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## ASSOCIATION BUDGETING IN A TOUGH ECONOMY

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Although many experts have declared the recession to be over and the signs are pointing to an upturn in the economy, many community associations will continue to feel the effects of the recent economic crisis for some time. As with many homeowners who have been affected by the economy, associations are looking at ways to tighten their belts and to effectively deal with the budgeting issues they now face. When preparing an annual budget in tough times, there are a number of factors that should be considered.

Most associations have experienced an increase in delinquencies over the past couple years. It is important when preparing an annual budget to take into account the fact that some homeowners will not pay their assessments in a timely manner and that a certain percentage of assessments may prove to be entirely uncollectible as the result of foreclosure, bankruptcy or other related reasons. As a corollary to the issue of delinquencies, the Board of Directors has a fiduciary obligation to collect unpaid assessments. In many cases, doing so will require the association to involve a legal professional in order to assist the association in collecting delinquent accounts. Associations should therefore also include these anticipated legal fees and costs into their budgets. Although the Minnesota Common Interest Ownership Act (“MCIOA”) and many associations’ governing documents provide that the legal fees and costs incurred in collecting unpaid assessments may be charged back to the delinquent owner and collected in addition to the assessments, the association will still bear the responsibility of paying for the legal services up front in most cases.

Aside from legal fees and costs that an association can expect to incur in collecting delinquent assessments, associations will want to include in their annual budgets an additional cushion for legal and professional fees and costs that may be encountered for any number of reasons. Most associations face issues at one time or another where legal advice and/or representation may be required. These situations can range from needing a legal opinion on any number of issues or having an attorney assist with enforcing the governing documents or dealing with a difficult homeowner to having to defend against a lawsuit by a homeowner or pursuing claims against a builder for construction defect issues. Associations wanting to update, revise or amend their rules and regulations or any of their governing documents are also strongly encouraged to seek legal advice throughout the process. An association faced with any of these legal issues that has not properly budgeted for legal fees and costs will find itself either looking to levy a special assessment to cover the costs or, worse yet, will be unable to obtain the necessary legal or professional advice to properly deal with the situation in which it finds itself.

more money to hire someone else to fix the work later on (assuming it can be fixed). A job done right the first time will almost always prove more cost-effective in the long run than one that has to be fixed at additional time and expense to the association. Boards should therefore be aware of what they are getting for their money when contracting for insurance, maintenance, snow removal, accounting, legal and any other services.

An association looking to make significant changes in its annual budget, including any significant increase in assessments, should always keep an open line of communication with its members to encourage member understanding and support of the Board's efforts to provide for the association's needs and maintain the integrity and value of the property, while dealing with the reality of the current economic conditions affecting the association.

If your association has questions concerning budgeting, the recent changes to MCIOA or any other legal issues affecting your community, you can contact the author, Phaedra J. Howard, Esq., at (952) 746-2142 or [phoward@hjlawfirm.com](mailto:phoward@hjlawfirm.com).

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65.1 to subsection (b), the cost of repair or replacement of the common elements in excess of  
65.2 insurance proceeds and reserves shall be paid as a common expense, and the cost of repair  
65.3 of a unit in excess of insurance proceeds shall be paid by the respective unit owner.

65.4 (i) If less than the entire common interest community is repaired or replaced, (i) the  
65.5 insurance proceeds attributable to the damaged common elements shall be used to restore  
65.6 the damaged area to a condition compatible with the remainder of the common interest  
65.7 community, (ii) the insurance proceeds attributable to units and limited common elements  
65.8 which are not rebuilt shall be distributed to the owners of those units, including units to  
65.9 which the limited common elements were assigned, and the secured parties of those units,  
65.10 as their interests may appear, and (iii) the remainder of the proceeds shall be distributed to  
65.11 all the unit owners and secured parties as their interests may appear in proportion to their  
65.12 common element interest in the case of a condominium or in proportion to their common  
65.13 expense liability in the case of a planned community or cooperative.

65.14 (j) If the unit owners and holders of first mortgages vote not to rebuild a unit, that  
65.15 unit's entire common element interest, votes in the association, and common expense  
65.16 liability are automatically reallocated upon the vote as if the unit had been condemned  
65.17 under section 515B.1-107, ~~and~~. The association shall have the power to, and shall,  
65.18 promptly prepare, execute and record an amendment to the declaration reflecting the  
65.19 reallocations. Notwithstanding the provisions of this subsection, if the common interest  
65.20 community is terminated, insurance proceeds not used for repair or replacement shall be  
65.21 distributed in the same manner as sales proceeds pursuant to section 515B.2-119(c).

65.22 (k) The provisions of this section may be varied or waived in the case of a common  
65.23 interest community in which all units are restricted to nonresidential use.

65.24 Sec. 11. Minnesota Statutes 2008, section 515B.3-114, is amended to read:

65.25 **515B.3-114 REPLACEMENT RESERVES; SURPLUS FUNDS.**

65.26 (a) ~~The annual budgets of the association shall provide from year to year, on a~~  
65.27 ~~cumulative basis, for adequate reserve funds~~ include in its annual budgets replacement  
65.28 reserves projected by the board to be adequate, together with past and future contributions  
65.29 to replacement reserves to cover fund the replacement of those parts components of the  
65.30 common interest community which the association is obligated to replace. ~~These reserve~~  
65.31 ~~requirements by reason of ordinary wear and tear or obsolescence, subject to the following:~~

65.32 (1) The amount annually budgeted for replacement reserves shall be adequate,  
65.33 together with past and future contributions to replacement reserves, to replace the  
65.34 components as determined based upon the estimated remaining useful life of each

66.1 component; provided that portions of replacement reserves need not be segregated for  
66.2 the replacement of specific components.

66.3 (2) Unless otherwise required by the declaration, annual budgets need not include  
66.4 reserves for the replacement of (i) components that have a remaining useful life of more  
66.5 than 30 years, or (ii) components whose replacement will be funded by assessments  
66.6 authorized under section 515B.3-115(e)(1), or approved in compliance with clause (5).

66.7 (3) The association shall keep the replacement reserves in an account or accounts  
66.8 separate from the association's operating funds, and shall not use or borrow from the  
66.9 replacement reserves to fund the association's operating expenses, provided that this  
66.10 restriction shall not affect the association's authority to pledge the replacement reserves  
66.11 as security for a loan to the association.

66.12 (4) The association shall reevaluate the adequacy of its budgeted replacement  
66.13 reserves at least every third year after the recording of the declaration creating the  
66.14 common interest community.

66.15 (5) Unless otherwise required by the declaration, after the termination of the period  
66.16 of declarant control, and subject to approval (i) by the board and (ii) by unit owners,  
66.17 other than declarant or its affiliates, of units to which 51 percent of the votes in the  
66.18 association are allocated, the association need not annually assess for replacement reserves  
66.19 to replace those components whose replacement is planned to be paid for by special  
66.20 assessments levied under section 515B.3-115(c), or by assessments levied under section  
66.21 515B.3-115(e)(2). The approval provided for in the preceding sentence shall be effective  
66.22 for no more than the association's current and three following fiscal years, subject to  
66.23 modification or renewal by the same approval standards.

66.24 (6) Unless otherwise required by the declaration, subsection (a) shall not apply to a  
66.25 common interest community which is restricted to nonresidential use.

66.26 (b) Unless the declaration provides otherwise, any surplus funds that the association  
66.27 has remaining after payment of or provision for common expenses and reserves shall be  
66.28 (i) credited to the unit owners to reduce their future common expense assessments or (ii)  
66.29 credited to reserves, or any combination thereof, as determined by the board of directors.

66.30 **EFFECTIVE DATE.** The amendments to this section are effective and apply to  
66.31 common interest communities for their fiscal years commencing on or after January 1,  
66.32 2012.

66.33 Sec. 12. Minnesota Statutes 2008, section 515B.3-115, is amended to read:

66.34 **515B.3-115 ASSESSMENTS FOR COMMON EXPENSES.**