

## **ASSOCIATION FINANCES**

**Joonho Yu**

**PENLAND & HARTWELL, LLC**

In the management and administration of condominium associations, no single issue is more important to each and every unit owner than the financial stability of the association. A condominium association's finances directly affect all aspects of a condominium association, from the maintenance of the common elements to the resale value of individual units. Most people already know that a condominium association has an annual budget which is funded by regular monthly assessments paid by the unit owners, and that certain exigent circumstances may require a special assessment. However, many are unfamiliar with the mechanics of preparing, adopting, or revising, an annual budget or a special assessment. This article will explain these procedures, and address many common misconceptions and mistakes made by condominium associations and unit owners alike.

### ***The CONDO ACT and "Governing Documents"***

All matters related to the operation of a condominium association are controlled by the *Condominium Property Act*, 765 ILCS 605/1 et seq. ("CONDO ACT"). In addition, all condominium associations are subject to their own "governing documents," such as a *Declaration of Condominium*, *By-Laws*, and *Rules and Regulations*. In most cases, these "governing documents" are usually consistent with (and sometimes identical to) sections of the CONDO ACT, but in cases wherein there is a conflict, the CONDO ACT always controls. This is a common mistake made by condominium boards and unit owners who may rely on "governing documents" which may include provisions inconsistent with the CONDO ACT, and therefore, may be incorrect. For this reason, it is always important to review both the "governing documents" and the CONDO ACT, or seek the advice of a professional.

### ***Powers and Duties of Board of Managers***

Section 18.4 of the CONDO ACT, entitled “Powers and Duties of Board of Managers,” establishes the minimum powers and duties of a condominium board, and it should come as no surprise that the first 3 enumerated powers/duties all relate to financial matters: “(a) To provide for the operation, care, upkeep, maintenance, replacement and improvement of the common elements ... (b) To prepare, adopt and distribute the annual budget for the property ... (c) To levy and expend assessments...” It is extremely important to note that all decisions regarding these matters are made solely by the board of directors, not by a vote of the unit owners. While a unit owner may voice his/her opinions during the open meeting in which the board adopts a course of action, the actual decision itself is made by the board members only.

#### **A. MANAGING THE COMMON ELEMENTS**

The first enumerated power/duty in Section 18.4 of the CONDO ACT is “(a) To provide for the operation, care, upkeep, maintenance, replacement and improvement of the common elements.” In other words, a condominium board has the authority to expend funds to manage the common elements. However, if the cost of an “improvement” to the common elements exceeds 5% of the annual budget, then unit owners with at least 20% of the total votes may (within 14 days of the board’s approval of such expenditure) petition the board to “reconsider” said expenditure. Within 30 days of delivery of such a petition, the board must call a meeting of all unit owners, at which time unit owners with a majority of the total votes can reject said expenditure. Unless all these actions are taken in a timely manner, the board’s decision approving such an expenditure is forever ratified by operation of law.

## **B. ANNUAL BUDGETS**

### ***Preparing An Annual Budget***

The second enumerated power/duty in Section 18.4 of the CONDO ACT is “(b) To prepare, adopt and distribute the annual budget for the property.” The CONDO ACT provides additional guidance to boards as to this issue in Section 9(c) of the CONDO ACT by stating that an annual budget must include all anticipated expenses by category, all anticipated income from assessments and other sources, and reasonable reserves. Usually, the anticipated expenses and the anticipated income can be readily ascertained based upon the previous annual budget (factoring in any additional planned expenses and inflation). However, it should be noted that an “initial” annual budget prepared by a developer prior to turnover will likely require significant scrutiny and modification since developers have a tendency to understate anticipated expenses in order to show a more attractive lower monthly assessment amount to prospective purchasers. At minimum, an annual budget should be drafted so that a condominium association’s income meets all its operating expenses, with an additional amount set aside for reserves (as discussed below). This analysis is often complicated by the rising costs of goods (such as maintenance supplies) and services (such as employee wages or vendor charges), new governmental requirements (such as fees, reports, inspections), as well as trends in unit owner delinquencies (which will directly impact a condominium association’s income). Property Management may be of great help to a condominium board in preparing an annual budget as they usually have significant experience and knowledge regarding these issues.

### ***Reasonable Reserves***

Often a more difficult inquiry for a condominium board as to an annual budget is the amount of reasonable reserves. Section 9(c)(2) of the CONDO ACT provides some general guidance in this regard: “[t]o determine the amount of reserves appropriate for an association, the board of managers shall take into consideration the following: (i) the repair and replacement cost, and the estimated useful life, of the property which the association is obligated to maintain, including but not limited to structural and mechanical components, surfaces of the buildings and common elements, and energy systems and equipment; (ii) the current and anticipated return on investment of association funds; (iii) any independent professional reserve study which the association may obtain; (iv) the financial impact on unit owners, and the market value of the condominium units, of any assessment increase needed to fund reserves; and (v) the ability of the association to obtain financing or refinancing.” The exact amount of reasonable reserves will obviously vary greatly based upon the size, age, and location, of a condominium association, and so the advice of a professional (usually in the form of a “Reserve Study”) is highly recommended. It should be noted that, if a condominium association’s “governing documents” do not require a reserve, then Section 9(c)(3) of the CONDO ACT allows a condominium association to waive this “reserve requirement” by agreement of unit owners with at least 2/3 of the total vote. However, pursuant to Section 9(c)(4) of the CONDO ACT, such waiver must then be disclosed “in the financial statements of the association and, highlighted in bold print, in the response to any request of a prospective purchaser...” For the practical reason of having funds readily available for emergency situations, and also to maintain property values (i.e. the sales, financing, or refinancing), it is recommended that condominium associations maintain a reserve account.

### *Adopting An Annual Budget*

Once an annual budget has been prepared, a condominium board must strictly adhere to the procedures and requirements for its adoption, which are contained the in the by-laws of the condominium association. Section 18(a)(6) and Section 18(a)(8)(i) of the CONDO ACT provides a minimum framework for adopting an annual budget. First, all unit owners must receive, at least 30 days before its adoption, a copy of the proposed annual budget indicating each unit's proportionate share of assessments and "which portions are intended for reserves, capital expenditures or repairs or payment of real estate taxes." Second, the annual budget must be adopted in an open meeting of all unit owners. Third, all unit owners must receive notice of the meeting at which the board will adopt the proposed annual budget at least 10 days, but not more than 30 days, before the same. Once again, it should be noted that it is the board of directors that adopts the proposed annual budget, not the unit owners. While reasonable discussion and comment regarding the proposed annual budget is encouraged, the final decision rests solely with the board of directors, and the unit owners do not vote on this issue.

However, pursuant to 18(a)(8)(ii) of the CONDO ACT, if the adopted annual budget would result in the sum of all assessments payable in the current fiscal year exceeding 115% of the sum of all assessments payable during the prior fiscal year, then unit owners with at least 20% of the total votes may (within 14 days of the board's adoption of the annual budget) petition the board to "reconsider" the adopted annual budget. Within 30 days of delivery of such a petition, the board must call a meeting of all unit owners, at which time unit owners with a majority of the total votes can reject the adopted annual budget. Unless all these actions are taken in a timely manner, the adopted annual budget is forever ratified by operation of law.

## **C. SPECIAL ASSESSMENTS**

### ***Type Of Special Assessments***

The third enumerated power/duty in Section 18.4 of the CONDO ACT is “(c) To levy and expend assessments.” This includes levying special assessments. Section 18(a)(8)(iii) of the CONDO ACT defines a special assessment as “any common expense not set forth in the budget or any increase in assessments over the amount adopted in the budget.” In general, there are 3 “types” of special assessments: 1) non-emergency special assessments for the maintenance, repair, or replacement, of common elements; 2) non-emergency special assessments for additions and alterations to the common elements; and 3) emergency special assessments. Each type of special assessments has its own separate procedure for adoption and ratification, but all special assessments must be separately assessed against each unit owner.

### ***“Regular Special Assessments”***

The procedure for adopting a special assessment which relates to the maintenance, repair, or replacement of the common elements, and which is not an emergency (as discussed below), is somewhat similar to adopting an annual budget. Pursuant to Section 18(a)(8)(i) of the CONDO ACT, all unit owners must receive a copy of the proposed “regular special assessment” with the notice of the meeting at which the board will adopt the proposed “regular special assessment” at least 10 days, but not more than 30 days, before the same. Pursuant to Section 18(a)(6) of the CONDO ACT, the proposed “regular special assessment” must indicate each unit’s proportionate share of assessments and “which portions are intended for reserves, capital expenditures or repairs or payment of real estate taxes.” Once again, it should be noted that it is the board of directors that adopts the “regular special assessment,” not the unit owners. While reasonable discussion and comment regarding the proposed “regular special assessment” is allowed, the

final decision rests solely with the board of directors, and the unit owners do not vote on this issue.

However, pursuant to 18(a)(8)(ii) of the CONDO ACT, if the adopted “regular special assessment” would result in the sum of all assessments payable in the current fiscal year exceeding 115% of the sum of all assessments payable during the prior fiscal year, then unit owners with at least 20% of the total votes may (within 14 days of the board’s adoption of the “regular special assessment”) petition the board to “reconsider” the adopted “regular special assessment.” Within 30 days of delivery of such a petition, the board must call a meeting of all unit owners, at which time unit owners with a majority of the total votes can reject the adopted “regular special assessment.” Unless all these actions are taken in a timely manner, the adopted “regular special assessment” is forever ratified by operation of law. This type of special assessment usually relates to unexpected expenses as to the maintenance of the common elements but which do not constitute an emergency (as discussed below) such as painting, caulking, re-carpeting...etc (work that does not materially change the common elements).

#### ***“Alteration Special Assessments”***

The procedure for adopting a special assessment which relates to the addition or alteration of the common elements, and which is not an emergency (as discussed below), is very different from the procedures for adopting an annual budget or a “regular special assessment.” Pursuant to Section 18(a)(8)(i) of the CONDO ACT, all unit owners must receive a copy of the proposed “alteration special assessment” with the notice of the meeting called for the purpose of adopting the proposed “alteration special assessment” at least 10 days, but not more than 30 days, before the same. Pursuant to Section 18(a)(6) of the CONDO ACT, the proposed “regular special assessment” must indicate each unit’s proportionate share of assessments and “which portions

are intended for reserves, capital expenditures or repairs or payment of real estate taxes.” However, unlike an annual budget or a “regular special assessment,” pursuant to Section 18(a)(8)(v) of the CONDO ACT, a proposed “alteration special assessment” must be approved by unit owners with at least 2/3 of the total votes. A proposed “alteration special assessment” cannot be assessed without this approval. This type of special assessment usually relates to improvement projects as to the common elements such as lobby renovations...etc (work that does materially change the common elements).

### ***“Emergency Special Assessment”***

Finally, the procedure for adopting a special assessment which relates to an emergency or a matter mandated by law is relatively unique and very different from the procedures for adopting an annual budget, “regular special assessment,” or a “alteration special assessment.” Pursuant to Section 18(a)(8)(i) of the CONDO ACT, all unit owners must receive a copy of the proposed “emergency special assessment” with the notice of the meeting at which the board will adopt the proposed “emergency special assessment” at least 10 days, but not more than 30 days, before the same. Pursuant to Section 18(a)(6) of the CONDO ACT, the proposed “regular special assessment” must indicate each unit’s proportionate share of assessments and “which portions are intended for reserves, capital expenditures or repairs or payment of real estate taxes.” Only the board of directors adopts the “emergency special assessment,” not the unit owners. While reasonable discussion and comment regarding the proposed “emergency special assessment” is allowed, the final decision rests solely with the board of directors, and the unit owners do not vote on this issue. Furthermore, pursuant to Section 18(a)(8)(iv) of the CONDO ACT, unit owners do not have a right to petition the board to “reconsider” adoption of the “emergency special assessment.” Thus, once adopted by the condominium board (pursuant to notice at an open

meeting of unit owners), an “emergency special assessment” is final and irrevocable. Section 18(a)(8)(iv) of the CONDO ACT states that “‘emergency’ means an immediate danger to the structural integrity of the common elements or to the life, health, safety or property of the unit owners.” It should be noted that a condominium board may have already expended funds from the association’s reserve account to address an emergency situation due to the exigencies of the circumstances, and that the “emergency special assessment” is being assessed to replenish these reserve funds.

### ***Final Thoughts***

Very few decisions by a condominium board are as closely scrutinized or hotly debated as those relating to the finances of an association. This is especially true in these dire economic times. Therefore, it is extremely important that condominium boards adhere strictly to the requirements of the CONDO ACT and their “governing documents,” and seek the advice of experienced professionals in this regard.