Snow Removal Costs A Financial Crisis

By Donald E. Harris, CPA

The winter of 2009/2010 is finally over, but one resounding question lingers: What can be done to fund the significant direct and associated costs of snow removal?

Record snowfalls made the winter of 2009/2010 a very tough period for community associations both financially and physically. The December and February snowstorms devastated association operating budgets and current cash flows. Snow removal budget line items, even for an association that aggressively budgeted for a harsh winter, are probably inadequate to cover the snow removal costs associated with these storms. Even associations that have built up excess operating funds, based on our recommendations of 10 to 20 percent of annual assessments, may not have enough funds to cover the costs. Additionally, budgetary problems are not limited to the snow removal budget line items. Other budget line items, such as road repair, grounds maintenance, and most significantly tree removal, have been impacted by the storms. Smart annual budgeting and accumulation of excess operating funds are the first two lines of financial defense in an effort to try and fund these extraordinary expenses.

Significant events, such as this past winter's snowstorms, demonstrate the need for associations to be in a strong financial position and to maintain appropriate levels of prior year excess operating funds. They also demonstrate the need to plan for financial contingencies.

To answer the question posed in the first sentence of this article, an association first needs to consider all the costs that are (or may be) related to these storms. This determination may include consideration of the following:

- Snow removal and its related costs
- Tree removal and landscape damage
- Road, curb, and sidewalk repair (plow truck damage)
- Ice damming and related interior repairs (insurance may apply)
- Under-insurance deductible repairs
- Insurance deductibles
- Possible future premium increases
- Future replacement of trees, plants, and other landscaping.

Once these potentially significant costs are determined, consideration can be given to how they will be funded or paid for. The association should carefully review its current financial situation in relation to the current year budget line items and prior year surplus funds. This review should include:

- Carefully analyze the current year budget line items for additional funding
- Determine if any prior year excess operating funds exist
- Determine if prior year operating or contingency reserves are available.

As noted above, the first place to look for additional funding is the current year budget. While analyzing the current year budget, the association should ask several questions:

- What services or maintenance items can we defer until the next operating year?
- What services can we elect not to provide or to limit in the current year?
- Do we have any current year budget line items that are running under budget?
- Do we have a contingency budget line item to utilize?

To determine if any prior year excess operating funds exist, the association should review the balance sheets of the prior year audit or internal financial statements for an account in the equity section titled "Unappropriated Members' Equity" (or similar verbiage like "Prior Year Excess Funds" or "Retained Earnings," etc.). If a surplus exists, these funds could be utilized as additional funding sources for snow removal and related costs.

Similar to "Unappropriated Members' Equity," any prior year accumulation of funds designated as an "Operating or Contingency Reserve" could also be used to fund storm costs, as long as no legal restrictions prevent their use. If these funds exist, they can also be found in the equity section of the balance sheet.

Once the options mentioned above are fully utilized, and it is determined that they, too, are insufficient, the association should consider the following:

- Administer a special assessment
- Borrow from the replacement reserves
- Draw on a credit line.

Special Assessment

A special assessment would be our first recommendation for the association to consider. We believe this action to be the most fiscally responsible. It provides immediate cash inflows and liquidity to fund the storm expenses without impacting the current year operations (services) or the replacement reserves. The storms are unusual, non-recurring, financially material, and fresh in the minds of the homeowners. The homeowners should understand the very unique problems and difficulties in dealing with such events. The association would need to review its legal documents related to special assessments and should discuss the action with its attorney.

Borrow from Reserves

Should the association borrow cash set aside for the replacement reserves? Although this is not a best practice, an association could utilize or borrow cash from the replacement reserves under certain circumstances.

If this action is taken, a well considered and detailed plan would need to be developed, documented, and put into place. The plan must detail how cash borrowed from the reserves fund will be reimbursed, which must occur over a relatively short-term period. A detailed plan would be required to satisfy any income tax complications.

Snow removal expenditures are operational in nature and, in and of itself, should never impact the amount designated for an association's replacement reserve equity account. Funds designated as replacement reserve equity accounts should be based upon your current recommendations from your capital reserve study. This borrowing would only impact the cash available to fund the designated replacement reserves. Before any borrowing could occur, the association must complete a careful assessment to determine if enough cash is available to meet any short-term capital reserve expenditures, as determined or recommended by the capital reserve study.

A practical way of borrowing would be to temporarily suspend monthly cash contributions to the replacement reserves while additional cash is needed to pay for snow removal invoices.

A major point of emphasis related to this short-term borrowing is that the association would need to immediately implement plans to have a mid-year assessment increase or a significant assessment increase as part of the next one-or-two-year budget year cycle to repay the borrowed funds.

Line of Credit

If the association already has established a line of credit, it could be utilized to obtain quick cash to fund storm costs. However, since costs to obtain a new loan or line of credit can be high, it's generally not recommend an association pursue this avenue for such events.

The bottom line is that some very difficult financial decisions will need to be made regarding the financial impact of these storms. A careful financial review and a detailed plan will need to be performed by management and the board of directors. The faster a realistic financial plan is implemented, the faster the association can get back on a healthy financial track.

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