



STAFF REPORT– CAPITAL FUNDS POLICIES UPDATE WORKSHOP NO.2

STAFF REPORT PURPOSE

This staff report is prepared as a source of information and presents background material and discussion of issues and concepts relating to Tahoe Donner capital reserve funds, the work being implemented out of the 2024 Strategic Annual Objective – Capital Funds Policies Update project.

This staff report focuses on the expected discussion at the Special Board Meeting scheduled for April 30, 2024 agenda item, Capital Funds Policies Update Workshop No. 2 regarding the macro concept of where facility replacement should be planned and funded and the options available to the board to:

1. Keep facility replacement planned and funded for in the Development Fund; or
2. Move facility replacement planning and funding to the Replacement Reserve Fund; or
3. Move facility replacement planning and funding to a subset or sub-fund of the Development Fund or Replacement Reserve Fund; or
4. Move facility replacement planning and funding to an altogether new capital improvement reserve fund.

This report does not discuss other fundamental aspects of the policies including funding plan (funding parameters and adequacy measures), reporting, project budgeting, and expenditure. Those will be addressed in a separate staff report to support any future board workshops and decision-making by the Board for the policies' update drafting.

INTRODUCTION

In July 2023 the Community Associations Institute (CAI) adopted a new Reserve Study Standards. The standards are nationally recognized and implemented in the common development industry, by states, and by common interest development in policies and regulations to develop and maintain a Reserve Study and associated funding plan. The purpose of the standards “is to inform and guide the reserve study provider (and common interest developments) ... with the minimum requirements necessary for the preparation of a reserve study.”¹

Staff presented the changes to the CAI Reserve Study Standards at the September 22, 2023 board meeting (see Exhibit A). The new standards instituted a broadening of language, clarification, and refined guidelines that were often in question by Reserve Specialists and HOA staff across the nation.

Separately, resulting from years of discussion on appropriate reserve funding for facility replacements and learning lessons from the Alder Creek Adventure Center and Downhill Ski

¹ Reserve Study Standards, California Associations Institute, July 2023.



Lodge Replacement projects, the Board of Directors and staff developed a 2023 Work Plan Goal to address facility (a.k.a., building) replacement more proactively.

Goal –Building Replacement Program: Provide a building replacement policy to the Board that includes a funding mechanism that incorporates all existing buildings.

Deliverable - Staff to develop an association building replacement policy and associated funding plan. The materials will include a draft policy and a funding schedule with estimated investment ranges; the materials are to be made available to the Board in May 2023 for consideration and adoption. The process will include evaluating our current Development Fund and Replacement Reserve Fund policies and funding levels, and other relevant financial and facility plans related to existing buildings. The plan will include an updated inventory of TDA's existing buildings, including a replacement schedule and projected costs. Staff may, with Board approval, utilize outside resources to develop the draft policy and funding plan.

Staff began executing this goal by drafting a Building Replacement Schedule (a.k.a., building replacement inventory or facility replacement schedule) and presented initial thoughts to the Board of Directors at the April 23, 2023 regular board meeting (See Exhibit C). This presentation included a preliminary analysis and discussion on where facility replacement should be planned and funded; staying either in the Development Fund or moving to the Replacement Reserve Fund. The presentation excluded any option for a new reserve fund specifically for facility replacement or other alternatives such as subsets or sub-funds.

Work to complete the goal was interrupted due to the staff leadership change and subsequently wrapped into the 2024 Strategic Objectives. Staff and the Board recognized that a comprehensive capital funds policies update was needed to address the new CAI Reserve Study Standards, facility replacement, funding plans, and other general policy updates.

The 2024 Annual Strategic Objective under Planning, Development, and Infrastructure is:

Objective – Capital Policies Update: Update the existing capital fund policies ahead of the annual budget process to align with the TDA Strategic Plan goals and objectives related to association facilities and infrastructure, including a long-term funding strategy and financial plan for capital improvement, reinvestment, and building replacement.

Measurements + Metrics of Success of the Objective: Capital policies updated, Capital Funding Schedules updated, and updated inventory of Tahoe Donner's existing buildings including a replacement schedule and project costs.

Initial work on the objective project ("Project") began in January 2024 with a sub-committee of the board, and a small working group comprised of the Finance Committee Chair, Joe Niedringhaus, past Finance Committee Chair, Cathy Ravano, Finance Committee member, Craig Falk, and key staff. The leadership of the working group transitioned at the end of February 2024 from a sub-committee of the board to a staff-led one. The working group virtually remained the same. Throughout February through mid-April, the group walked through in detail, all aspects of



the topic to analyze and support staff from policy-related issues to testing the internal working financial model.

The board has had project updates each month as the project developed and iterated. The most recent project update and initial conversation and feedback, in the form of a workshop, with the Board on the broader concepts of the project were held during the March 29, 2024 regular board meeting. At that workshop, the board provided feedback on drafted project objectives and outcomes. The feedback was incorporated into the below updated working drafts which will require board vetting and approval.

Project Objectives

- Clarify and communicate the Association's legal obligation for planning, saving, and the expenditure of capital improvement reserve funds
- Align and integrate the 2023 Community Association Institute (CAI) Reserve Study Standards with policies
- Create an effective facility replacement policy and funding plan within existing reserve funds or an alternative
- Develop a sustainable and normalized capital funding plan
- Define a transition plan to grow into savings that creates a more normalized Annual Assessment
- Define all terminology and update policies to reflect current procedures and process

Project Outcomes

- 2024 Annual Strategic Objective implemented
- The Capital Funds Policies and associated Funding Plans and/or Projections are updated
- Policy adoption in time for the 2025 budget process (August – October 2024)
- An implementation plan is provided if there are changes to the funding plan and assessment projections
- Organizational alignment on long-range financial planning and policy implementation

In addition to the April 30, 2024 workshop, several other workshops are expected as the path to writing policy updates develops and we drive toward Board approval. The third workshop will entail a broad discussion on the New Equipment Fund and elements of the capital funds' funding plans.

Important to note is that while this project is important for the long-term financial planning of the Association, the current policies are functioning. The work being completed in the capital funds policies update is looking beyond 2025, will most likely include a transition period, and provide the flexibility the Association needs while ensuring obligations are met.



CURRENT STATE

Tahoe Donner and the Board of Directors' Obligations

The duties of the Tahoe Donner Board of Directors are defined by state law and the Tahoe Donner First Restated Covenants and Restrictions and Restated Bylaws, and Tahoe Donner policy resolutions, collectively referred to as the “governing documents.”

The duties of the Board include, among other things:

The duty to act as fiduciaries for the Association requires the Board to make decisions about what it believes to be in the best interest of the Association and its membership. This fiduciary duty includes the duty of care, the duty to act within the scope of the Board’s authority under the law and the Association’s governing documents, and the duty of loyalty.²

The duty to maintain and repair the Association’s Common Areas and Common Facilities, and the duty to replace the Association’s Common Areas and Common Facilities when, at the end of their useful life, they can no longer be reasonably or practically maintained and repaired.³

The duty to provide funding for the Association’s Common Expenses, which include “all expenses or charges incurred by or on behalf of the Association for the management, maintenance, administration, insurance, operation, repairs, additions, alterations or reconstruction of the Common Area, Common Facilities, or Other Association Real Property,” as well as “any amounts reasonably necessary to fund reserves for the maintenance, repair, expansion and replacement of the Common Areas and Common Facilities and Other Association Real Property.”⁴

The duty to conduct periodic reserve studies to identify “the major components that the association is obligated to repair, replace, restore, or maintain that, as of the date of the study, have a remaining useful life of less than 30 years,” and to establish a reserve funding plan “to meet the association’s obligation for the repair and replacement of all major components with an expected remaining life of 30 years or less.”⁵

² Tahoe Donner Association Administrative Resolution 2021-4, Board of Directors Code of Conduct.

³ First Restated Declaration of Covenants and Restriction of Tahoe Donner, Article III, Section 6(a); Article VII, Section 1; Article VIII, Section 1(b); and California Civil Code §4775.

⁴ First Restated Declaration of Covenants and Restriction of Tahoe Donner, Article 1, Section 9.

⁵ California Civil Code §5550. This section further provides that “components that the board has determined will not be replaced or repaired” may be omitted from this funding plan, provided that, per California Civil Code §5300, the Annual Budget Report includes a “statement as to whether the board has determined to defer or not undertake repairs or replacement of any major component with a remaining life of 30 years or less, including a justification for the deferral or decision not to undertake the repairs or replacement.” However, as noted above, under the Governing Documents, the board is obligated “to operate the Association, including its Common Facilities,” and therefore may not defer or abandon repairs, improvements, or replacement if the board reasonably believes that deferring or abandoning repairs, improvements, or replacement will jeopardize the board’s ability to fulfill its obligation to continue to operate the Association’s Common Facilities. See also California Civil Code §4177, §4178, §5300, §5560, and §5565.



The Tahoe Donner Covenants and Restrictions require the Association to be responsible for the establishment of the Annual Assessment based upon the preparation of an annual budget that estimates “...the total amount required to fund...anticipated Common Expenses ... (including additions to any reserve fund established to defray the costs of future repairs, replacement or additions to the Common Area and Common Facilities) ...”⁶

Common Expenses are defined to include, but are not limited to “...any amounts reasonably necessary to fund reserves for the maintenance, repair, expansion and replacement of Common Areas and Common Facilities...”⁷

The board must ensure that all Assessment funds are used exclusively for the following purposes: “(a) to promote the recreation, health, safety and welfare of the Owners and other residents within the Properties; (b) to promote the enjoyment and use of the Properties by the Owners and their families, tenants and guests; and (c) to provide for the repair, maintenance, replacement, protection and expansion of the Common Area and Common Facilities.”⁸

Finally, the Tahoe Donner Board of Directors “...shall maintain any other accounts it shall deem necessary to carry out its purpose, including reserve accounts for replacement of capital improvements...”⁹

Reserve Accounts

The Development Fund (“DF”), Replacement Reserve Fund (“RRF”), and the New Equipment Fund (“NEF”) are reserve fund accounts for “the repair, maintenance, replacement, protection and expansion of the Common Area and Common Facilities.”¹⁰ These funds have related administrative policy resolutions defining their purpose, authority, guidelines, procedures, funding plans, and ancillary regulations.

As these funds are reserve funds, they must comply with the applicable state law, including the Davis-Stirling Common Interest Development Act and the Governing Document’s provisions governing reserve funds, including provisions on temporary transfer of reserve funds, and annual review and disclosures.

Development Fund

The Development Fund (DF) was established as authorized in governing documents to accumulate funds for large-scale projects identified as necessary due to the new capacity requirements or changing needs of the Association. To facilitate the future use of Development

⁶ First Restated Declaration of Covenants and Restrictions of Tahoe Donner, Article IV, Section 2(a).

⁷ First Restated Declaration of Covenants and Restrictions of Tahoe Donner, Article I, Section 9.

⁸ First Restated Declaration of Covenants and Restrictions of Tahoe Donner, Article IV, Section 6.

⁹ Restated Bylaws of Tahoe Donner Association, Article XII, Section 4.

¹⁰ Covenants and Restrictions, Article IV, Section 6.



Fund assessments toward the funding of large-scale projects, each year projects are identified as eligible for such future funding.

Projects designated as eligible, though not approved, to receive funding from future assessment contributions include

real estate acquisitions, building upgrades and additions (i.e. expansion), and building replacements that do not qualify for funding from the Replacement Reserve Fund. While the Replacement Reserve Fund provides reserves for the replacement of individual building components, it does not provide funding for the functional obsolescence or structural replacement of existing buildings or new facilities.¹¹

For the Development Fund, Capital Projects needs are determined through a capital project vetting process, which once accepted are added to the 20-Year Capital Plan. Subsequently, a determination is made as to which projects will move forward to the 10-year Development Fund Projection (a.k.a., Capital Funds Projection - CFP) based upon the needs of the Association, feasibility, availability of funds and considered in the best overall interests of the Association and the Owners.

For certain projects like facility replacements or large upgrades the Development Fund may be “used in conjunction with and in addition to the reserves provided by the Replacement Reserve Fund.”¹² Recent examples of this are the Alder Creek Adventure Center, Trout Creek Recreation Center Expansion (2019/20), and the Downhill Ski Lodge Replacement.

All Development Fund projects are “individually designated and cost estimates using the best information available to ensure that accumulated reserves will be sufficient to cover future needs, but are not excessive to the needs of each designated project... (the cost estimates) will be updated annually”¹³ through the annual budget process. “In order to manage individual projects and aggregate Development Fund balances and expenditures, certain capital projects may need to be rescheduled or reexamined.”¹⁴

Funding parameters for the Development Fund include “the annual contribution...will normally be one-twentieth (1/20), or five percent (5%), of the capital improvement projects...over a subsequent 20-year period. However, funding may be adjusted upward or downward as required to ensure adequate funding for planned projects.”¹⁵

¹¹ Tahoe Donner Association Administrative Resolution 2017-3 Development Fund Policy.

¹² Resolution 2017-3 Development Fund Policy.

¹³ Resolution 2017-3 Development Fund Policy.

¹⁴ Resolution 2017-3 Development Fund Policy.

¹⁵ Resolution 2017-3 Development Fund Policy.



Replacement Reserve Fund

The Replacement Reserve Fund (“RRF”) accumulates and expends funds for “the repair, replacement, restoration and maintenance of, and additions to, or enhancements of the major components, which the Association is obligated to maintain (exclusive of structure replacement which is included in the Development fund).”¹⁶

This reserve fund, reserve study, and funding plan are mandated by statute and Tahoe Donner Governing Documents regulations. The RRF policy aligns with the statute and Governing Documents, and the California Department of Real Estate’s Reserve Study Guidelines for Homeowners Association Budgets (“CDRE Reserve Study Guidelines”).¹⁷

A reserve study is a “budget planning tool that identifies the components a community association is responsible for maintaining or replacing, the status of the reserve fund, and a stable and equitable funding plan to offset the anticipated future major common area expenditures.”¹⁸ A reserve study is a “limited evaluation is conducted for budget and cash flow purposes.”¹⁹

A reserve study provides planning and guidance and has a 30-year outlook. It is made up of “major components that the association is obligated to repair, replace, restore or maintain...having a useful life of less than 30 years”²⁰ at a minimum to comply with the statute.

Tahoe Donner’s RRF policy states, “Major common area components include the Association’s Common Area and Facilities, as defined in the Association’s Governing Documents, and any property and equipment with a value in excess of \$2,000.”

Over two decades ago Tahoe Donner retained Hughes Reserves as the Association’s reserve specialist to prepare its initial reserve study. In compliance with California Civil Code §5550, a full reserve study update, including visual inspection, is scheduled every 3 years and is performed by Hughes Reserves and/or in conjunction with staff. Annual updates to the Reserve Study are completed by staff, with consultation of Hughes Reserves.²¹

Unlike some HOAs, our Reserve Study is supported and maintained by dedicated staff in addition to Hughes Reserves consultation. As a result, we are in a better position than some HOAs who can lag in updating their reserve study taking the “review annually” at its face value and leaning on the every three-year visual inspection for updates on component estimates which can have an impact on their funding plan and Annual Assessment, especially during periods of escalating inflation and/or other factors.

¹⁶ Tahoe Donner Association Administrative Resolution 2019-1 Replacement Reserve Fund Policy.

¹⁷ The CDRE Reserve Study Guidelines were last updated in 2010 and aligned with state law at the time, guidelines of the Association of Professional Reserve Preparers, and the Community Associations Institute.

¹⁸ Reserve Study Standards, California Associations Institute, July 2023.

¹⁹ Reserve Study Standards.

²⁰ California Civil Code §5550.

²¹ As an aside, the Association regularly evaluates the consulting relationship through an RFP process, with the most recent occurring in 2021 at the same time as the Reserve Study 3-year update.



Replacement of Tahoe Donner facilities is not currently included in the Reserve Study based on two factors:

1. Assumption, that with proper maintenance of the facility (roof replaced, paint/stain frequently, etc.), and/or major remodels, a facility's useful life should exceed the 30-year scope of the Reserve Study. However, many of Tahoe Donner's facilities are 50 years or older with "life-of-the-building"²² components soon to be expiring or expired.
2. According to the current policy, the Development Fund is intended to include funding for facility replacement.

The goal of the RRF funding plan is to "maintain a consistent annual reserve allocation."²³ As part of the annual budget process upcoming component replacement estimates are updated, and a funding analysis is completed to inform the funding plan both short-term and long-term.

The policy defines the funding parameters as follows,

- A minimum balance that equates to 10% of the Association's Net Property and Equipment (Total Property and Equipment less Land and land improvements), as documented in the prior year's Independent Auditor's Report and accompanying year-end financial statements).
- The annual Replacement Reserve Fund assessment allocation shall be increased by a minimum of 4% each year until the Percent Funded level excess 25% and until the Replacement Reserve Fund balance is equal to or exceeds 10% of Net Property and Equipment.
- Once 25% funded or greater is achieved, the current year's funding level also needs to consider the reserve study's future years' percent funded and cash balances, in order to minimize the need for large adjustments in future years.²⁴

As provided for in California Civil Code 5515, a temporary transfer or borrowing from the RRF is available as a funding source to the Association provided certain steps, including membership notification and repayment plan within one year. This period may be extended for an additional one-year period with similar member notification and repayment requirements.

New Equipment Fund

The New Equipment Fund ("NEF") is an established reserve account to acquire new capital assets identified as necessary for more efficient operations, or to provide new machinery and equipment for programs, activities, and services to the membership.

²² The CDRE Reserve Study Guidelines define "life-of-a-building component" as "components (such as the building foundation and structure)...(e.g., the electrical or plumbing system...)." According to the CDRE guidelines, "if there is reason to expect the item to wear out within the time span of the reserve study, then that item...should be included as a reserve study component."

²³ Tahoe Donner Association Administrative Resolution 2019-1 Replacement Reserve Fund Policy.

²⁴ Resolution 2019-1 Replacement Reserve Fund Policy.



In general, this fund is a source of smaller dollar, non-large scale capital investments, which have not been identified in the CFP of the Development Fund. “The annual contribution to the NEF will normally be determined to cover planned expenditures for specific capital assets (assets in excess of \$2,000 individually or combined) and a contingency reserve for unanticipated needs. A contingency reserve minimum balance of \$25,000 will be maintained in the NEF, with Board approval required to draw down below this minimum.”²⁵

The NEF will be discussed in more detail in a separate staff report as supporting materials at a future Capital Funds Policies Update workshop.

DISCUSSION - POLICIES UPDATE TOPICS

Reserve Study Standards - Selecting and Qualifying Reserve Components

The most significant changes to the CAI Reserve Standards revolve around component selection and long-life, non-tangible, and maintenance-related components. This report highlights some of the more substantive changes. The full standards can be referenced in Exhibit B.

Component Selection

The existing RRF policy states that components eligible to be included in the Reserve Study are, “major common area components (that) include the Association’s Common Area and Facilities: owns, leases, and rents with an estimated remaining useful life of 30 years or less...and, any property and equipment with a value in excess.”²⁶ With each successive 3-year review and annual maintenance of the Reserve Study, the inventory of components and their estimated value grows in part due to aging infrastructure falling within the 30-year horizon of the Reserve Study, and in part due to best practices implemented with full-time dedicated staff focusing on the Reserve Study and funding plan.

The current RRF policy contemplates guidelines for component selection by relying on the State of California Department of Real Estate (CDRE) Reserve Study Guidelines for Homeowner Association Budget, last updated in 2010. Staff and Hughes Reserves fully expect the DCRE to update their guidance to align with the new CAI Reserve Study Standards. However, as this will take time, Hughes Reserves (and other reserve specialist firms) is recommending implementing the CAI Reserve Study Standards into policy and practice and considering utilizing them in parallel in the future.

The new standards include improved language for component selection using the terminology of a “3-part test” and supported with extended guidelines. The 3-part test being,

1. The association has the obligation to maintain or replace the existing element.
2. The need and schedule for this project can be reasonably anticipated.

²⁵ Tahoe Donner Association Administrative Resolution 2017-4 New Equipment Fund Policy.

²⁶ Tahoe Donner Association Administrative Resolution 2019-1 Replacement Reserve Fund Policy.



3. The total cost for the project is material to the association, can be reasonably estimated, and includes all direct and related costs.

An example of the supportive guidelines that bring clarity to component selection include,

“Component definitions are not constrained by capital or no-capital state or Internal Revenue service definitions. If desired at the reserve study provider’s discretion, all non-capital (per IRS or other tax authority definitions) items may be categorized separately.”²⁷

And,

“Common area preventative or corrective maintenance projects qualify as reserve components, if they otherwise meet the definition of “component.” In other words, a “component” does not need to be a cyclical repair or replacement of a tangible physical item.”²⁸

The improvements made to the standards in this area aid practical implementation, analysis, and decision-making when staff and reserve specialists perform work in the Reserve Study. Utilizing this 3-part test as part of Tahoe Donner’s practice will be important for maintaining consistency in component selection.

Maintenance Components

As described in the CAI Standards, “maintenance projects commonly fall short of “replacement” but may pass the defining test of a reserve component and be appropriate for reserve funding.”²⁹

Tahoe Donner has at times included such maintenance repair or replacement projects like painting, asphalt maintenance, and floor refinishing, and only recently (in the last 10 years) began including components like mastication of the firebreaks and tree removal projects. The new standards clarify that further projects like defensible space corrective maintenance of the Common Areas meet the 3-part test for component selection and can be included in the Reserve Study.

Non-Tangible Components

Non-tangible items were previously left untreated in guidance and standards. Non-tangible items are things like inspections, evaluations, and reviews of design drawings. This absence of guidance left reserve specialists to further rely on their knowledge and best practices. The new CAI Reserve Study Standards now discuss and make consideration to include eligible components in the reserve study.

Long-Life Components

In the CDRE’s Reserve Guidelines, long-life components, those components with a remaining useful life greater than 30 years, were recommended to be reported on, and only once they

²⁷ Reserve Study Standards, California Associations Institute, July 2023.

²⁸ Reserve Study Standards.

²⁹ Reserve Study Standards.



reached a useful life of 30 years or less would they be included in the reserve study and funding plan. Additionally, the prior standards did not include the building shell and

Life-of-a-building” components (such as the building foundation and structure) {were} generally omitted from the reserve study...However, if there {was} a reason to expect the item to wear out before the building..., then that item (e.g., the electrical or plumbing system...) should be included as a reserve study component.³⁰

Tahoe Donner has been practicing this methodology for several decades.

The new CAI Reserve Standards now treat long-life components more extensively. “There is no minimum or maximum limit to useful life or remaining useful life estimates used in a reserve study.”³¹ The new standard provides reserve specialists and associations with three methodologies but is not exhaustive) to choose from to account and fund for long-life components.

“Typical evaluation (for long-life components) techniques for consideration include:

- A. Inclusion of long-life components with funding in the study.³²
- B. Addition of long-life components with funding at the time when they fall within the 30-year period from the date of study preparation.³³
- C. Identification of long-life components in the component inventory, even when they are not yet being funded in the 30-year funding plan.”³⁴

Based on these updates, not only can long-life “life-of-a-building” components be included, but also a facility replacement project can be included in the reserve study so long as it meets the 3-part test and is in alignment with state statute and any board-adopted policy.

Facility Replacement

Commitment of Funds Specific to Facility Replacement

The Board and certain members have expressed that there is a lack of understanding of the obligation the Association (vis a vis each member through their Annual Assessment) must fund for facility replacement, and there are varying opinions on how to do that (special assessment versus saving over time).

To further resolve any ambiguity or certain member sentiment that funding for facility replacement is discretionary the policy update should define a compulsory approach through policy to allocating funds specifically toward facility replacement otherwise we will be repeating

³⁰ Reserve Study Guidelines for Homeowner Association Budgets, State of California, Department of Real Estate, August 2010.

³¹ Reserve Study Standards, California Associations Institute, July 2023.

³² This means that a facility with a useful life of 50 years will be in the reserve study component inventory with the funding plan accounting for its estimated cost.

³³ This methodology “B” mimics California Civil Code §5550 (b)(1)

³⁴ Reserve Study Standards.



the cycle of the past sprints.³⁵ A “replacement reserve fund” style approach helps to regulate and smooth the funding plan to minimize the potential for large increases in the future. This is possible through improved policy language and the funding plan.

Additionally, consideration of pressure to keep the Annual Assessment low has in the past artificially depressed the assessment allocation to the Development and New Equipment Fund or caused a tradeoff approach to take a portion of one fund’s allocation to bolster another’s, or other such decisions. Whereas, between the RRF policy funding parameters and state regulations, the Annual Assessment contribution to the RRF has been less challenged. This issue can be addressed with enhanced funding parameters in a policy update.

Responsible Approach to Funding

The CAI Reserve Study Standards advise that an association’s reserve study funding plan “should provide for reliable and timely execution of the association’s major repair and replacement projects...without the reliance on additional supplemental funding.”³⁶ According to one CAI Reserve Study Standards co-author (Robert Browning, Browning Reserves), additional supplemental funding “means special assessment or borrowing.”

Having a funding plan that is sufficient to meet the total estimated funding requirements year-to-year and over the rolling 30-year period for funds accumulated over time through the Annual Assessment is required under this interpretation. This objective is consistent with the C&Rs which state that “The Special Assessment power conferred hereunder is not intended to diminish the Board’s obligation to plan and budget for normal maintenance, replacement and repair of the Common Area, existing Common Facilities or Other Association Real Property through Regular Assessments (including the funding of reasonable capital repair and replacement reserves).”³⁷

One of the financial objectives of the Association since 2003, has been to avoid special assessments after experiencing a special assessment to fund the first extensive Trout Creek Recreation Center expansion and the Golf Clubhouse (the original building replaced by The Lodge) replacement projects.

Major efforts to appropriately plan for and fund facility replacement over the years have occurred, to make headway on funding requirements so, when the time was right and the need was real to address the aging infrastructure, the Association could make decisions to either refurbish, enhance, and/or replace each facility knowing the funding was available without requiring a special assessment.

While no facility replacement is guaranteed, the Association must plan for the worst-case scenario. That said, history has demonstrated that the Association takes a variety of approaches when it comes to addressing aged facilities which do not always result in facility replacement.

³⁵ Meaning, periods where the Development Fund portion of the Annual Assessment must be dramatically increased to ensure adequate funding for high-cost facility replacements is available.

³⁶ Reserve Study Standards.

³⁷ First Restated Declaration of Covenants and Restrictions of Tahoe Donner, Article IV, Section 3(a)(ii)



The Association goes to great lengths to extend the useful life of facilities through regular maintenance, repair, major remodels, and upgrades, to additions.

We will now turn to discuss the strengths and weaknesses of options before the Board on where facility replacement should be planned and funded in the following order:

1. Keep facility replacement planned and funded for in the Development Fund; or
2. Move facility replacement planning and funding to the Replacement Reserve Fund; or
3. Move facility replacement planning and funding to a subset or sub-fund of the Development Fund or Replacement Reserve Fund; or
4. Move facility replacement planning and funding to an all-together new capital improvement reserve fund.

Development Fund – Facility Replacement Option (Status Quo)

Facility replacement has traditionally been planned for and funded by the Development Fund. Currently, any facility replacement that has a remaining useful life of 10 years is in the Development Fund Projection Schedule. Many of the issues that are discussed in this section will exist regardless of what fund we are using.

Existing Framework History

The most compelling and strongest arguments for staying with the status quo for facility replacement are:

1. The principle of the framework is sound but needs improvement to shore up weak points identified in this staff report and in future discussions (Workshop 3).
2. Continuing facility replacement in the Development Fund ensures consistency of approach over time.
3. Because the Development Fund has been the reserve fund for facility replacement over time, members who understand the budget process and fund accounting understand that this fund includes facility replacement.
4. The current framework and policy provide flexibility in the decision-making process to ensure the best use of resources whether that be related to project timelines, member needs, organizational needs, or something else.

While staff and the working group agree that improved member education is needed, keeping facility replacement in the Development Fund requires less communication versus the challenge of building an understanding of moving funds into a new capital improvement fund or existing RRF.

A weakness of the existing framework for facility replacement is that some members find it confusing that facility replacement funding is derived from two different funds, the Development Fund and the RRF.



Cost Estimates

The current Development Fund Projection Schedule used in the budget process includes a 10-year outlook with cost estimates. While staff thinks this is important and is supportive of building out estimates beyond 10 years, there are weaknesses in cost estimates including,

- Facility replacement projects move through refinement.
- The execution of and level of rigor on cost estimates increase the closer the project gets to construction. Conversely, the cost estimate preciseness declines outside of the construction bid phase of a project and the scheduling of the project.
- Members can perceive the cost estimate as a hard and fast number even though the capital fund projection during the budget process year to year is an iterative approach over the lifespan of the project.
- Assumptions of cost estimation are not defined in policy. Because facility replacement and most Development Fund projects are high-cost investments, there is heightened scrutiny, thus a real need to be transparent and educative.

Adequate Funding

Focus and prioritization of adequate funding to an appropriate level to mitigate the peaks and valleys of timing for facility replacement and/or major enhancement projects have increased in the last decade as several of the largest and oldest facilities have either, 1) exceeded their remaining useful life, 2) are approaching that state, or 3) require extensive upgrades and/or additions to meet the needs of the Association.³⁸

A core component of determining adequate funding is building out a facility replacement schedule. This schedule identifies each facility, the estimated useful life, history of remodeling and other repairs that may extend its useful life, current estimated cost per square foot of existing facility, contingency, comparison with insured replacement value, and replacement reserve funds associated with components. This schedule not only aids capital improvement funding requirements but also improves alignment with the Association's insured replacement values.

As mentioned above, staff began work to develop a facility replacement schedule last year and has completed an updated draft schedule. With the working group, staff turned to building a strawman model utilizing the facility replacement schedule to support any recommendations on policy changes and future capital budget development (to be discussed at the next board workshop which will focus on policy funding parameters). Creating the facility replacement schedule strengthened the ability to create a strawman model that addresses the project objectives and keeps the facility replacements in the Development fund.

³⁸ For example, the Alder Creek Adventure Center (the old Cross Country Center/Equestrian Barn which exceeded its useful life), the Downhill Ski Lodge - exceeded its useful life, and the "Northwoods Campus) (Northwoods Clubhouse, Tennis Center, Northwoods Pool, and ancillary facilities like the Recreation Hut) – nearing or exceeding their useful life and require extensive upgrades and/or additions.



Confidence in planning will increase with the added internal tools to test assumptions year-to-year. That said, anything outside of an actual construction bid has a high degree of variance in this high-inflation environment as the time horizon increases.

Should the Board decide to move facility replacement into the RRF, subset or sub-fund of either the Development Fund or RRF, or an altogether different and new capital improvement fund, the same can be said to be true, but with potentially less flexibility to shift funding priority between facility replacement and non-facility replacement related enhancements like snowmaking installation at Eagle Rock, or the Maintenance Yard Fueling Station Improvement projects, which presently exist in the Development fund.

Funding Horizon

A subset of adequate funding is the concept of funding horizon, meaning the period that the Association begins funding for facility replacements (savings) to meet the funding requirements at the time of planned implementation (spend).

Staff and others have reviewed the Association's practice leading up to the last two facility replacement projects – Alder Creek Adventure Center and the Downhill Ski Lodge – as sprints. The past Board of Directors decided to increase the Development fund to ensure funding accumulated and available for the projects. Member feedback along the course of narrow funding windows and large increases to the Development Fund portion of the Annual Assessment has been met with reduced member satisfaction.³⁹

A more balanced approach is to designate funding horizon principles that can be set to achieve funding requirements, smoothing out the assessment contribution and avoiding big spikes or outsized impact on the Annual Assessment. Suggested funding principles are:

- For projects over \$10MM, start accumulating capital 20 years out.
- For projects between \$5-\$10 MM, start 15 years out.
- For projects less than \$5 MM, start 10 years out.
- Rules can be modified (time and dollar amount) for best effect.

With enough flexibility in policy language, these principles can be refined year-to-year or customized to a certain project achieving the Capital Funds Policies Update project objectives. This approach could also be considered in RRF long-life component methodology as well.

³⁹ Tahoe Donner Association 2023 Member Survey



Replacement Reserve Fund Option

As discussed in the Reserve Study section above⁴⁰, adding facility replacement as part of the RRF is an option, and in many ways just as compelling as keeping with the status quo. However, there are some limitations to this option.

First, and most important, is member trust. Staff highlighted in the Development Fund section above that there is concern about member perception of a shift of facility replacement funding from the Development Fund to the RRF. Similarly, there may be unintended consequences of the change that impact the Association.

Shifting the facility replacement to the RRF reduces visibility because they will be included in the Reserve Study with a couple thousand other components. Staff would suggest there be additional reporting in the form of a one-off budget schedule that reports on the facility replacement components should the Board move in this direction.

Carrying the facility replacements in the RRF reduces the flexibility of funding decision-making that the Development Fund creates. Conversely, this change can strengthen the focused savings of facility replacement and have these funds accumulate in the same fund as the facility components reducing member confusion of multiple funds for functional equivalent replacements.

The strength of this option lies in the statute for reserve funds relating to existing assets, the CAI Reserve Study Standards on long-life components, and the CDRE Reserve Study Guidelines on “life-of-a-building” components.

If the Board is inclined to the option of putting facility replacement in the RRF, they would have to first decide on the long-life methodology⁴¹ regarding facilities, then update the funding parameters of the RRF policy, followed with a robust communication and education plan to implement leading into, and as part of the budget process, and continuing until member understanding reaches a stasis.

⁴⁰ See page 11 of this staff report.

⁴¹ See page 11 of this staff report.



Below is a breakdown of the advantages and disadvantages of each of the CAI Reserve Study Standards' long-life funding methodologies.

Methodology Option	Advantage	Disadvantage
A. Inclusion of long-life components with funding in the study (beyond 30 years)	<p>There is a certain simplicity to this approach with no additional disclosure requirement</p> <p>Longer savings horizon</p>	<p>Including building replacement components in a policy that has thousands of other components does not give the building replacement components the visibility that they deserve</p>
B. Addition of long-life components with funding at the time when they fall within the 30-year period from the date of study preparation	<p>Current practice</p> <p>Longer savings horizon</p>	<p>Including building replacement components in a policy that has thousands of other components does not give the building replacement components the visibility that they deserve</p> <p>Requires separate inventory for components 31+ years out Requires additional annual disclosures (see above disadvantage)</p> <p>Estimates will have to be carefully prepared and updated</p>
C. Identification of long-life components in the component inventory, even when they are not yet being funded in the 30-year funding plan	<p>Allows for flexibility control timing of inclusion</p> <p>Possible longer savings horizon</p>	<p>Including building replacement components in a policy that has thousands of other components does not give the building replacement components the visibility that they deserve</p> <p>Requires additional annual disclosure</p> <p>Would require policy parameters for implementation</p>

Methodology "A" is the most straightforward approach to addressing long-life components with a useful life of over 30 years. Facility replacement components would be input into the Reserve Study according to the facility replacement schedule and saved equally over time and beyond 30 years.



Tahoe Donner has practiced the long-life methodology “B” for many years which is the minimum requirement under California Civil Code §5550. If the Board were to apply this method for facility replacement funding requirements would begin for facilities when they have a remaining useful life of 30 years, which many facilities do.

Methodology “C” would allow for funding horizon principles but not for full customization if needed (step up funding approach). Assuming the Board supports the idea of a funding horizon concept for facility replacement, the Reserve Study is not designed for flexibility or functionality. As you may remember, a reserve study is a budgeting tool that is built to identify and estimate costs utilizing estimated useful life. Unless you manually follow a separate schedule and input a facility or facilities into the study according to the schedule to initiate funding, the study can’t perform this functionality. One could argue that this is less transparent than the current Development Fund.

Subset or Sub Fund of the Development Fund or Replacement Fund Option

Another option is a subset or sub-fund of the Development Fund or Replacement Reserve Fund. A subset of one of the existing funds would be a functionality of financial reporting through fund schedules. For the Development Fund, this would entail detailing facility replacements and non-facility replacement projects along with the funding requirements and projections. This is easily accomplished and can improve facility replacement transparency in reporting.

Common in fund accounting, a sub-fund would allow for restricted fund purposes and usage. Creating a sub-fund would be a functionality of accounting and financial reporting. A sub-fund has a separate account with financial and tax reporting requirements.

Weaknesses of a sub-fund are, 1) increased investment fees associated and 2) potential reduction to investment potential by having money further separated in investment accounts.

Overall, this option increases the complexity of capital funds, and staff questions whether this fully achieves the intent of the project objective to clarify the Association’s legal obligation for planning, saving, and expenditure of capital improvement reserve funds.

Altogether New Capital Improvement Reserve Fund Option

As stated at the beginning of this staff report, the Board can create reserve funds to accumulate funds for “any amounts reasonably necessary to fund reserves for the maintenance, repair, expansion and replacement of the Common Areas and Common Facilities and Other Association Real Property.”⁴²

Creating an altogether new capital improvement reserve fund for facility replacement would be similar to creating a sub-fund of the Development Fund or RRF. It would have similar strengths and weaknesses as a sub-fund would have, except that it would be a stand-alone fund.

⁴² First Restated Declaration of Covenants and Restriction of Tahoe Donner, Article I, Section 9.



Staff and other advisors feel that if given the option between a sub-fund and a new reserve fund, a sub-fund is preferable. That said, the Association has two well-established funds that can achieve the objectives of the Capital Funds Policies Update without adding layers.

Findings for Broad Policy Concepts Discussed

1. Regardless of where we plan and fund facility replacements, we need to address policy issues relating to commitment to a strategic, forward-thinking funding plan, adequacy measures, cost estimating, member communication, etc. (Workshop 3 topics)
2. The Board should consider renaming the funds to align with their purpose as a matter of improving understanding of the purpose and roles of the capital funds. (Future workshop)
3. The most straightforward option is to stay the course but refine and strengthen the guardrails of the Development Fund policy. The policy update will be a major update.
4. Shifting facility replacement into the RRF, creating a sub-fund or a new capital improvement fund (Facility Reserve Fund) potentially lessens the flexibility in the decision-making process to ensure the best use of resources whether that be related to project timelines, member needs, organizational needs, or something else.
5. To improve facility replacement transparency in the Development Fund, a subset of reporting can be easily managed.
6. The Development Fund policy update should include language enhancing understanding of the obligation to save and fund adequately. Funding adequately would be further defined and enhanced with funding parameters (Workshop 3 topic).
7. The Development Fund policy should apply funding horizon principles of:
 - a. For projects over \$10MM, start accumulating capital 20 years out.
 - b. For projects between \$5-\$10 MM, start 15 years out.
 - c. For projects less than \$5 MM, start 10 years out.
 - d. Rules can be modified (time and dollar amount) for best effect.
8. Coupled together with fresh eyes on the CDRE Reserve Study Guidelines and the new CAI Reserve Study Standards, the RRF policy stands to be a major update.
9. The RRF policy update should include language enhancing understanding of the obligation to save and fund adequately. Funding adequately would be further defined and enhanced with funding parameters (Workshop 3 topic).
10. The RRF policy update should align with the CAI Reserve Study Standards and the CDRE Reserve Study Guidelines once it too is updated.



11. Replacement Reserve Fund policy should continue to apply the long-life component methodology of: “Addition of long-life components with funding at the time when they fall within the 30-year period from the date of study preparation.”⁴³

PROJECT NEXT STEPS

Several other workshops are planned to achieve the project milestones for addressing other elements of the policy including the funding plan and parameters, writing draft updates to the policies, Board review and feedback of draft policies, and eventual approval. The next workshop will entail a broad discussion on the New Equipment Fund and elements of the capital funds’ funding plans.

ATTACHMENTS:

- Exhibit A: Newly Updated National Reserve Standards, Staff Presentation, September 22, 2023
- Exhibit B: Reserve Study Standards, California Associations Institute, 2023
- Exhibit C: Building Replacement + Rehabilitation Funding, Staff Presentation, April 28, 2023
- Exhibit D: Administrative Resolution 2017-3 Development Fund Policy
- Exhibit E: Administrative Resolution 2019-1 Replacement Reserve Fund Policy
- Exhibit F: Administrative Resolution 2017-4 New Equipment Fund Policy

Staff Report prepared by: Annie Rosenfeld, General Manager

Board of Directors Meeting: April 30, 2024

⁴³ Reserve Study Standards, California Associations Institute, July 2023.