurricanes, floods) and unnatural disasters (Wall Street collapse),” says **Bailey**. “So small automatic increases are a good idea to build the reserve fund and to show potential buyers that problems do not exist, these increases are automatic and do not mean that the building is not doing well.”

Being able to count on small increases of one or two percent each year can be especially helpful as buildings age and repairs become more of an issue. Many of today’s co-op and condo buildings were constructed in the 1950s and ‘60s before being converted in the ‘80s and ‘90s. Now those buildings are more than half a century old “and a lot of the things that were done at the time of conversion, like windows, are past their useful life,” says Stillman.

On the downside, **Bailey** says, “money is tight and if these increases are not immediately needed, you will not only be financially harming the owners, but also potential buyers who may be priced out of buying in the building.”

In short, there are no easy solutions when it comes to balancing a budget in an uncertain economy and at a time when, for almost everybody, every dollar counts. “The problem with doing budgets is you have to be a bit of a fortune teller,” says Stillman.

Despite the best efforts of boards and management, sometimes the budgetary prophecies can fall short and that red ink starts appearing. When that happens, difficult choices must be made. By being open and honest with residents, however, those choices can become a group effort and solutions can become consensus.

Liz Lent is a freelance writer and a frequent contributor to The Cooperator.