## Memorandum for Big Canoe POA Board

## Subject: Capital Funding Report

**Date: 23 October 2018**

1. As part a POA initiative to develop a new long range master capital plan for Big Canoe, the Finance Committee was tasked with looking at potential funding options. Specifically, the Committee was asked to do a comparative study of how other like communities funded capital requirements and make recommendations to the board concerning practices that could potentially be appropriate for Big Canoe.

2. The study was limited to direct resourcing of capital reserve accounts through which capital requirements can be funded. We did not look at operational budgets, which in all cases are funded by assessments and fee structure. The committee recognizes that operational performance can have an impact on net cash potentially available for contribution to capital reserves. However, reliance on operational performance solely year over year was seen as too unpredictable but could serve as a bonus in any given year.

3. The committee reviewed a list of 46 communities in Georgia, South Carolina, North Carolina, Alabama, Tennessee and Virginia. The list was compiled through recommendations from the General Manager, Consulting groups that work with communities like Big Canoe, Senior Staff, Directory of private communities in the Southeast and personal knowledge of committee members. The 12 selected for further review reflected a cross section of large/small/mountain/coastal/newer/older communities across 6 states considered to be attractive and competitive with Big Canoe. The Major findings are as follows:

   a. **POA owned Amenities**: In 7 of the 12 communities surveyed, the POA owned the amenities with access and participation available to all property owners. All 7 communities charged a mandatory initiation fee as a condition of property purchase. Those fees ranged from $8,000 to $20,000 as either a flat fee, multiple of the assessment or a percentage of the home value capped at some level. The fee revenue is used to fund Amenity Capital Costs.
   b. **Privately owned Amenities**: In 5 of the communities surveyed, Amenities were owned by a private club system with access limited to members. All privately owned club systems charged Initiation fees that funded Amenity capital requirements. One of the communities required mandatory amenity participation and payment of initiation fees while the remaining left Amenity participation optional. Club Initiation fees ranged from $4,000 to

$50,000 in those communities surveyed. POA operations and common community Infrastructure are managed and funded on a separate budget supported by assessments and fees.

c. **<u>Amenity Membership Dues</u>**: All 12 communities surveyed had a monthly dues structure for Amenity membership. Each community packaged the memberships differently. Private club dues structure was in most cases significantly higher with a wider range of choices and included food minimums for dining. POA owned Amenity structures typically offered fewer choices at lower rates. Dues are used to fund Amenity operations.

d. **<u>Infrastructure Capital Funding</u>**: 10 of the 12 communities surveyed had the common problem of capital funding for gated community infrastructure like roads, common areas and major projects outside the Amenities. The exceptions are private communities without gates meaning that major infrastructure requirements are funded by the county. The committee found a number of methods were used to fund those Infrastructure requirements. In most cases the POA designated a percentage of monthly assessments to be placed in capital reserve for non-amenity infrastructure. This revenue was incremental to Initiation Fees. Typically that was 15%-20% of total assessment. In some communities with lower infrastructure needs, capital projects were funded via special assessment. In those communities where special assessments were being or had been used to fund infrastructure, there was an effort underway to build a more robust capital reserve and flow of revenue.

e. **<u>Assessments:</u>** All communities surveyed had a monthly assessment to support operations. Typically, those assessments are reasonably similar to Big Canoe in the range of $2,500 - $4,000. It is difficult in some cases to isolate monthly assessment from social membership. In addition, many of the communities had a robust fee system for services, e.g. annual fees for gate transponder or guest passes.

f. **<u>Capital Reserve:</u>** All communities surveyed either have a Capital Reserve fund or are building one. Those in the building process are newer communities that will be faced with increasing capital needs. Typically communities are maintaining a running balance of about $2MM or more.

4. Fundamentally, all communities are facing the same capital issues and using similar funding methods to address the challenge. Big Canoe is unique among all communities surveyed in that it does not have a mechanism to provide a continuous flow of new money into capital reserve to fund future capital requirements. As a consequence, annual depreciation credit is consumed in routine equipment replacement and general repair leaving no residual for more expensive replacement items and major projects. In addition, Big Canoe has a larger community infrastructure than most communities surveyed, e.g. Firehouse, Post Office, miles of surface roads and Core Village. The

committee believes that the POA has to create new funding revenue streams to support the long range capital master plan.

5. Discussion of common methods used by like communities to fund capital requirements:

a. **Initiation Fees:** This is the most common method used by other communities to fund capital reserve. In communities where amenities are private, Initiation fees are limited to amenity membership and packaged based on desired participation. In communities that own Amenities the Initiation fee is associated with joining the community. The difference between the surveyed communities and Big Canoe is that Initiation fees have been a standard requirement since inception. To establish such a requirement in Big Canoe would require property owner vote for approval. The clear advantage of an initiation fee is that it appropriately shifts some of the capital burden to new buyers who join the community. There are differences in how the fee is charged. The majority charge a flat fee as a dollar amount or multiple of the assessment for all new property owners. The thinking is that everyone gets the same amenity access and use the same infrastructure. Lot buyers are charged a lesser amount initially with a makeup premium upon dwelling construction. Others use a percentage of the property value as a basis, typically capped at a dollar amount to avoid large gaps in capital contribution. Revenue generated through Initiation fees will always be a function of property sales in any given year. Most communities compensate for that with a small percentage of normal assessment devoted to capital reserve as well.
b. **Assessments:** A direct solution to capital funding is to simply raise assessments to meet capital reserve requirements. In communities with privately owned amenities, the club systems typically employ a similar method by raising annual dues or imposing minimums to cover amenity capital costs. The clear advantage of using assessments as sole funding is that the POA board could potentially impose those fees, as necessary, after consultation with property owners but without a vote for approval. No community surveyed used annual assessments as the sole source of capital reserve funding for both Amenity and Non-Amenity Infrastructure. Most communities surveyed did earmark a percentage of annual assessments, incremental to Initiation Fees, for capital reserve.
c. **Special Assessments:** Using special assessments to fund larger capital projects had been employed in some of the communities surveyed to meet large or unusual expenses. For example, coastal communities used special assessments to clean up storm damage. In some instances, for major projects, this was accompanied by assumption debt and the use special assessment to cover amortization and debt service. Special assessments require property owner vote and approval for every project. They are suited to unusual

circumstances but are not generally favorably viewed as a means to fund a long term capital plan.

6. The committee believes that the best course of action is to employ a combination of Initiation Fee and earmarks to general assessment to create the necessary capital reserve revenue stream. This is in keeping with best practices from communities like Big Canoe. All new revenue should flow to a capital fund separate from the current restricted capital reserves.

7. **The committee recommends the following:**

   a. **Create an initial contribution to a capital reserve fund via a board designated percentage of free cash, if any, net of amortization and 1 month operating expenses at the end of 2018. Continue this practice into future years.**
   b. **Direct any revenue from sale of POA property to the capital reserve rather than debt reduction. This assumes that the sale of property occurs in a reasonable timeframe.**
   c. **Designate a percentage, to be determined by the board, of annual assessment revenue for capital reserve beginning with the 2019 budget.**
   d. **Implementation of an Initiation fee for new buyers. The specific amount and basis for the fee to be determined by the board after completion of the long range master plan. This step will require consultation with and vote by property owners. The proposal should give property owners the option to decide whether capital revenue required to support the approved master plan is raised via Initiation Fees for new property owners or as an additional levy to general assessments. The label placed on this fee will be important in property owner dialog. For example, a mandatory Community initiation fee for new buyers accompanied by a short (1-2 months) period of introductory Amenity membership may be more favorably viewed than the same fee labeled something else.**
   e. **Upon completion of master plan upgrades to Amenities, reevaluate monthly Amenity dues for specific venues to be closer to market for similar facilities in other private communities.**

Ralph Ripley
Chair
Finance Committee