

Masthope Mountain Community

# Capital Reserve Plan

Board of Directors  
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# Capital Reserve Plan

Masthope Mountain Community Policy

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## Purpose and Goals

### Purpose

The purpose of this Capital Reserve Plan (the Plan) for the Masthope Mountain Community (MMC) is to ensure the stability of MMC's ongoing capital asset management, and to maximize the predictability of the funding needed for this management. The Plan is an MMC policy approved by action of the Board of Directors.

The document cannot be interpreted as a spending plan; spending is governed by the annual MMC budget. Rather, this Plan is a management tool for the transparent collection, forecasting, allocation, use, and calculation of the MMC reserves.

Capital asset management is mainly achieved through continued and iterative asset life cycle management, taking into account the expected useful life of each capital asset, the remaining life at any point in time after purchase, and its expected future replacement cost. This also includes asset maintenance if that maintenance will extend the useful life of the asset.

The Plan will also allow to identify any gaps in capital asset funding, and to develop, implement and improve the strategies and plans necessary to mitigate the effects of funding gaps on the ability of MMC to maintain and replace its capital assets.

Lastly, the Plan is used to specify and document the assumptions, constraints, and limitations of the continuously evolving capital asset management strategies for MMC.

### Goals

The Plan is intended to provide the management framework to establish, build, and maintain an amount of Capital Reserves that aligns with the needs of MMC. In order to accomplish that goal, MMC through its Board of Directors intends to actively monitor and manage the Plan, providing transparency for how Capital Reserves are funded, allocated to assets, and spent.

The Plan is meant to be a "living document" which will be updated as the needs and assets of MMC change and evolve. The Plan therefore needs to ensure that software and other tools are maintained and kept current to adequately determine, monitor and report on the state of MMC's Capital Reserves. This includes, but is not limited to, the Reserve Analyst® software, and the set of tools and reports identified in the Appendix of this document.

## Structure of This Document

This Plan consists of two parts that are designed to be managed separately:

1. The Capital Reserve Plan itself. The Plan provides the policy foundation for the Capital Reserve management, but does not contain any current or actual data.
2. Appendix A: Work Documents. These documents are updated and made current based on the provisions of the Plan. The work documents contain the actual data and measures in order to enact the policy. The tools used to produce these work documents will evolve over time with the explicit intent to provide the Board of Directors and MMC Management with simple to use tools to capture current and verifiable data, based on the general guidelines and policies contained in the Plan.

Sections that prescribe actions by the Board of Directors are marked with a vertical line, as in this paragraph.

#### Relationship to Other Policies and Documents

This Plan is a standalone MMC policy under the direction of its Board of Directors. It therefore aligns with the following fundamental documents in effect for MMC:

1. "DECLARATION OF PROTECTIVE COVENANTS, RESTRICTIONS, EXCEPTIONS, RESERVATIONS AND CONDITIONS" (the Declaration)
2. "BYLAWS OF MASTHOPE MOUNTAIN COMMUNITY PROPERTY OWNERS COUNCIL" (the Bylaws)
3. "MASTHOPE MOUNTAIN COMMUNITY PROPERTY OWNER'S HANDBOOK" (the Handbook)

In addition, this policy will provide guidance and frameworks for certain parts of the annual budget, which is approved under the rules spelled out in the Bylaws.

#### Assumptions

It is understood that the replacement cost calculation for any asset will always be the result of an estimation process and cannot be arbitrarily precise. Different asset related factors need to be understood, such as the useful life assigned to the asset. In addition, there are economic factors such as the rate of inflation and the interest achievable through prudent investment. The following assumptions are part of the Plan:

1. Useful Life

In order to estimate the replacement cost of an asset, the useful life of that asset needs to be determined.

*"Useful life" is typically defined as the number of years the component is expected to serve its intended purpose if given regular and proper maintenance. If the association fails to provide proper maintenance, such as dealing effectively with the presence of wood-destroying pests or organisms [...], then it may become difficult to anticipate the "useful life" of components. (1)*

One estimate of useful life is the material manufacturer's warranty. (1) Another estimate can be derived from published handbooks and manufacturer's manuals. Still another source of information can be the assessment of seasoned professionals. Since these sources may yield widely varying estimates of useful life for any given asset, it is normally advantageous to consult more than one source. (1)

During the annual review of this Plan, the Board of Directors will review the values for the useful life of assets as listed in the reports of the Reserve Analyst software, with the intent to ensure reasonableness and consistency of these estimates. After every annual review, the Reserve Study will be updated with the new agreed upon estimates.

2. Inflation

In order to assess the replacement costs of long-lived capital assets, replacement cost calculations need to take into account an inflation rate in order to avoid as much as possible an underestimation of cost.

During the annual review of this Plan, the Board of Directors will agree on a calculation parameter to account for inflation. This parameter can be set to zero (0) to simplify the calculation, and it cannot be more than the previous annual (12 months) Consumer Price Index (CPI). After every annual review, the Reserve Study will be updated to account for any changes in the inflation parameter.

### 3. Interest

The calculation of available Capital Reserves needs to take into account the interest rate if and when these funds are prudently invested in low-risk interest or dividend bearing accounts.

During the annual review of this Plan, the Board of Directors will agree on a calculation parameter to account for interest. This parameter can be set to zero (0) to simplify the calculation, and it cannot be more than the verified actual interest generated by these funds. After every annual review, the Reserve Study will be updated to account for any changes in the interest parameter.

### 4. Capital Asset Thresholds

Capital Assets can range from a few hundred dollar for small equipment and tools to several million dollars for buildings and infrastructure items. In order to simplify the Reserve Fund management, it is often advantageous to identify a threshold value below which capital asset replacements and maintenance will be funded as budget line items directly through the annual budget process and not from the Capital Reserves.

During the annual review of this Plan, the Board of Directors will agree on a calculation parameter to account for this capital asset threshold. The Board of Directors may also identify other assets to be funded from budget line items, even if their value is above the Capital Asset Threshold amount, as long as they are on a recurring rotational replacement schedule and the annual budget line item amounts contribute to the rotational schedule (for example, vehicles used for public safety).

After every annual review, the current in-effect assumptions and parameter values will be published and documented as part of the Work Documents in Appendix A of this Plan.

## Types and Funding of MMC Capital Reserve Accounts

### Restricted Capital Account (RCA)

#### Purpose

The Restricted Capital Account is defined in Article I.D-9, of the Bylaws of MMC. It is to be used to fund the repair, replacement or acquisition of capital assets.

#### Funding

The RCA is funded through operational surpluses and special assessments. The operational surpluses may be generated from the Unrestricted operational budget, or from the Food & Beverage operational surpluses. In the latter case, only surplus funds over and above 25% of the Food & Beverage operations surplus contribute to the RCA funding. In addition, the RCA fund is subject to minimum and maximum funding levels. More details can be found in Article III.Q of the Bylaws.

## Major Asset Replacement Accounts (MAR)

### Purpose

The Major Asset Replacement Accounts are defined in Article I.D-9 of the Bylaws of MMC. They are a set of restricted capital accounts to be used exclusively for the replacement of specified capital assets.

### Funding

The MAR accounts are funded through assessments, transfer fees, and RCA surplus funds as established in Article III.Q-14, of the Bylaws. A contribution to the MAR in the amount of 2% of the previous year budget is part of every annual budget.

## Food & Beverage Capital Account

### Purpose

The Food & Beverage Capital Account is used for the capital assets associated with the Summit restaurant

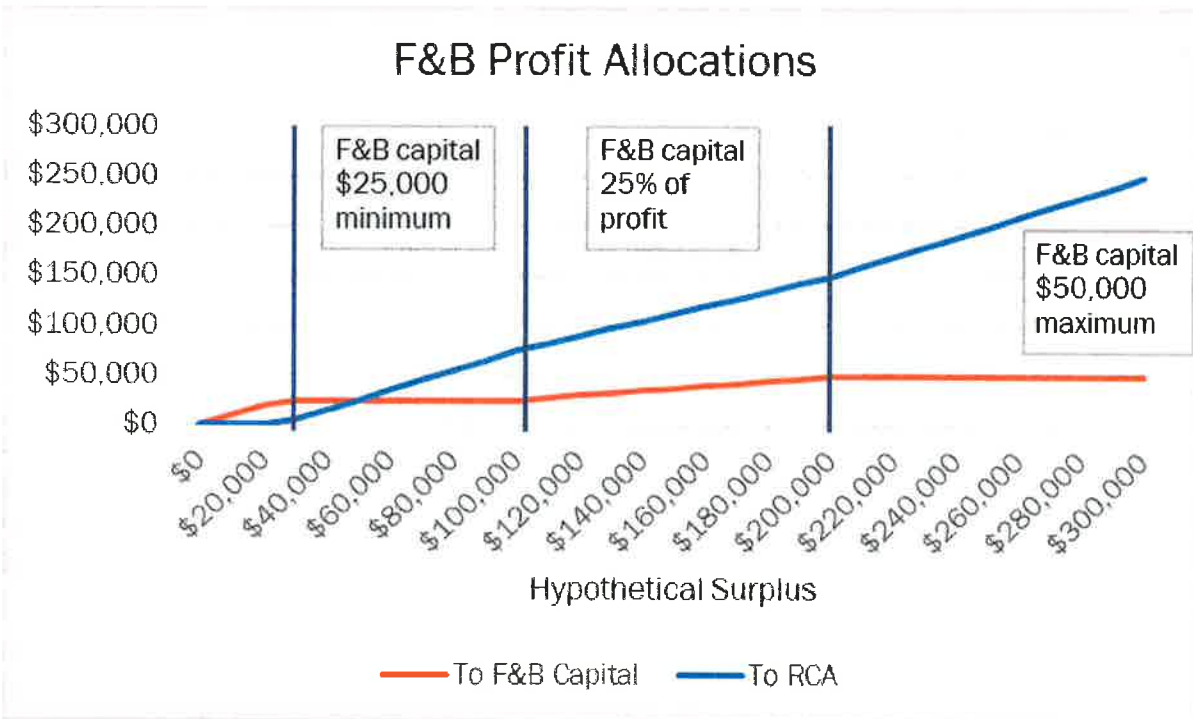


Figure 1: Funding of F&B Capital Account and RCA from F&B Surplus

and facilities (scramble food court, Tiki Bar, Property Owners Lounge, etc.) and the Marketplace.

### Funding

The Food & Beverage Capital Account is funded from the operational surplus generated by the Food & Beverage operations (Summit and Marketplace). The funding for the capital account is equal to 25% of the Food & Beverage operational surplus of the previous budget year, with a minimum of \$25,000 and a maximum of \$50,000. Funds can be rolled over from budget year to budget year. See [Figure 1](#).

Funding Flows

Figure 2 shows the different flows that feed the individual Reserve Funds. The relationship and funding

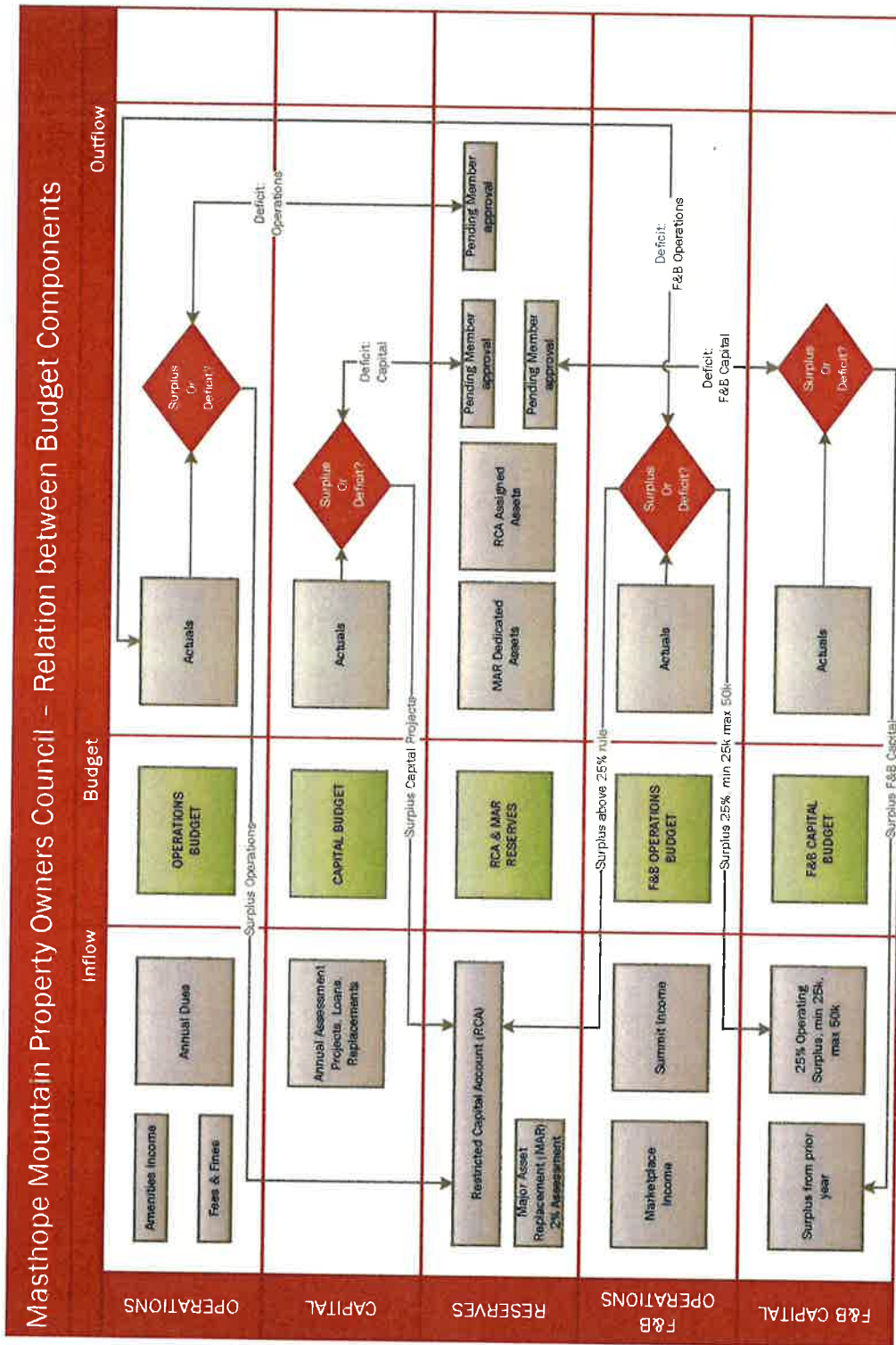


Figure 2: Relation and Flows Between Budget Components

mechanisms are specified through the Bylaws.



## Use of MMC Capital Reserves

In general, the Capital Reserves of MMC may be used for the replacement, maintenance, and the acquisition of capital assets. In emergency situations, and with approval of the membership only, the Capital Reserves may also be used to supplement operations budgets if a shortfall would impede the continued operation of MMC. However, there are restrictions in the use of individual capital accounts as dictated by the Bylaws. The following [Table 1](#) summarizes the allowed use of MMC Capital Reserves and the account limits imposed by the Bylaws (PY, Previous Year).

Table 1: Allowed Use of MMC Capital Reserves

Use and Limits	Restricted Capital Account (RCA)	Major Asset Replacement Accounts (MAR)	F&B Capital Account
Asset Replacement	YES	YES	YES
Asset Maintenance	YES		YES
Asset Acquisition	YES		
<i>Operations Shortfall</i>	<i>Only After Membership Approval</i>		
Lower Account Limit	10% PY Budget	N/A	0
Upper Account Limit	20% PY Budget	No limit	\$50,000

## Calculation of Reserve Funding Goals and Reserve Deficits

A critical part of the Plan is the determination of the funding goals for the Capital Reserves. The funding of full replacement costs may not be reasonable for all capital assets, but at a minimum, the Plan needs to describe how the replacement funding will be established. As an example, the replacement cost for a large building may total several million dollars which would put a significant burden on the reserves funding at a 100% replacement. On the other hand, a minor asset such as a restaurant refrigeration unit should be accounted for at a 100% replacement funding. This hybrid between a "Fully Funded Model" (1) and a "Threshold Funded Model" (1) is best suited for the mix of Capital Assets present at the MMC.

The process to determine the Reserve Funding Goal is therefore described by the following schematic:

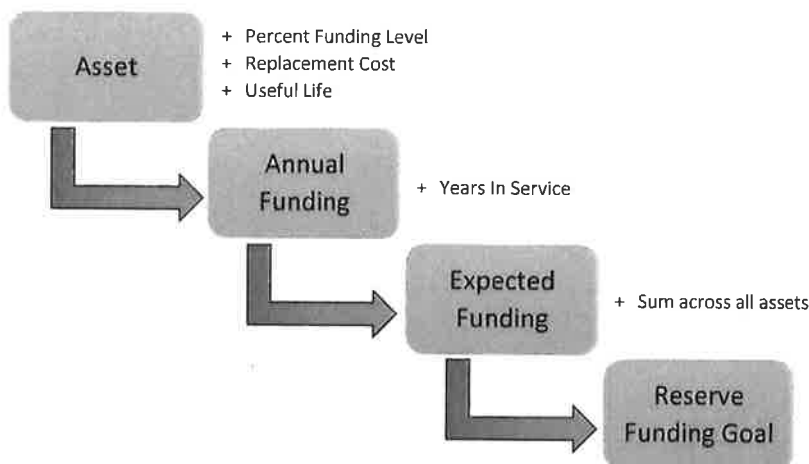


Figure 3: Calculating the Reserve Funding Goals

The following sections describe how these components are calculated

### Percent Funding Level per Asset

A Percent Funding Level (PFL) needs to be determined for each capital asset owned by MMC. While the PFL for most assets will be at or near 100% (for full replacement cost reserve funding), the most expensive assets in MMC will require a lower PFL in order to avoid undue burden on the reserve funding.

Note that Article III.Q-14 of the Bylaws specify a minimum PFL of 25% for any asset allocated to an MAR account. However, any MAR allocated asset can have a PFL value above that minimum.

### Annual and Expected Funding per Asset

For any given capital asset, the Annual Funding and the Expected Funding amounts are defined as follows:

$$\text{Annual Funding} = \text{PFL} \times \frac{\text{Replacement Cost}}{\text{Useful Life}}$$

and

$$\text{Expected Funding} = \text{Annual Funding} \times \text{Years in Service}$$

### Reserve Funding Goals

In order to calculate the annual and total Reserve Funding Goal needed for MMC, the values for Annual Funding and Expected Funding need to be summed up for all capital assets MMC owns.

$$\text{Annual Reserve Funding Goal} = \text{Sum (Annual Funding) for all assets}$$

$$\text{Total Reserve Funding Goal} = \text{Sum (Expected Funding) for all assets}$$

For all of MMC's capital assets, the Annual Funding and Expected Funding are automatically calculated by the Reserve Analyst software.

### Reserve Deficits

In many cases, especially during the buildup phase of reserves, it is useful to define Current Funding Level as the amount of funds that are in reality available and either allocated to an asset (MARs) or in general available for a range of assets (RCA, F&B).

- For all assets that have allocated reserves (only true for assets managed under the MAR rules), an Asset Reserve Deficit is defined as the difference between the asset's Expected Funding and the asset's Current Funding Level:

$$\text{Asset Reserve Deficit} = \text{Expected Funding} - \text{Current Funding Level}$$

- For the combined total of all assets (managed under RCA, MAR, and F&B rules), a Total Reserve Deficit is defined as the difference between the Total Reserve Funding Goal and the Total Current Funding Level across all accounts:

$$\text{Total Reserve Deficit} = \text{Total Reserve Funding Goal} - \text{Current Funding Level}$$

### Impact of Inflation and Interest

The Expected Funding for each asset is affected by inflation and interest. For any positive gain through interest, the Expected Funding can be reduced, while the loss through inflation needs to be compensated through higher funding levels. If *Interest* represents the annual interest gained, and *Inflation* represents

the annual inflation rate, then the following equation can be used to calculate a Comprehensive Funding level. (1)

$$\text{Comprehensive Funding} = \text{Expected Funding} \times \left( 1 + \frac{1}{(1 + \text{Interest})^{\text{Years in Service}}} - \frac{1}{(1 + \text{Inflation})^{\text{Years in Service}}} \right)$$

If the Board of Directors determines as part of the assumption review (see section on [Assumptions](#)) that non-zero values for either interest or inflation are to be taken into account, then the Reserve Funding Goals calculation must take into account *Comprehensive Funding* rather than *Expected Funding*. [Table 2](#) provides hypothetical examples for different combinations of Replacement Cost, Useful Life, Years in Service, and Interest and Inflation levels.

Table 2: Examples of Expected and Comprehensive Funding For Different Values of Interest and Inflation

Asset	Replacement Cost	Useful Life	Years in Service	Expected Funding	Comprehensive Funding
<b>Scenario 1: Interest 5% Inflation 3%</b>					
Asset 1	\$10,000	5	3	\$6,000	\$5,787
Asset 2	\$14,000	7	4	\$8,000	\$7,590
Asset 3	\$30,000	15	11	\$22,000	\$20,553
<b>Scenario 2: Interest 0% Inflation 3%</b>					
Asset 1	\$10,000	5	3	\$6,000	\$6,344
Asset 2	\$14,000	7	4	\$8,000	\$8,679
Asset 3	\$30,000	15	11	\$22,000	\$24,453
<b>Scenario 3: Interest 5% Inflation 0%</b>					
Asset 1	\$10,000	5	3	\$6,000	\$5,442
Asset 2	\$14,000	7	4	\$8,000	\$6,911
Asset 3	\$30,000	15	11	\$22,000	\$18,099

## Annual Plan Review

This Plan and all its parts will be reviewed by the Board of Directors as part of the annual budget planning. The Treasurer will be responsible that the review is scheduled, and that all necessary data and reports are made available to the Board. The review will be structured into two distinct parts:

1. Annual Reserve Review
2. Annual Policy Review

### Annual Reserve Review

During the annual reserve review, MMC Management will provide the following reports and work with the Treasurer to finalize the reports for the Board review:

1. MH RESERVE STUDY Report. This report is a comprehensive asset list of all MMC Capital Assets and is the central and most important detail report for the annual reserve review. The report is output from the Reserve Analyst© software. This report lists the following data:
  - o Description of the asset
  - o Replacement Year of the asset

- Useful Life of the asset
- Adjustment – any manual adjustment made to the useful life
- Remaining Life of the asset
- Current Cost of the asset. This is the replacement cost.
- Assigned Reserves for the asset
- Expected Funding value for the asset. The software refers to this as “Fully Funded”

During the annual reserve review, the Board of Directors will review this report with focus on

- Completeness of the asset list (including new assets acquired since last review)
  - Reasonableness and consistency of (a) replacement costs, (b) useful and (c) remaining life
  - Assigned Reserves and
  - Expected Funding.
2. Capital Asset Replacement Schedule (CARS) Report. This report provides an overview of replacement data and will be structured in the following way:
    - Assets grouped by replacement year. This allows a view of how many assets and what amount of asset value will need to be replaced per year.
    - Assets grouped by Useful Life. This allows a view of how many assets are short-lived and how many are durable, plus the associated asset values.
  3. Asset Allocation Statement. This report provides a list of all capital assets assigned (1) to MAR accounts and managed under MAR rules, (2) to the F&B account, (3) to the RCA account. The list will have the same information as the MH RESERVE STUDY report.
  4. Reserves Funding Goal Statement. This report provides a view of the Funding Goals for each account (see [Reserve Funding Goal](#) for details):
    - Funding Goal for the RCA
    - Funding Goal across all MAR accounts
    - Funding Goal for the F&B Capital Account
  5. Reserves Deficit Statement. This report provides a view of the difference between the overall Reserves Funding Goal and the Currently Allocated Funding:
    - For zero (0) values for inflation and interest: The report lists the total Reserve Funding Goal and the Currently Allocated Funding
    - For non-zero values for inflation and interest: The report lists the total Comprehensive Funding Goal and the Currently Allocated Funding.

#### Annual Policy Review

During the annual policy review, the Board of Directors will review all sections of the Plan with the goal of identifying and enacting any updates and changes to the Policy itself and the underlying assumptions.

#### References

Several publicly available resources have been consulted for this Plan:

1. **State of California, Department of Real Estate.** Reserve Study Guidelines for Homeowner Association Budgets. [Online] <https://www.dre.ca.gov/files/pdf/re25.pdf>.
2. **Nonprofits Assistance Fund.** Nonprofit Operating Reserves and Policy Examples. [Online] <https://www.nonprofitsassistancefund.org>.

3. **The Wallace Foundation.** Maintaining Operating Reserves: An Organizational Imperative for Nonprofit Financial Stability. *Resources for Nonprofit Financial Management.* [Online] <http://www.wallacefoundation.org/knowledge-center/resources-for-financial-management/Pages/Maintaining-Operating-Reserves.aspx>.

4. —. Operating Reserve Policy Toolkit for Nonprofit Organizations. *Resources for Nonprofit Financial Management.* [Online] <http://www.wallacefoundation.org/knowledge-center/resources-for-financial-management/Pages/Operating-Reserve-Policy-Toolkit-for-Nonprofit-Organizations.aspx>.