2021 Budget for Capital Reserves

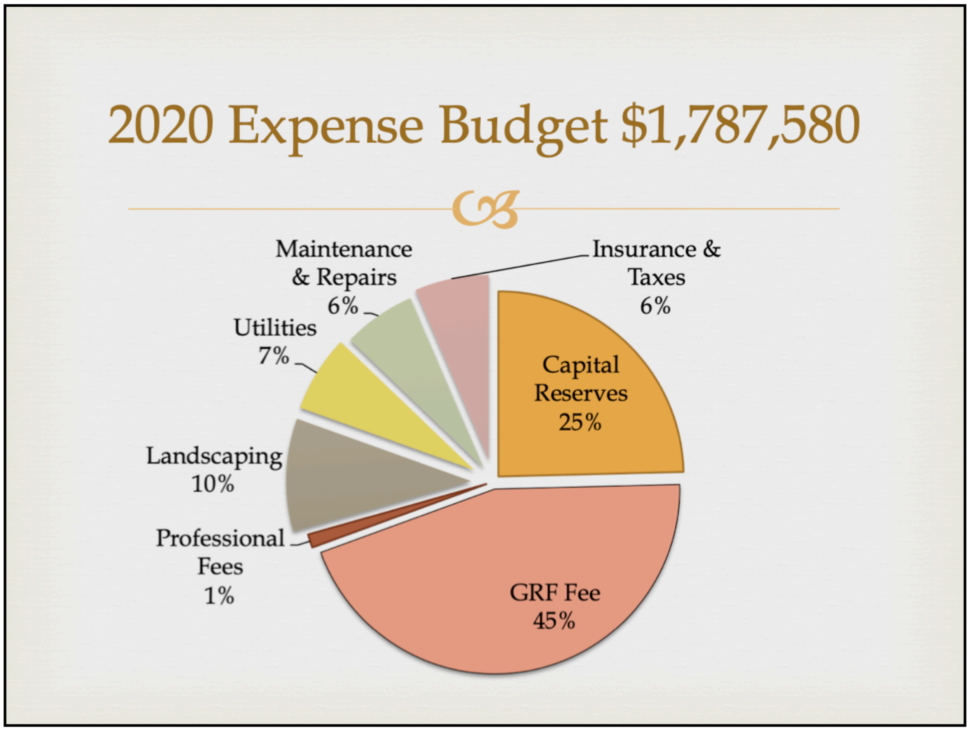
Mutual 6

September 18, 2020

At the August 7th Town Hall meeting, I gave an overview of our budget describing our revenue sources and various expenses. I described how your monthly payment is split into 3 accounts:

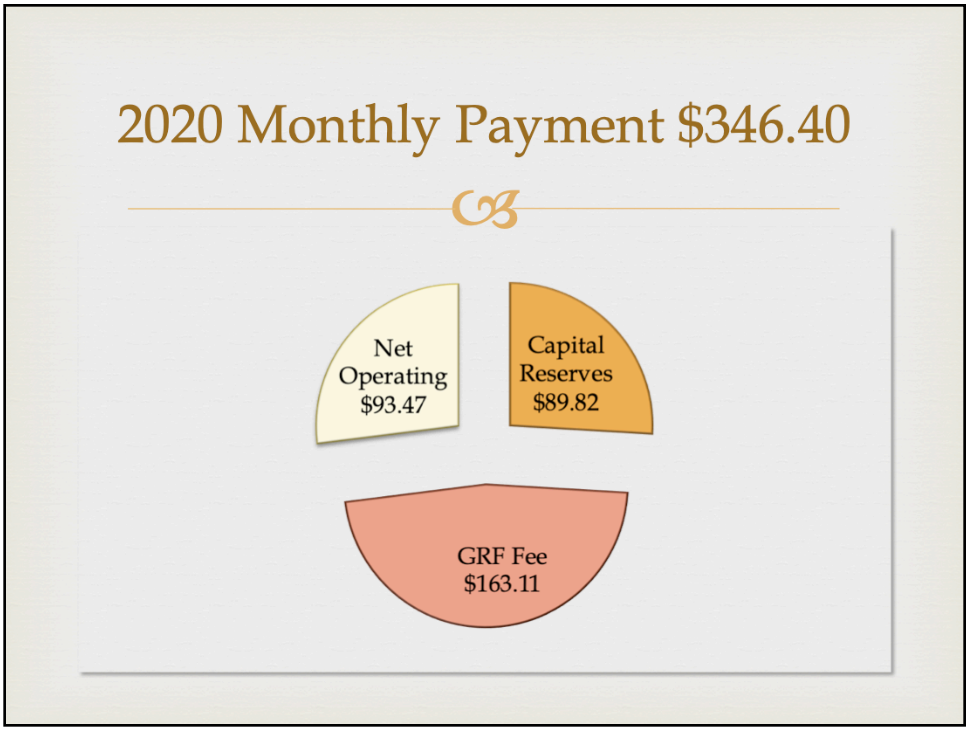
- First is the GRF allocation pass-through for operation and maintenance of common areas and facilities;
- Second, the Mutual 6 operating budget that goes to pay annual expenses such as landscaping, service maintenance, utilities and taxes; and
- Third, the Mutual 6 capital reserves for major construction projects. Capital reserves are for common area maintenance projects. The projects must have a limited, predictable useful life, and cost more than 1% of our operating budget. So Reserves are not an emergency or contingency fund for unpredictable expenses. Every dollar is tied to a specific project.

- Today I'm going to talk about this third category, the capital reserves, and how we evaluate the appropriate level of funding. At the September 25th Board Meeting, I'll go over the second category, the details of our operating budget. Before I do that, let me just refresh your memory.



This pie chart is very similar to a chart I showed you last month of the 2019 Year-End Actual Expenses. Our current 2020 budget actual expenses include:

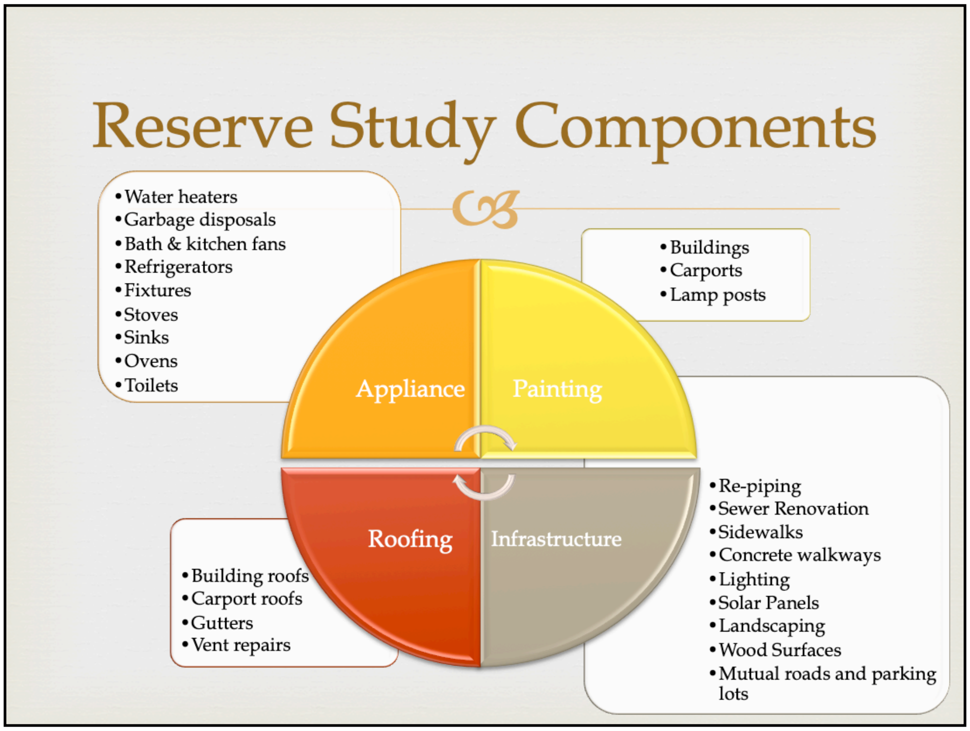
- A 45% pass-through to GRF for community facilities management.
- On the right hand side, you see 25% for Capital Reserves including Appliance Replacement.
- And that leaves us with 30% for actual operating expenses, or $549,235, that is budgeted for
    - landscaping (10%),
    - utilities (7%),
    - service maintenance and repairs (6%),
    - Insurance and Taxes (6%), and
    - Professional Fees (1%).



The monthly 2020 assessment is $346.40. Whatever you paid monthly in excess of this is set aside by Finance to pay your individual property taxes. In its more simplified form, here are the 3 major expense categories for the 2020 budget and how your monthly assessment is allocated.

- So just as you saw in the previous chart, 45% of your monthly fee goes to GRF for community facilities and administration. That's $163.11 per unit per month.
- You are paying $89.82 per month per unit toward Capital Reserves and Appliance Replacement.
- And $93.47 per unit per month operating costs.

Again, for this presentation I'm just going to focus on the Capital Reserves projection for 2021. On September 25th I'll go through the Operating budget.



Mutual 6, GRF and I think all the LW mutuals hire the same consultant to prepare annual Reserve Studies. Reserve contributions are a kind of “savings account” designed to offset the replacement cost of our Capital assets. When done well, we are able to predict how much we’ll need in any given year to maintain our assets, and we are financially prepared for when those projects eventually require replacement.

The foundation of every Reserve Study is the list of the components or capital replacement projects needed to maintain our Mutual over the long-term. As I said earlier, money is assigned to specific projects. There are 4 Reserve categories (going clockwise):

- Painting of buildings, carports and lamp posts;
- Infrastructure reserves for re-piping, sewer renovation, sidewalk and other concrete replacements, sidewalk and parking lights, solar panel replacement, major landscaping projects such as tree maintenance, repair and replacement of all wood surfaces, and repair of Mutual roads and parking lots.
- The third category is roofing that includes gutter replacement and vent repairs.
- And our last category is Appliance replacement that includes water heaters, garbage disposals, exhaust fans, refrigerators, fixtures, stoves, sinks, ovens and toilets.

Project Examples

Project Examples	Useful Life	Age as of 2021	Remaining Useful Life	Low to High Cost in 2020
Light Poles (170)	30	21	9	Low $61,000 High $96,000
Roofing (2 buildings)	30	31	3	Low $150,000 High $211,000

For each of the components, we determine its Useful Life based on industry standards, how old it is, when it will need to be replaced, and how much it will cost in today's dollars. The cost estimates will be different each year because they are adjusted for inflation, industry trends and special "Leisure World insider information" based on what other mutuals pay for the same work due to quantity discounts.

I'll give 4 examples to show how we deal with different situations. The first project is replacement of the light poles in the common areas. We have 170 poles, the industry standard says they should last 30 years, and they'll be 21 years old as of 2021. We have no reason to accelerate or decelerate the project at this time so we'll plan on doing the project in 9 years. The estimated replacement cost based on our zipcode is from $61,000 to $96,000 in today's dollar. You may think this is an insignificant project that can be extended indefinitely, but remember that this project includes replacement of miles of electrical conduit that decays over time creating a significant safety concern (as evidenced by the swimming pool project).

In the second example, we started our roof replacement project in 1990 with 2 buildings. Although the industry standard is for replacement every 30 years and those roofs will be 31 years old next year, we actually anticipate that we can stretch out the replacement date until 2024. The estimated replacement cost in this situation actually increased significantly from last year's Reserve Study. The industry standard in our area increased 44% from $4.15/sf to $6/sf. We have not received bids in LW since the COVID pandemic so we don't know if our rate will be the same as the local area rate. At this point, we are staying with the industry norm but it's hoped that this increase is related to a temporary COVID supply chain problem and that we'll be able to get a better price in 2024.

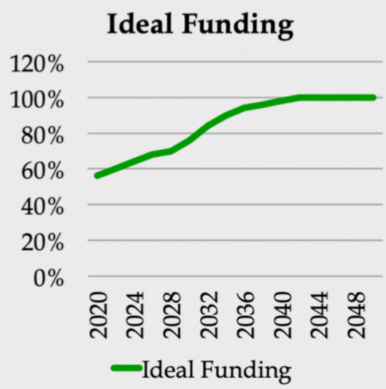
Project Examples	Useful Life	Age as of 2021	Remaining Useful Life	Low to High Cost in 2020
Copper Re-pipe (34 buildings)	60	58	0	$1,455,000
Sewer Rehabilitation (34 buildings)	70	60	9	Unknown $1-2 million

The third example is copper re-piping that as I mentioned in August is our highest priority project. Re-piping will resolve the odor problem reported by many shareholders, but more importantly, it will prevent a potential line break. Because of the pipe locations, one leak could damage 4 units and for that reason alone, Physical Properties has identified this as our highest priority project. The cost for this project is fairly solid and we anticipate starting it sometime in 2021. We will fund it from the roofing and infrastructure reserves.

As for sewer rehabilitation, we have added it for the first time to the 2021 Reserve Study. Sewers last 70 to 100 years but I'm sure you've heard of the sewer breaks in other mutuals. To our knowledge, there's never been a comprehensive evaluation of our sewer lines so we don't know if they will last another 9 years. We also aren't sure about the cost, although we have tentatively identified it as at least a $1 million funding need based on the sewer relining project in Mutual 1. This year, the Board will have all Mutual 6 sewer lines video recorded because the only thing worse that a sewer leak is a sink hole caused by a sewer leak. Based on the video data, we'll be able to make a more informed decision about the remaining useful life of the sewer system, determine the best way to rehabilitate the sewer lines that run under our buildings, parking lots and streets, and have a more accurate cost estimate for next year's Reserve Study.

Re-piping and sewer rehabilitation are the worst kind of projects for an association because instead of preparing and setting aside funding for the projects over the years they just pop up as urgent issues. It's the financial equivalent of when your youngest child graduates from college and you find out that you're pregnant with twins. Only without the joy.

Ideal Funding Level

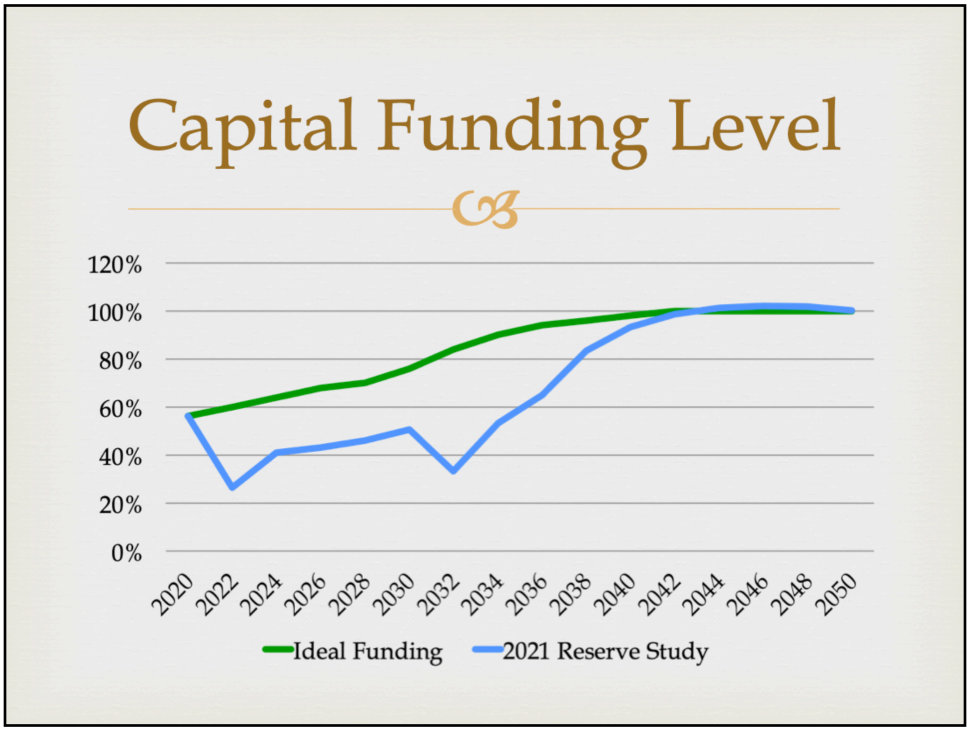


Painting: $100,000 Cost Estimate

No. of Years	Annual Reserve	Total Reserve	% Funded
10	$10,000	$100,000	100%
10	$5,600	$56,000	56%

That was just an example of the kinds of projects and analysis that go into preparing a Reserve Study. So after we update the component project list, we want to get a pretty line that looks like the green line. We started 2020 with a funding level of 56%. That means that we have 56% of the funds needed to complete the various projects on the dates they are due to be completed. For example, if we had $100,000 painting project that we planned to complete this year, we'd only have $56,000 of what we need and would have to borrow money from another project. Per industry standards, a financially sound Reserve account would be from 70% to 100% funded. The green line represents a reasonable path to be 70% funded in 8 years, and 100% funded by 2038.

And what's magical about 70%? Studies and trends indicate that when you are below 70% funded you have an increased potential for a one-time, lump-sum special assessment if a project you were expecting to do in the future becomes an urgent issue and needs to be completed immediately. The further below 70% funding, the greater the likelihood of a special assessment, and anything below 30% is a red alert.



In this chart you see the green ideal path to full funding and the blue line representing the funding level resulting from our proposed capital reserve budget. What changed? The cost of roofing increased 44%; the repipe project was just added 2 years ago; and we discovered that sewers, gutters and Mutual street repairs were missing entirely from the report. Once we complete the copper repiping project next year, the funding level will dip to 26% in 2022. In 2031 it will also dip below 30% as we finalize the roofing project and sewer rehabilitation. We take two big hits because we are actually funding projects and that is **very positive news**. We are able to recover from these unexpected projects and reach 70% funding in 2037 and 100% funding in 2043. In the next two slides I'll show you everything we can accomplish over the next 10 years.

Project Plan

Year	Project	Cost Estimate
2021	Re-pipe 34 buildings	$1,455,000
2021	Drainage & tree maintenance	$64,000
2021	Water heaters (laundry + 168 units)	$102,000
2021	Sidewalk repair	$100,000
2024	Roofing and gutters (2 bldgs)	$218,400
2025	Wood repair & paint all exteriors	$317,000
2025	Roofing and gutters (5 bldgs)	$479,900
2025	Signage replacement	$140,000

Based on our capital reserve funding plan, we will be able to complete the following projects:

- Re-pipe all buildings
- A drainage improvement project between buildings 62 and 67 and tree trimming throughout the Mutual
- Replacement of 168 water heaters that are 15 years or older, including most of the laundry rooms
- Sidewalk repair to improve drainage and remove any developing trip hazards
- In 2024 we will begin re-roofing and gutter replacement with 2 buildings most in need. Possibly the oldest, possibly not.
- In 2025, we'll replace damaged wood and paint all exteriors.
- We'll also continue the re-roofing and gutters for 5 more buildings.
- There is a reserve for signage replacement that will probably be transferred to another project such as Mutual street repair.

Project Plan (cont.)

Year	Project	Cost Estimate
2026	Roofing and gutters (5 bldgs)	$460,900
2026	Sidewalk repair	$52,000
2027	Roofing and gutters (5 bldgs)	$460,900
2027	Water heaters (232 Units)	$162,400
2028	Roofing and gutters (5 bldgs)	$479,900
2029	Roofing and gutters (5 bldgs)	$498,900
2030	Renovate pole lights	$96,000
2030	Roofing and gutters (2 bldgs)	$218,400
2030	Sewer renovation to begin	$1,156,000
		$6,461,700

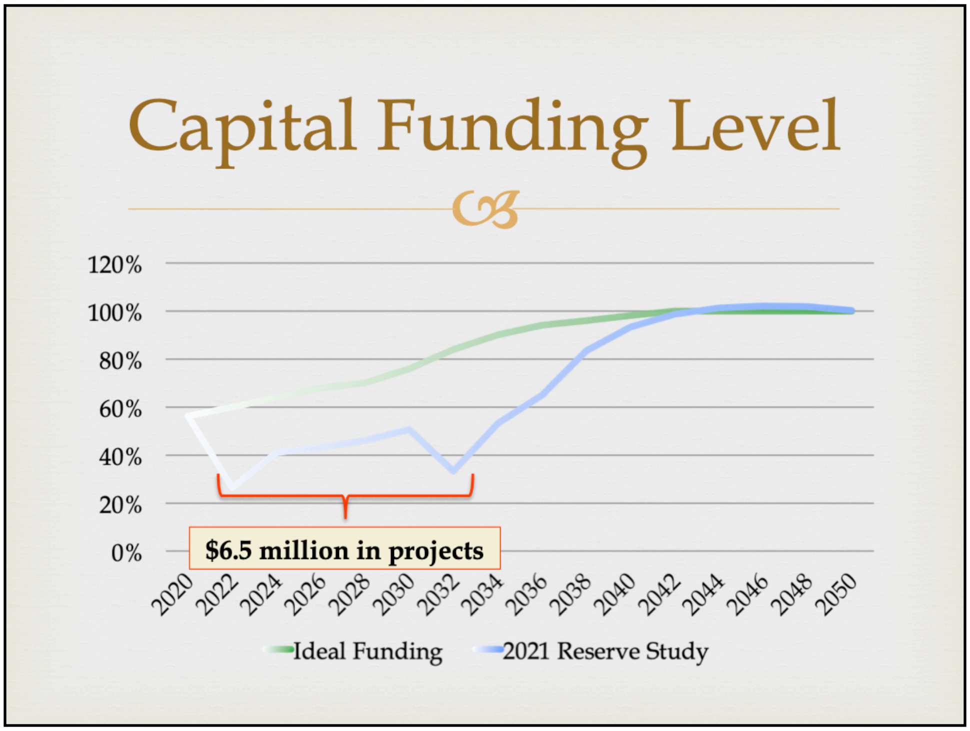
Between 2026 and 2030, the plan is to:

- Re-roof 22 more buildings
- Do additional sidewalk repairs
- Replace 232 water heaters 15 years and older
- Renovate pole lights
- And hopefully the start of a sewer renovation project.

Please bear is mind that this is the plan as we see it now, and that there will almost certainly be changes:

- The sewer renovation project will change as we learn the condition of the sewers and figure out the best way to address it.
- The signage replacement may well be deferred and become a Mutual street and parking repair project.
- And all the cost estimates will be adjusted for inflation and industry trends.

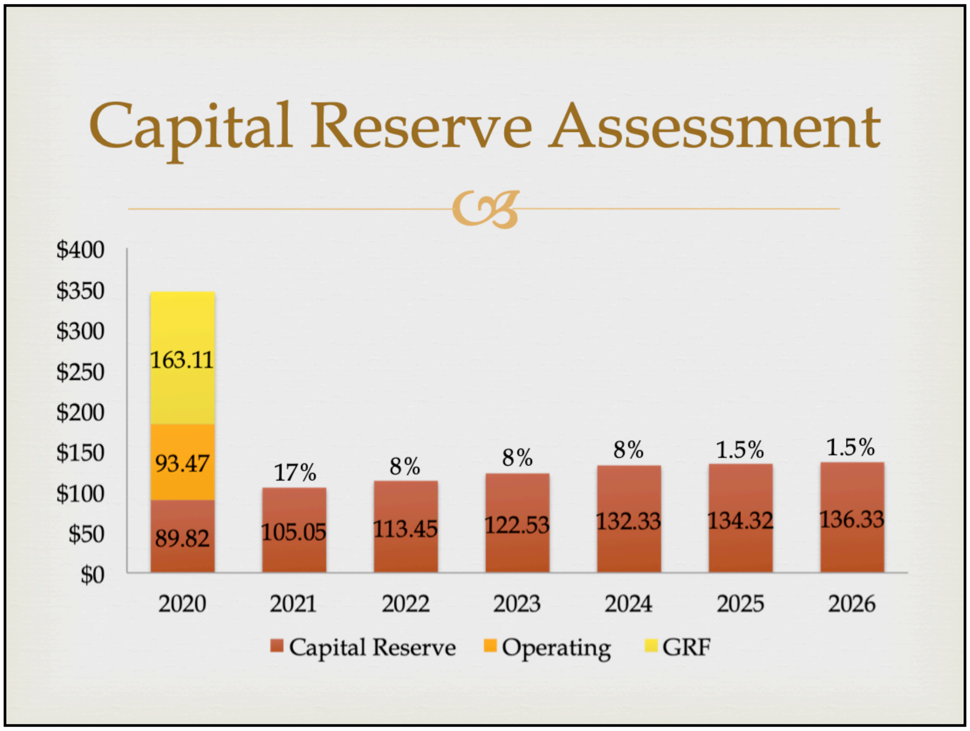
But the beautiful part of this chart is the bottom line. In 10 years, we will have spent $6.5 million dollars in renovations.



The fact that those dips are the result of our spending $6.5 million and completing the majority of our high value projects offsets the typical alarms that would be raised. These projects will be funded with our proposal unless:

- we don't take action to increase our capital reserves assessment; or
- We have a premature catastrophic failure of a component.

There are no certainties when you are this close to the bone. In 2031 through 2033, our starting reserve fund balance will be approximately $900,000. That's running a very tight ship.

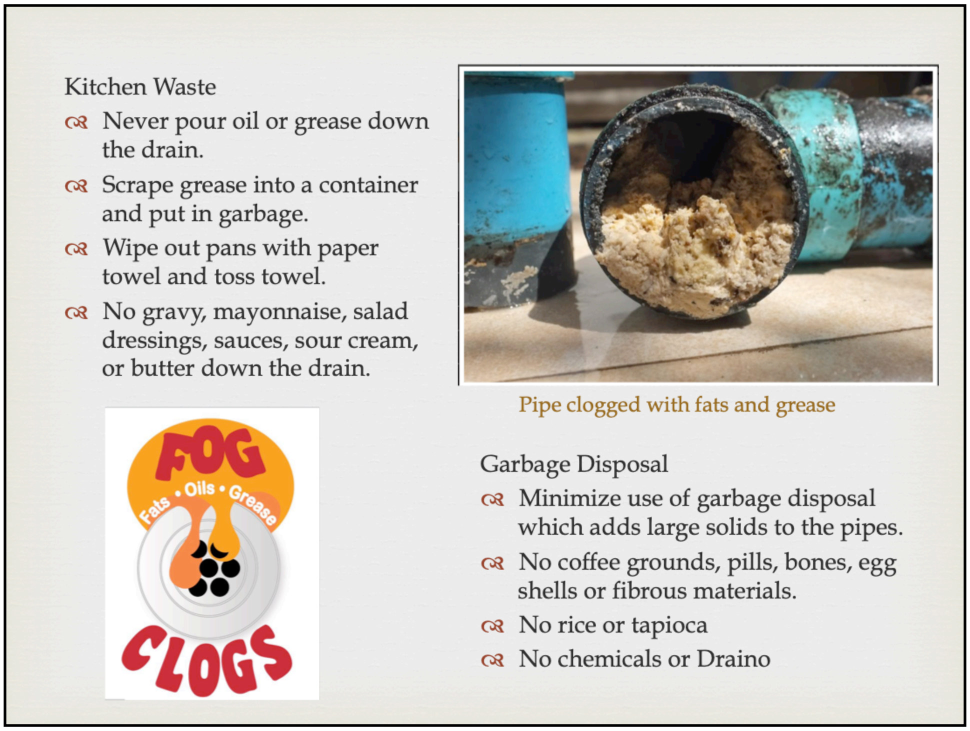


Let me tell you the assumptions we used for capital reserve assessments. I've included the 2020 Budgeted assessment for Capital Reserves, Operating Fund, and GRF in this chart so you understand that I'm only talking about the capital reserve assessment here today. Next week we'll talk about the operating budget and I don't know when we'll have the assessment for the GRF portion. But the figures you have seen to-date are based on the following assumptions for increases to the Capital Reserve fund:

- At $105.05/month/unit, the 2021 assessment is a 17% rise over the prior year.
- An 8% increase over the subsequent 3 years.
- A 1.5% increase in all subsequent years. When we complete our projects, look how the annual assessment goes down and stays steady at 1.5%.

After much discussion with the Reserve Study consultant and running multiple scenarios, this is the best scenario we could come up with to fund our capital needs and yet stay within a reasonable increase for our shareholders. Before I wrap up, I want to share one more thing with our shareholders.

This is a picture of the Mutual 9 sewer problem and its BUDGET problem. In the first day alone I heard they spent $70,000. We do not want to be in this position. It is extremely important that we all obey the waste guidelines for garbage disposals and sewers. Treat the sewer system as if it had Irritable Bowel Syndrome. Flush ONLY toilet paper down the toilet! No paper towels, wet wipes, tissues, bandages, cotton balls or cat litter.



In the kitchen, never put fats, oils or grease down the sink!

- Scrape grease into a container and put in the trash,
- Wipe out pans and greasy plates with a paper towel and toss the towel;
- Minimize use of the garbage disposal because it adds large solids in the pipes;
- Don't dump gravy, mayonnaise, salad dressings, sauces, sour cream or butter down the drain;
- No coffee grounds, pills, bones, egg shells, or fibrous materials like banana or potato peels, celery, etc.
- No rice or other highly absorbent foods like tapioca
- And no chemicals (nail polish remover) or Draino.

Treating our sewer system delicately is essential to keeping our costs down and minimizing a major sewer problem.

For next steps, I'd like to have discussion of the proposed Capital Reserve Assessment. I know it's a shock for the Mutual with the lowest monthly assessments to consider a $15.23 monthly assessment increase, but the Reserve Funds are woefully underfunded and eventually we need to make a decision that is in the best interests of the shareholders.

I don't consider my home to be an "investment." It's where I choose to live for as long as I'm lucky enough to be here. Although I'm not looking out for how well my home appreciates, I am looking to ensure our homes are properly maintained. But some residents are concerned about the investment value of their home for the sake of their heirs, and it's good to keep in mind that new buyers don't buy into associations that are poorly maintained or where there's a high risk of a special assessment.

I've put in the hours and research to honestly say I believe this is the best reserve funding proposal I and our consultants could develop to get us properly funded, be fiscally responsible to our shareholders, and maintain our infrastructure. I will review the proposed operating budget at the September 25th Board meeting, and we will vote to ratify the budget at our October 23rd meeting.

Thank you for your attention and I am open for your questions.