

Masthope Mountain Community

# Capital Reserve Plan

Revision 2.0

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 any tools and reports identified in this document.

## Structure of This Document

This Plan provides the policy foundation for MMC's Capital Reserve management. It does not contain any current or actual data. Per the revised Bylaws, the actual reserve data are reported in regular reports by the MMC Treasurer at General Membership Meetings. The previously included Appendix A (Work Documents) has been dropped with this Revision 2.0 and replaced with information on realignment of Capital Reserves after the approval of new Bylaws in November, 2018.

BOD: Sections that prescribe actions by the Board of Directors are marked with a special indent, 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.

## General Context

### What are Reserves?

*Reserves are monies set aside for the future replacement or renovation of the major community components. Every major improvement to the community that the community is responsible to maintain, such as driveways, parking lots, street lighting, playground, pool, roofs, painting, etc. will eventually need major renovation or replacement. Therefore, a reserve “fund” should be set up for each of these major assets the community is responsible for. (1)*

Laws for community reserve funds vary state by state. (2) (3) California has some of the strictest requirements specifying that a Reserve Study must be redone every three years. (2)

### History of MMC’s Capital Reserves

MMC Boards of Directors have always been aware of the need for capital reserves, although the use of those reserves has always been more liberal than the strictest definition of a capital reserve. Reserves were used not only for repair or replacement, they were used for acquisition of new capital assets. This worked for the community while it was going through a period of significant growth.

Recently the community has made Bylaws changes giving new and true direction to capital reserve funding and use. Today the Board uses a Capital Reserve Study to track all community major assets and components of those assets. Each item identified in the study is tracked for date of in-service, expected life, replacement value and salvage/sale value. It is also possible to make adjustments to useful life should an item fail early or live longer than predicted.

Reserve reporting is the strength of using software, reports can be generated to forecast annual funding needs as well as annual spending forecasts.

1. The funding needs are used to determine the contribution needed to assure that assets remain properly funded for future repair or replacement. Funding for reserves comes from several different sources including assessments and operation surplus. See Section on [Types and Funding of MMC Capital Reserve Accounts](#).
2. Spending forecasts detail what is identified in the asset inventory that may require action in a budget year. The forecast is reviewed each year for adjustments prior to approval of the community during the budget process.

## Additional Capital Funding Sources

### Loan Surpluses

Years ago, MMC property owners approved loans for community improvements, for the ski area, the lodge, and the beach house/riverpark access. Due to an increase in the number of properties paying dues and prudent refinancing, surpluses have been generated by each of these loans creating another source for capital funding in these specific areas. Any funding available at the maturity of these loans will be transferred into specific capital accounts.

1. Lodge rebuild – After the original lodge was destroyed by fire the community voted to expand the new lodge using both insurance monies and a loan.
2. Beach house/Riverpark loan – The community approved the building of the beach house and upgrades to the river park, funding was provided using a loan.
3. Ski improvements – The community approved many upgrades to the ski area including the new Thundercloud double/double chair, funding was provided using a loan.

### Allocated Capital Project Funds

The Masthope community had voted on several capital projects such as the replacement of Lodge Lighting Systems, Lodge Roof Maintenance, Vehicle Replacements and rotational replacement of various capital items. For a transitional period until these projects are completed, the allocated funds are accounted for as additional capital funding sources.

### Today's MMC Reserves

Between 2017 and 2018, a complete review has been done of all MMC assets and funding sources for MMC reserves. What was discovered is that prior to the new by-laws there was no true distinction of delineation of reserves. What does this mean? Simply said all reserves were lumped together without distinction. Because the community has three basic financial groups – general community, ski, and food and beverage – it should also have three reserve funds and associated funding models.

All assets were aligned with their respective group, for example a ski lift goes to ski, a pizza oven goes to food and beverage while community vehicles go to general community. Once this was done and entered into the software, proper funding models were created and initial funding determined.

## 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. (2)*

One estimate of useful life is the material manufacturer’s warranty. (2) 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. (2)

BOD: From time to time, 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 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.

BOD: From time to time, 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 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.

BOD: From time to time, 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 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 sometimes 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. Currently, no such threshold is applied and all capital assets are managed through the Reserve Study.

The current in-effect assumptions and parameter values will be published and documented as part of the regular Treasurer’s reports on reserves.

## Types and Funding of MMC Capital Reserve Accounts

### Restricted Reserve Account – General

#### Purpose

The *Restricted Reserve Account – General* is defined in Article VII.B-4, of the Bylaws of MMC. It is to be used to fund the maintenance, replacement or acquisition of general community capital assets.

#### Funding

The *Restricted Reserve Account – General* is funded through operational surpluses, project surpluses, capital improvement fees, the sale proceeds of capital assets, and special assessments. The operational surpluses may be generated from the Unrestricted operational budget, or from the Food & Beverage operational surpluses. Funding also includes a mandatory minimum funding of 2% of the previous year's operating budget. More details can be found in Article VII.B-5 of the Bylaws.

### Restricted Reserve Account – Ski

#### Purpose

The *Restricted Reserve Account – Ski* is defined in Article VII.B-4, of the Bylaws of MMC. It is to be used to fund the maintenance, replacement or acquisition of capital assets for the ski operation.

#### Funding

The *Restricted Reserve Account – Ski* is funded through 25% of the net income due to the Association from Ski operations of the prior fiscal year, up to a maximum of \$50,000 annually, and special assessments. More details can be found in Article VII.B-5 of the Bylaws.

### Restricted Reserve Account – Food and Beverage

#### Purpose

The *Restricted Reserve Account – Food and Beverage* is defined in Article VII.B-4, of the Bylaws of MMC. It is to be used to fund the maintenance, replacement or acquisition of capital assets for the food and beverage operation.

#### Funding

The *Restricted Reserve Account – Food and Beverage* is funded through 25% of the net income due to the Association from Food and Beverage operations of the prior fiscal year, up to a maximum of \$50,000 annually, and special assessments. More details can be found in Article VII.B-5 of 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. The Bylaws have provisions that allow, in emergency situations and with approval of the membership only, that 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.

## 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. Special attention needs to be given to high-value, complex Capital Assets such as buildings or large-scale amenities. In particular, Capital Reserves should not be seen as the primary funding source for these high-

value items. For those assets, funding through loans may be better. However, the wear and tear components and systems of complex assets, such as HVAC systems, electrical, carpets, fixtures and the like must be identified in the Capital Reserves.

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

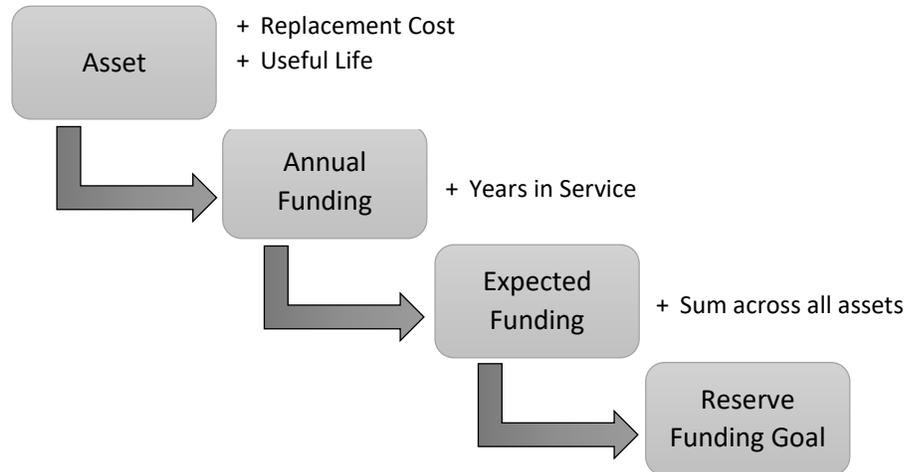


Figure 1: Calculating the Reserve Funding Goals

The following sections describe how these components are calculated

### Annual and Expected Funding per Asset

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

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

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.

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

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

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 for a range of assets.

- For all accounts, an Account Reserve Deficit is defined as the difference between the account's Expected Funding and the account's Current Funding Level:

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

- For the combined total of all assets, 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. (2)

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

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 1](#) provides hypothetical examples for different combinations of Replacement Cost, Useful Life, Years in Service, and Interest and Inflation levels.

*Table 1: 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:</b>					
	Interest	5%	Inflation	3%	
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:</b>					
	Interest	0%	Inflation	3%	
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:</b>					
	Interest	5%	Inflation	0%	
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

### Plan Review

This Plan should be reviewed and updated regularly by the Board of Directors. It may be advantageous to align the review with the issuance of the Treasurer’s Reserve Report at one of the General Membership Meetings.

### Change Log

First Issue, Revision 1.0	2017-09-30	Baseline version
Revision 2.0	2019-03-23	Amended to reflect new Bylaws

## References

Several publicly available resources have been consulted for this Plan:

1. **Hardy, Jeff.** TOPS Software Blog: Reserve Fund Accounting for Community Associations. *TOPS Software*. [Online] TOP, March 13, 2015. <https://camblog.topssoft.com/reserve-fund-accounting-for-community-associations>.
2. **State of California, Department of Real Estate.** Reserve Study Guidelines for Homeowner Association Budgets. [Online] <https://www.dre.ca.gov/files/pdf/re25.pdf>.
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. **Nonprofits Assistance Fund.** Nonprofit Operating Reserves and Policy Examples. [Online] <https://www.nonprofitsassistancefund.org>.
5. **The Wallace Foundation.** 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>.

## Appendix A: Realignment of Reserve Funds

With the approval of Vol XIII of MMC's Bylaws, the structure of Reserve Funds changed from the set of *Restricted Capital Account (RCA)*, *Major Asset Replacement (MAR)* accounts and *Food and Beverage Capital Account (FBCA)* to the set of *Restricted Reserve Account – General*, *Restricted Reserve Account – Ski*, and *Restricted Reserve Account – Food and Beverage*.

A portion of the RCA funds had been invested in CDARS (Certificate of Deposit Account Registry Service), a banking service similar to brokered CDs. This service provides investment diversification across different financial institutions while holding and managing funds at a single bank.

As of December 28, 2018, the following amounts were held in the previous set of reserve accounts:

*Table 2: Reserve Funds; Previous Reserve Account Structure*

Previous Alignment	As of 2018-12-28
RCA	\$775,723
CDARS	\$362,433
MAR	\$573,460
F&B	\$57,260
<b>Total</b>	<b>\$1,768,876</b>

Using the Reserve Study data on assets and replacement models, the following funds were reallocated into the new reserve accounts, with the Food and Beverage reserves being passed through:

*Table 3: Reserve Funds; New Reserve Account Structure*

New Alignment	As of 2018-12-28
Restricted Reserve Account – General	\$1,200,000
Restricted Reserve Account – Ski	\$511,616
Restricted Reserve Account – F&B	\$57,260
<b>Total</b>	<b>\$1,768,876</b>

## Appendix B: Other Capital Funding Sources

The loan surpluses referenced in section [Additional Capital Funding Sources](#) are listed below. The data are net of outstanding payments for the Fiscal Year 2018-2019, meaning that all outstanding payments for the months of January to April 2019 have been taken into account.

*Table 4: Additional Capital Funding Sources*

Additional Capital Funding Sources	As of 2018-12-28
Loan Surplus Lodge	\$147,951
Loan Surplus Beach	\$183,041
Loan Surplus Ski	\$64,654
<b>Subtotal</b>	<b>\$395,646</b>
Capital Project Funds	\$304,101
<b>Total</b>	<b>\$699,747</b>