AVALON VILLAGE RESERVE CALCULATION 2021 UPDATE

As far as is known, there have been two reserve studies prepared that project future reserve needs based on estimated costs for future capital expense categories. The original study was conducted in 2014 with the help of an outside consultant who was an expert in this type of calculation. The study was updated in 2018 and included updated cost estimates.

Each study was based on an estimated cost per cottage for each capital expense item. A useful life in years was estimated for each capital expense item. All calculations were based on a 2005 start date. The number of units that apply to each capital expense item was identified. For example, interior painting would apply to each of the 58 cottages while septic pumps would only apply to 2 pumps. Finally an annual cost was calculated as the cost per capital expense item times the number of units divided by the useful life. The starting year for costs to begin occurring is based on the 2005 start year and the estimated useful life for each capital expense item.

The 2014 study included the following capital expense items.

- Interior Painting
- Carpet Replacement
- Appliances
- Fireplace Burners
- Floor Replacement
- Roof Replacement
- Road Pavement
- Driveways
- Septic Pump Station
- Landscape

The 2018 study included the following additional capital expense items as well as the above items from the 20104 study.

Tree Removal
Walkways & Mailboxes
Windows
Siding
Cabinets
Countertops
Infrastructure

The 2014 study was based on the following assumptions.

Initial Replacement Reserve Balance	$400,000
Number of Units	58
Expense Cost Inflation % per year	2.00%
Interest Earned on Reserve Balance % per year	2.00%
Shareholder Contribution Annual Growth % per year	3.00%

The 2018 study was based on the following assumptions.

Initial Replacement Reserve Balance	$431,000
Number of Units	58
Expense Cost Inflation % per year	3.00%
Interest Earned on Reserve Balance % per year	2.00%
Shareholder Contribution Annual Growth % per year	3.50%

The 2018 study increased the annual rate of growth in expenses from 2.0% to 3.0% and the annual rate of growth in shareholder contribution from 3.0% to 3.5%.

The proposed 2021 study includes correcting several errors that were discovered in the calculations in the 2018 study.

Corrected the formula for the projected annual capital reserves contribution for the years 2024 and 2025.

Corrected the formula for the projected total annual expense to include all capital expense items.

Once these corrections were made, the calculated reserve balance declined to less than zero by 2034. It would not be prudent to let the reserve balance fall to less than zero.

There are several other adjustments that are being proposed for inclusion in the 2021 reserve study update.

The operating account borrowed funds from the reserves to purchase a new John Deere tractor several years ago. The unpaid balance on this loan was $19,392 at the end of 2020. This loan is being repaid at the rate of $3,600 per year. This amount is being added back to the reserve balance each year. Prior reserve studies have not recognized this annual repayment to the reserves and the proposed 2021 study has included this in its calculations.

It should also be noted that the operating account needs to borrow funds from the reserves to help pay the twice a year Hampden real estate taxes. For the April 2021 taxes the operating account borrowed $20,000. This activity is being excluded from the reserve study since the borrowed funds are routinely repaid over several months.

It is proposed to set the opening reserve balance for 2021 at $404,191, the actual ending balance for the reserves as of 12/31/2020.

Tree removal was added as a capital expense item in the 2018 reserve study. This should be an operating account expense and not a capital expense. It is proposed that tree removal be removed as a capital expense item in the 2021 study. This would result in the following capital expense items being included in the 2021 study.

Interior Painting

Carpet Replacement

Appliances

Fireplace Burners

Floor Replacement

Roof Replacement

Road Pavement

Driveways

Septic Pump Station
Landscape
Walkways & Mailboxes
Windows
Siding
Cabinets
Countertops
Infrastructure

It appears that we may be entering a period of higher inflation for many of the capital expense items included in the reserve study calculations, especially for building materials. This may be partially offset by higher interest rates for our cash balances. It is being proposed that the expense cost inflation rate be increased from 3.0% to 4.0% with an offsetting increase in the interest earned on reserve balances from 2.0% to 2.5%. With these adjustments, the reserve balance will decline to less than zero in 2033. The reserve balance can not be allowed to fall below zero. The only reasonable way to impact this outcome is to adjust the annual increases in the projected annual capital reserves contributions that each shareholder must pay. The following are the suggested assumptions for the 2021 study update to more adequately fund the reserves.

The 2021 study suggested assumptions.

Initial Replacement Reserve Balance	$404,191
Number of Units	58
Expense Cost Inflation % per year	4.00%
Interest Earned on Reserve Balance % per year	2.50%
Shareholder Contribution Annual Growth % per year	7.50%

Using these assumptions, the reserve balance is projected to decline from the $404,191 at the beginning of 2021 to $299,127 at the end of 2039. It is recognized that an annual increase

of 7.5% in the shareholder contribution to reserves may seem to be high, however, it is the only way to keep the reserves adequately funded. Keeping the reserves adequately funded is how to avoid possible future one-time assessments that might be needed for unanticipated capital expenses. It should also be noted that a well funded reserve along with a well maintained and attractive community increases the perceived value of our shares to prospective buyers and should translate into higher share prices when shares are sold.

The only other way to impact the level of reserves is to let the community fall into a state of disrepair. That might work in the short term but would result in even higher costs in the future and lower share values. Therefore it seems better to adequately fund the reserves.

It should also be pointed out that the calculations and assumptions in this study are not an exact science. The reserve calculations should be updated on a regular basis to ensure that we are maintaining an adequate reserve level to maintain the community.