Financial Forum
Hilton Head Island Motorcoach Resort
November 7, 2019

1. **Who's Who?**

    a. **Treasurer** – Ward Simmons

    b. **Finance Committee** – Bobby Lowman, Marylis Wozniacki, Kathy Chittenden, Ward Simmons.

    c. **Staff** – Kathy Chittenden (Manager) and Christine Butkiewicz (Front Desk Manager), responsible for making bank deposits, and approving and coding vendor invoices and payroll.

    d. **Bookkeepers** – Island Financial (Tammy Novak, Barbara Conway), responsible for billing quarterly assessments, paying owner rentals and vendor bills, payroll, and monthly financial statements.

    e. **Auditors** – June CPA (Pam June, Brenda LaBruna), responsible for performing quarterly "agreed-upon procedures," preparing income tax returns, and performing annual audit.

2. **Structure** - The resort is actually composed of two entities, a Property Owners' Association (POA) and a Limited Liability Company (LLC). The LLC is exclusively for motorcoach lot rentals. The POA is a non-profit corporation taxed as a homeowners' association, which handles all resort matters not related to motorcoach lot rentals. Each of the 401 lot owners is an equal owner of the POA; the LLC is owned by the POA.

3. **Financial statements** through September 30, 2019

    a. Allocation of expenses between POA and LLC is always continually refined as we approach the end of the year. Presently the POA shows a loss of approximately $55,000 and the LLC shows a profit of approximately $204,000, for a net total of $149,000, but there are many POA expenses that will be allocated against LLC income.

    b. The POA balance sheet reflects a note payable of approximately $95,000 (account 260). These funds were used years ago for clubhouse improvements. The monthly payments on this note are approximately $2,600 per month. The outstanding balance will be paid off in approximately three years.

    c. As of September 30, 2019, the combined cash balances of the two entities totaled approximately $980,000. On its face that sounds pretty good… but is it really?

4. **How Much Cash Should We Have?** Surprisingly, the answer is between $1,319,000 and $1,735,000. There are at least three components of the cash that the resort should have:

a. **Liabilities** – Amounts owed to vendors and others, totaling $315,000:

   i. Advance deposits from renters $160,000
   ii. Other short-term liabilities $60,000
   iii. Funds needed to retire note payable $95,000 (see above)

   While the argument could be made that the note payable should not be included here, the fact that it matures in the near future makes it appropriate to include. It would not be prudent to spend these funds for other purposes, and have to generate them again in the near term.

b. **Operating Reserve** – The resort is a large enterprise, and lots of money flows through it. The annual expense budget is almost $1.7 million, or about $141,000 per month. Conventional wisdom is to maintain between three and six months of operating expenses in cash, or between $423,000 and $846,000. This allows a measure of financial stability in the event of unexpected financial or operating emergencies. Given the resort's location and history, weather emergencies would certainly be included in those possibilities. (After hurricane Andrew rentals were almost completely nonexistent for two months.) Splitting the difference at four and one-half months yields an amount of $635,000.

c. **Replacement Reserve** (or Capital Reserve) – Fifty acres in the middle of Hilton Head Island is quite a valuable asset, and the improvements that comprise this resort are extensive. It is standard practice for homeowners' associations to obtain and periodically update an analysis of their reserve funds. The resort's last replacement reserve study was completed in 2010; the consultant has been retained to perform an update in early 2020. The 2010 study placed the then-cost to replace all the resort's improvements at $2,058,000.

   A reserve study inventories an enterprise's assets that will deteriorate over time (buildings, water systems, recreational facilities, etc.), determines the remaining useful life and the cost to replace each asset, and calculates the funds the enterprise should be reserving to fund replacements when needed. Depending on which of two commonly accepted methodologies is used, the 2010 study determined the resort should currently have either $581,000 or $989,000 in reserve funds. Again, splitting the difference yields an amount of $785,000.

In summary, combining liabilities of $315,000, an operating reserve of $635,000, and a replacement reserve of $785,000, the resort should have $1,735,000 in cash. Using the low-end amounts for the operating reserve ($423,000) and the replacement reserve ($581,000) still yields a balance of $1,319,000.

5. **Budget for 2020** – The budget anticipates expenditures totaling approximately $1,725,000. This includes three significant capital projects: the clubhouse elevator, a pedestrian/bicycle pathway from the front gate to Arrow Road, and some action on the third set of tennis courts which are presently unused. To raise the funds necessary to pay these expenses and begin to reduce the shortfall in reserves the budget anticipates revenue of approximately $1,8500,000. Out of this revenue approximately $600,000 is from site rentals, $125,000 from transfer fees and other

miscellaneous sources, and the remaining $1,125,000 from owner assessments. This translated into a quarterly per-lot assessment of $700, an increase of $100 over the 2019 level.

This decision has not been made lightly. Each of the members of the board is an owner who will pay this increase. In addition to the cash balances analysis described above, there are three other factors that reinforce this decision:

a. **History** – Over the last ten years the quarterly assessments have increased a total of 12.2%. This equates to an annual increase of 1.2% per year. This has not come close to keeping pace with general inflation. Those of you who have paid contractors, employees, etc. over the last ten years can probably verify this.

b. **Competition for Rentals** – Lot rentals provide about one third of the resort's income. Without this subsidy, all owners (not just those in the rental pool) would have to pay half-again as much in quarterly assessments. Every year there are new luxury motorcoach resorts coming online that offer newer and more extensive amenities, and that have more available land on which to expand their amenities. If we are to sustain the valuable income stream from lot rentals, we must continue to upgrade our facilities within the constraints of our available land.

c. **Comparison to Other Luxury Motorcoach Resort Assessments** – A comparison of the resort's assessments to those of any other luxury motorcoach resort reveals that our resort is well below market. This does not mean the assessments should be raised, it simply confirms the other indicators that our resort cannot sustain itself without making this needed adjustment.

6. In conclusion, as a board we take seriously our responsibility to be good stewards of the resort's property and the owners' money. The path of least resistance would have been to simply leave the dues where they were or raise them a smaller amount. We believe this would have represented a short-term gain that would have resulted in long-term pain. We believe that 2020 budget represents a significant step towards bolstering the financial security of the resort, and will be for the benefit of all owners.