



MEMORANDUM

DATE: September 19, 2019

TO: Mr. Kent Blumenthal, Ph.D., CAE
Chief Executive Officer – Green Valley Recreation, Inc.

FROM: Robert W. Browning, PCAM, RS
Browning Reserve Group

RE: Percent Funded Considerations

Green Valley Rec is in excellent financial condition with percent funded at 68.5%.

Here is why...

1. Strong Ending Balances

Over the next 30 years, despite GVR spending between \$800K to \$2M+ every single year, the reserve fund never drops below \$4.2M. And GVR only needs to raise the contribution by approximately 4% per year, which is 1.5% over the study's inflation rate. This is an extraordinary accomplishment that provides GVR with a large threshold every year, in case of cost increases, acts of god, or rampant inflation (within one year.)

2. Update Reserve Study Yearly

GVR, since BRG has been involved, has updated the reserve study every year. This is the best safety net any community could have in relation to protecting assets. Because if there are inflation increases on the components, any adjustments needed to the study can be made in real time. Also, if the interest earned projections are off target, the reserve balances are updated each year, so any fluctuations to the threshold can be dealt with in real time. If GVR starts updating the reserve study at longer intervals, say 5+ years, then GVR would be at greater risk for unforeseen circumstances.

3. Collaboration Between BRG & GVR

Every year, GVR staff provides BRG with data on all component expenditures. This creates an additional record of what is spent, but more importantly, these expenditures are the best indicator of future costs. This feedback loop is one of the best features of the reserve study and provides precision for future estimates.

4. Percent Funded Not a Good (Sole) Measure of Adequacy

When I spoke at GVR, I thought I had done a good, or at least mediocre job, of explaining the limitations of 'percent funded.' Percent funded is not a great indicator of reserve fund adequacy. It is one indicator but needs to be taken into context of the timing on projects.

If you look at Section IV of the reserve study on page 79, the percent funded is scheduled to go even lower over the next 15 years, before it builds to 100% later. This is expected, normal, and the result of GVR performing projects as planned.

Often, we find when communities are currently 100% funded, that means two things. One is the community is overfunded because usually the plan calls for no increases to the reserve contribution stream, despite costs going up every year by 2.5%. This means members now are paying more than they should have too. Secondly, the percent funded calculation turns into a runaway train meaning decreases to the contribution are often needed. Why ramp up the funding, just to lower it, or keep the contribution static?

A well-funded community is one where the yearly increases to the contribution are in the range of the component inflation factor, while never letting the ending reserve balance in any given year fall below a reasonable level. GVR meets this objective almost perfectly. Perfect would be 2.5% increases, yet we are projecting 4% increases.

Moreover, if the community does initiate a floor for percent funded, a corresponding cap is a terrible idea. The way percent funded is calculated, in order to have a static percent funded number, or even a range over time, is impossible without large increases and decreases to the contribution stream. And this flies in the face of one of the definitions of a reserve study which is to "create a stable and equitable funding plan."

5. Alternatives to Make the Funding More Conservative

Instead of transferring cash to reserves to meet a subjective percent funded status, there are other measures the board could take. Here are examples to help the study become more conservative:

- A. Increase inflation rate
- B. Lower interest rate
- C. Increase reserve contribution growth rate
- D. Provide staff & BRG with comments on major physical components that are causing alarm that the study may not be as conservative as it should be
- E. Combination of above

In closing, and as I said in person earlier this year, GVR is in great financial condition, now and in the foreseeable future. I am sure it has gotten there with the attention to detail by management, staff, and leaders in the community.

We appreciate the opportunity to help the community make these decisions and wish you the best of luck.

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