FINANCE COMMITTEE MEETING

Minutes and Notes

August 22, 2024

Attendees:

- Marlene Fletcher, Committee Co-Chair, Board Member
- Jeff Mihalic (Committee Co-Chair), Board Member, Vice President
- Tom Eklund (non-voting board member, Board Treasurer)
- Clark Furlow, Board Member, Board President
- Dave Galloway, Committee Member
- Karen Curry, Committee Member
- Nancy Auseklis, Committee Member
- Sue Kwapich, SVEA Accountant
- Linda Horensavitz, SVEA General Manager
- Mark Lube, SVEA Operations Manager

Meeting Purpose:

Review and approval of the Reserve Study

Review and approve the Draft Capital Budget 2024-2025

Review and approve version 2 of the Draft Operations Budget 2024-2025

Review and approve the third quarter financials

Meeting Minutes

- Jeff Mihalic established a quorum and called the meeting to order at 3:02 p.m.

- The third party Capital Reserve Study was reviewed and discussed. Committee members made several observations about the inaccuracy of the study in regard to the timing of certain major expenditures, the low (1%) forecast interest earned on reserves, and the large increase in the capital dues requirement.

- Staff had previously noted the inaccuracies in the Study and Chuck Williamson had prepared a worksheet that addressed these inaccuracies. A copy of this worksheet was distributed to the Committee. Chuck's worksheet included additional capital items, modified the timing and amounts of certain existing capital items and added the Village Pool loan payments over the next 6 years while holding dues at the recommended $203 without escalation. It also included Rental Amenity Fee revenues of $30,000 annually (with the remaining $120,000 annually being applied to the Operating budget). The Committee determined that Chuck's version of the capital reserve forecast was much more accurate, especially over the next 10 years. However, Chuck's version showed a deterioration in the capital reserve forecast, primarily because of the Village Pool loan payments and the absence of annual dues escalation. This deterioration was in spite of the fact that Chuck incorporated the Study's recommendation to set capital dues at $203/member/year.

- Jeff Mihalic then distributed a modified version of Chuck's worksheet that showed the impact of raising dues by 3% every year to keep up with the assumed rate of inflation. Jeff suggested that along with a 29% increase in capital dues next year (from $157 to $203 annually), the annual increase is needed to build reserves and keep pace with inflation.

- Linda provided a history of SVEA dues over 34 years, beginning in 1990 through today. It showed that SVEA dues had been increased only 8 times in the 34 years, but some increases were in the range of 18 to 21%. The Committee noted that spreading dues increases evenly over the years would be the most fair method to all homeowners.

- Jeff provided a summary worksheet that showed SVEA's dues levels over the past 34. Total (Operating and Capital) dues increases tended to track fairly closely with the Consumer Price Index, increasing 211% while CPI increased 233% over the 34 years. However, Capital dues failed to keep pace with the Consumer Price Index (rising only 187% over 34 years while the CPI rose 233%). This approach of sporadic dues increases led to inadequate funding of the Capital Reserve while Operating Dues continued to increase on pace with the CPI in order to fund operations. In fact, Operating dues growth slightly outpaced the CPI, increasing 237% over the 34 years. So while many people appreciated that dues had been raised only 8 times, it wasn't apparent that total dues had actually increased at nearly the same rate as inflation.

- Based on this insight, the Committee agreed that it was more prudent to simply raise dues each year consistent with the actual CPI increase. Therefore the Committee will consider a larger first year dues increase, followed by annual CPI based increase, or a series of larger increases spread over several years, followed by annual CPI increases.

- The Committee also discussed setting a target level for capital reserve funding. The Study recommends a threshold of 70% to be categorized as "Strong" and a "Low Risk of Special Assessment". After reviewing the net capital reserves at the end of each year over the 10 years, the Committee felt comfortable targeting a range of 50% to 60% funding level, with a longer term target to increase our target to 60% to 70% funding.

- The Committee noted that several million dollars would be sitting in the capital reserves toward the end of the 10 year horizon, and that we should continue our policy of investing our cash reserves in Treasuries. The Committee felt that we should assume a return of greater than 1% net of taxes. Jeff and Marlene took an action item to review interest rate forecasts and suggest a new interest rate assumption. (Preliminarily, we believe that a rate closer to 2% may be more appropriate, at least for the next 2 years. This is yet to be reviewed with Committee),

- The Committee requested Linda to have the third party revise its spreadsheet to address the items adjusted in Chuck's spreadsheet, along with an increase in the interest rate assumption. Their revised spreadsheet must be available in time for distribution to board members prior to the September 12th board meeting.

- Jeff requested that Staff work with the Finance Chairpersons to prepare a two-page summary of the capital reserve study along with Committee's recommendation for approval of the study and the Committee's recommendation for Capital Dues beginning in 2024/25. This document will be included in the September 25th board packet.

- Staff noted that the reserve study will need to be approved by the Board no later than September 20, 2024, or any additional changes will result in additional charges.

- The Committee questioned why the entire Renal Amenity fee was not included as capital revenues. We assumed a 25% reduction from the current level of Rental Amenity Fee income due to the proposed changes in the fee structure that allow landlords not to opt in to amenity access. As a result, we conservatively estimate that our annual fees revenues may drop from $200,000 to $150,000 next fiscal year. Of that total amount, $30,000 will be allocated to Capital Reserve and the remaining amount to Operations ($120,000.00). This split is consistent with the analysis done for the Rental Amenity Fee presentation, which is based on the operations and capital costs that are directly associated with the amenities. Note that previously 100% of rental amenity fees went to the capital reserve. Therefore, Operations will realize $120,000 of new revenues for fiscal 2024/25.

- The Committee also discussed the wisdom of paying off the Village Pool loan. While it will be possible to pay off the Village Pool loan in late 2025, the Committee agreed to continue to hold the loan until its termination in 6 years because the 3% interest rate is very attractive and paying it off early would result in very low capital reserves that would expose SVEA to a possible shortfall in the event of any unforeseen capital requirements. Keeping the loan for another 6 years gives us time to rebuild our reserves.

- The Committee noted that any unforeseen capital expenditures could most likely be an insured event, so those unforeseen requirements may not be as extreme as feared. Regardless, we agreed to continue to hold the loan through its termination date.

- The Committee further discussed the need to reach the recommended level of 70% of the fully funded reserve amount. The committee feels that the reserve study is overly conservative based on SVEA's experience. The Committee felt that in the next 10 years we would be comfortable reaching 50 to 60% of the fully funded reserve amount, and that in the years ahead we would consider whether to keep progressing toward the recommended level of 70%.

- Several Committee members made note of the expected large increases in sub-association dues and their own special assessments and suggested that we take that into consideration as we set our dues increase.

- The Committee discussed our expected legal expenses for this year and next year. Clark believes that we will need to increase next year's legal budget to $75,000 to match this year's budget in order to have sufficient funds to document any agreement regarding the Elkhorn village core parking lot. Linda was asked to increase the operations budget accordingly and come back to us with the impact on Operating dues. (Linda has already completed this action).

- Linda noted that the operating budget for 2024/25 had been completed and that total dues (capital plus operations) would increase by 15%, from $734 to $845 annually. Operations dues would increase from $626 to $642, while Capital would increase from $108 to $203.

- Jeff noted that the current year capital dues of $108/member/year was artificially low (reduced from $157 to $108) because $80,000 of capital dues were shifted to fund operations. This was a one-time transfer to meet operational needs. We are performing better than budget this year so we forecast to move the $80,000 back to capital at the end of this year. Therefore when thinking about our current capital dues, we should remember the prior 7 years dues level was $157/member/year. Given that we are studying a step up to the recommended level of $203/year, it would seem logical to start at $157 or greater.

- Clark asked us to consider delaying or phasing in the dues increase over several years to ease the impact for homeowners. Jeff Mihalic answered that if you increase capital dues by 5% for five years, you get to almost the same place versus a large year one increase followed by CPI increases. Staff noted that the total dues increase would be an increase of $111/member/year, or only $9.25 per month. After much discussion it was agreed that this level of increase should be manageable for homeowners, so no phasing was necessary. However, we agreed that we would first need to see the impact of any further dues increases when the Operations budget is finalized.

- Linda noted that the CPI had increased by more than 20.2% over the past 3 ½ years. We should point out to members that we only increased dues 9% over the past nine years, so we still need to catch up in both Operations and Capital.

- Clark Furlow suggested that we should consider a new policy to keep abreast of inflation. The Committee agreed that we should increase dues annually based on the actual rate of inflation instead of a flat 3% as shown in the Study, and that it should become SVEA policy.

- The Committee agreed that we should slowly build the reserves during the next 6 years while the loan is being paid off, ideally keeping the reserves funding level between 50 and 60% of full funding. Once the loan is paid off, we can consider whether to push toward the 70% threshold recommended in the Study.

Action items:

- Marlene Fletcher and Jeff Mihalic will do some research on the rate of return and suggest a new assumption for the interest earned net of taxes. (We are now assuming 2.3% to match the CPI increase)

- Linda Horensavitz will update the operating budget, taking the legal expense to $75,000, and will send out an updated copy to the committee. (Complete)

The meeting was tabled at 4:49 p.m. until August 27, 2024. The following agenda items will be addressed when the Committee reconvenes on Thursday, August 29th:

1. Linda will present the updated Operating budget and the associated increase in Operating Dues. The Committee will be asked to review and approve the proposed Operating budget and the level of Operating Dues.

2. Linda will provide an updated version of the Capital Reserve Study that includes the updated suggested interest rate and the Capital budget for 2024/25. The Committee will be asked to approve the Capital Reserve Study, even though we are modifying certain assumptions and reflecting the impact on Capital Reserves using our internally developed spreadsheets.

3. Using our internally developed spreadsheets, Jeff will provide three alternatives showing the impact of a phased-in dues increase on Capital Reserve funding. The Committee will review these and determine which alternative is best for SVEA.

4. Linda and the Finance Co-Chairs will present a draft two-page recommendation for the SVEA Board (may not be ready in time for Thursday's continued meeting).

5. Sue Kwapich will present the Q3 Financial Statements and the Finance Co-Chairs will present their summary and a recommendation for approval. The Committee will be asked to approve the Financial Statements and recommend Board approval.

August 29, 2024 - Finance Committee Meeting Continuation

Attendees: Same as August 22 except Nancy Auseklis could not attend due to surgery.

- Jeff Mihalic continued the committee meeting starting at 2:00PM, noting the expected absence of Nancy Auseklis and directing committee members' attention to the five remaining agenda items as shown in these meeting notes.

Fiscal 2024/25 Operating Budget:

- Linda Horensavitz presented the updated fiscal 2024/25 Operating Budget., distributing copies of the detailed budget to attendees. This version includes $75,000 allocated for legal fees (to match the current year's budget). The Proposed budget for Operating Expense now totals $1,404,036, which is a 16% increase from the current year's budget. The main drivers of this year-over-year increase include $87K for the Administrative budget, $63K for a full year of Harker Pool operating expenses and $25K for income taxes and expected insurance premium increases.
- The Committee was reminded that the Executive Committee must approve the increase to the Administrative Payroll budget, which is driven by conversion of one position from part time to full time, a two month overlap where two GM's are in position., a 3% COLA assumption and merit increases to bring certain staff members up to market rates.
- Proposed Fiscal 2024/25 Operating Revenues now total $1,441,236, which is a 20% increase from the Current year's budget, driven by a 10% dues increase and the allocation of $120,000 of Rental Amenity Fee revenues to Operations. This is a change from prior years where 100% of Rental Amenity Fee revenues were allocated to the Capital budget. This change was made to align the allocation of RAF revenues with the Rental Amenity Fee analysis that showed that 75 to 80% of Amenity costs were driven by Operations, while only 20 to 25% were driven by Capital spending. This is a windfall to the Operations budget and explains why the proposed Operating dues are only 10% higher than the current year even though budgeted expenses are up 16% (and up by 20% once the RAF buffer is included).
- The RAF buffer is a $37,000 cushion for a potential shortfall in the Rental Amenity Fees due to introduction of the Opt-In feature. We are currently assuming a 75% Opt-In rate for homeowner/landlords, but SVEA staff is concerned that the Opt-In rate may be closer to 50%. Therefore, Staff recommended the added buffer to reduce the risk of revenues falling short of operating expenses.
- The proposed Operating dues for 2024/25 are $688 per member per year, which is a 10% increase from $626 in the current year, bringing annual Operating Dues revenues to $1,130,621. We are still using 1642 members to calculate the annual revenues because Staff expects only a small increase in total members as new condominiums come online.
- The Committee voted to approve the proposed Operating Budget for fiscal 2024/25 along with the dues of $688/member/year. The Committee also approved annual dues increases equal to CPI (assumed to be 2.3% for this coming year) to keep revenues on pace with expenses. This approach was viewed to be favorable and fair to all members versus the sporadic increases over the past 34 years. The motion to approve was made by Marlene

Fletcher and seconded by Karen Curry. The motion passed unanimously. It was also noted that the board treasurer, a non-voting committee member, also agreed with the vote.

Capital Reserve Study

- Linda distributed copies of the updated Capital Reserve Study, which was performed by Association Reserves, a Bellevue, Washington based company who had performed the last Capital Reserve Study five years ago.
- The update included several changes requested by Staff, including:
  - Inclusion of eleven capital items that were not captured in the initial Study.
  - Adjustments to the expected useful life of certain capital assets to match expectations.
  - Increasing the expected interest rate earned to 2%, net of taxes, to better match economic forecasts for the coming years.
  - The expected inflation rate remained at 3% even though near-term economic forecasts are fractionally lower and therefore not a significant difference in the first 10 years.
- The updated Study recommended annual capital reserves of $310,140 per year to achieve full funding of capital reserves. This equates to annual dues of $188/year/member. The Study also recommended annual dues increases commensurate with inflation in order to allow dues to reach the fully funded level.
- One significant assumption was not incorporated into the Study due to their protocols, and that is the Village Pool annual loan payments of $186,268 which continue for six more years and is funded through capital reserves. The other assumption not captured is the portion of Rental Amenity Fee revenues that flow to the capital reserve. Because of these omissions, Staff produced a worksheet that mirrors the Study but includes these adjustments.
- The Committee approved the Capital Reserve Study by general acclamation, noting that we must focus on the worksheet provided by Staff to determine the appropriate amount of capital reserves. The Committee agreed that the first 10 years of the forecast deserves the greatest attention as it has the highest level of accuracy.

Capital Reserve Analysis/ Capital Budget for 2024/25

- The Committee was provided with copies of Staff's spreadsheet. Jeff Mihalic explained the spreadsheet and walked through four options to rebuild the Capital Reserves. Options were included to phase in the Capital Reserve increase over a period of 4 to 5 years, as well as up front increases followed by annual CPI increases. It was noted that if we did not escalate the dues annually, the dues for year one would have to be higher and would be a greater near term burden on SVEA members.
- The proposed 2024/25 Capital Budget assumed in the analysis is $198,814. Significant items include funds to replace/upgrade SVEA's computer systems and website, replacement of certain furnishings at Harker Park/Pool and Village Pool, Seal coat of Harker parking lot and replacement of Harker Center carpeting.

- The Committee agreed to approve the recommended option "D" as described by Jeff Mihalic. This option starts the capital dues at $188 per year, then escalates the dues annually based on the CPI. This approach will keep capital reserves near 50% of full funding through year 10. The capital reserve level then climbs toward 70% of full funding by year 20 and remains at or near 70% thru year 30. The Committee felt that this level of funding was appropriate, noting that our capital reserves start at$1.1M next year, growing to $2.2M by year 10, $4.5M by year 20 and $7.5M by year 30. While these levels are significantly higher in future years, the impact of inflation combined with the aging of our pools and other high value assets command a higher level of reserves in order to avoid loans or special assessments. In Linda's experience with other HOA's, it was typical for an HOA to target funding at the 70% level. In fact, the Capital Reserve Study identifies 70% as the baseline to be categorized as "Strong Reserves" and "Low Risk" of special assessments.
- Linda also noted that certain states are implementing regulations that set minimum levels for capital reserves to ensure that HOA's are properly funded. Most notably, Nevada is introducing regulations requiring a minimum level of 70% of full funding. To comply, HOA's must be at that level or have a plan to reach that level. The Committee felt that by approving Option D, SVEA would clearly have a plan to reach 70% funding should Idaho ever choose to adopt such a regulation.

- Dave Galloway made a motion to approve the Capital Reserve Study and Capital Reserve Analysis, along with approval of Option D for the Capital Dues. The motion was seconded by Marlene Fletcher. The motion was approved unanimously. It was also noted that the board treasurer, a non-voting committee member, also agreed with the unanimous vote.

- The Committee also agreed by general acclamation that SVEA should have a policy to review the capital reserve analysis and assumptions each year when setting next year's budget - and confirm that we are continuing to progress toward the 70% funding level.
- The Committee also agreed by general acclamation that SVEA should have a policy to escalate the capital dues annually with the CPI, and that the same policy be applied to the Rental Amenity Fees. It was noted that cost escalation in the Sun Valley area is actually greater than that measured by the CPI. However, we were not able to find any regional indices that might be more accurate.
- The Committee discussed whether or not it was appropriate to raise SVEA's guest fee at this time. The Committee agreed by general acclamation that the guest fee should be raised from $5.00 to $10.00 to keep pace with the escalation of guest fees throughout the Wood River Valley.

2024/24 Q3 Financial Statements

- The Committee received copies of the Q3 Financial Statements prior to the meeting. Sue Kwapich was unavailable, so Jeff Mihalic walked through the highlights with the committee, including:

- Overall YTD net income of $582,605 was $257,766 better than budget. This better the plan performance is inflated by the collection of 2nd half dues while incurring only one quarter of expenses. It was noted that net income is forecast to be $68,000 better than plan at year end.
- Cash at end of Q3 was $1,628,244, a decrease of $301,966 during the month due to construction payments on the Harker Pool and routine operating expenses.
- Construction in progress on the Harker Pool had risen to $2,102,678 as the pool neared completion and the final invoices are being received. While this is above the $2.0 million budget, we have an offset of $175K of cash from Insurance proceeds for previously damaged equipment that was replaced via the pool construction. Chuck noted that the final bills are expected in September, and the total cost is expected to approach $2.2 million.
- SVEA's total assets at the end of Q3 have grown to $7,996,872, up nearly $500,000 from the end of Q2. Current assets are $1.6M, down from $2.0M at the end of Q2 due to continued operating expenses and investment into the Harker Pool. Staff is reinvesting cash into Treasuries during the month of August as final invoices are paid on the Harker Pool.
- Village Pool loan balance is down to $1,030,496, driving a continued decrease in SVEA's liabilities. Staff noted that we had previously mentioned to membership that the special assessment would allow the Village Pool loan to be paid off sometime in 2025. However, given the results of the updated Capital Study, as well as the 3% loan interest rate, Staff now recommends that we hold the loan through its termination, allowing the capital reserves to remain at roughly $1 million through the remaining six-year payment period. Otherwise, Staff feels that any unexpected capital requirements in the next few years could increase the risk of a capital shortfall. The committee agreed with that approach, noting that it should be clearly explained to membership.
- The committee approved the Q3 financial statements by general acclamation.

Closing

- Jeff Mihalic noted that all committee members would receive a copy of the minutes as well as the documentation being prepared for the September 25 Board meeting. We will seek committee member's feedback and approval of these documents, including:
    - 2024/25 Operating Budget and Operating Dues recommendation
    - Capital Reserve Study Update, Capital Reserve Analysis, 2024/25 Capital Budget and Capital Dues recommendation
    - Financial Policies recommended for Board approval
    - 20234/24 Q3 Financial Statements
- The meeting ended at 3:30PM.