Somerset Estates HOA
Virtual Town Hall Meeting
Long Range Planning

Welcome

October 27, 2020, 7:00 PM
Zoom Online

[Slides for discussion only. Not Association Records.]

The SEHOA Board is working to set the community on a path that leads to financial stability. This presentation is the result of extensive collaboration among the board members who've worked hard to gather and analyze our situation. Through a series of in-person and virtual meetings, physical and electronic publications, and web postings, we hope to inform our community about the facts, share our recommendations and solicit approval for a funded Long Range Plan that will remedy longstanding deficiencies and chart a path forward that increases our home values.

Our combined community has known about the insufficiency of our financial reserves for decades. Unfortunately, the historic approval hurdles embodied in our previous declarations made it nearly impossible to remedy this shortfall. It wasn't until 2018 when SEHOA was founded that we adopted rules that opened the way to resolving the problem. After addressing more immediate issues, the SEHOA board began an effort in earnest to quantify the problem and develop a viable plan in August 2020. This presentation reviews our findings and recommendations. Adopting and funding a LRP will yield several benefits for our community. *

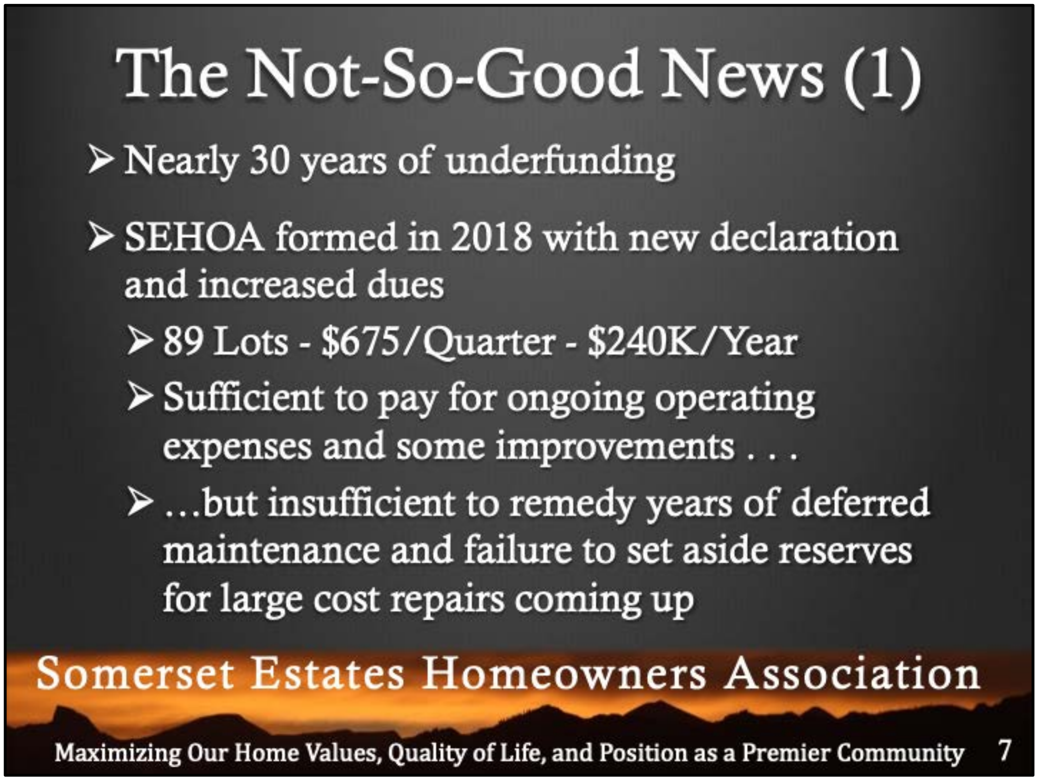
This presentation will cover the topics listed above. The goal is to recap our HOA's financial condition, share the board's recommended action and solicit input from homeowners. While you will not be asked to vote or approve a particular proposal today, we will ask you to consider the merits of a special assessment near the end. We kindly ask that you hold your questions until the end so we can get through the presentation. There is a slide number at the lower right for each slide. We suggest you note which ones you have questions or comments about so those slides can be re-displayed during the discussion section at the end. Thank you.

Current Situation

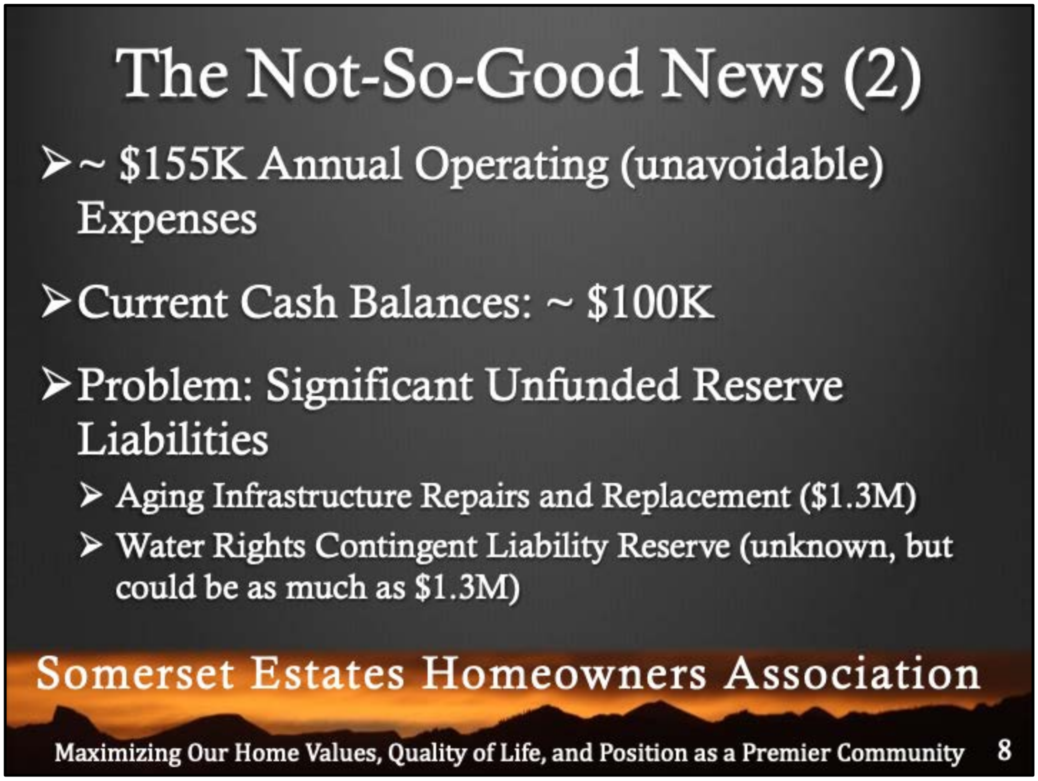
Somerset Estates Homeowners Association

Maximizing Our Home Values, Quality of Life, and Position as a Premier Community 5

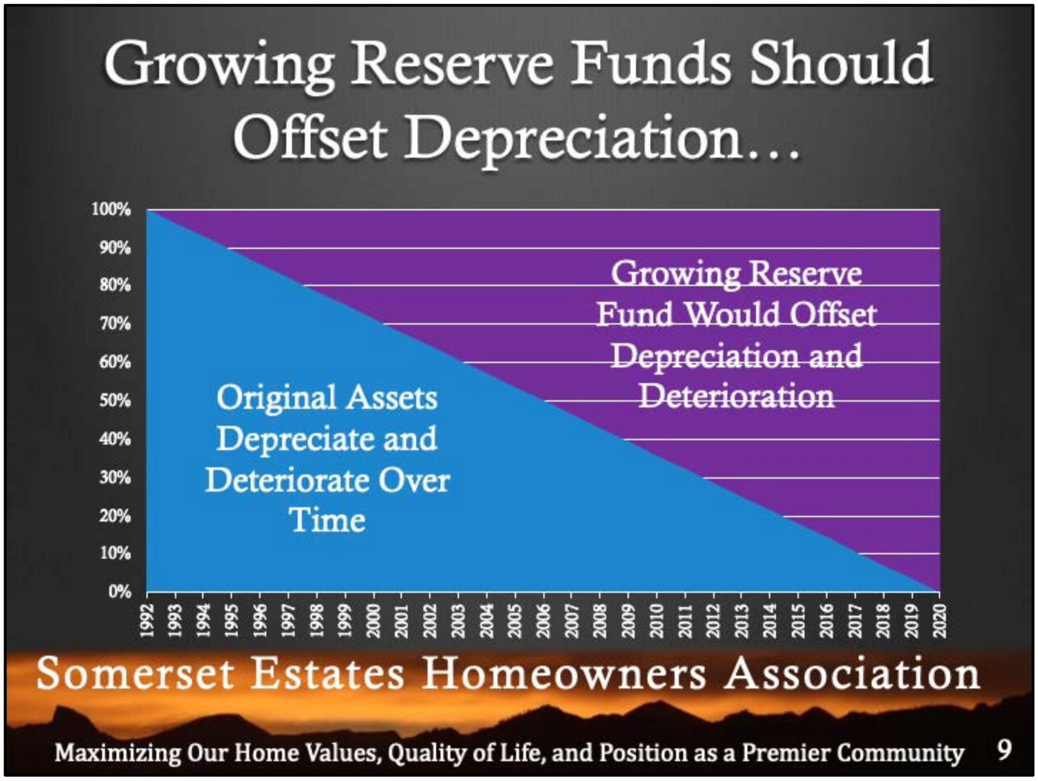
According to a 2020 US News and World Reports survey, Boulder is #1 among 150 top US cities as the very best place to live! Now we have an opportunity to be the best place to live… in the best place to live!



The combined SHOA/SEHOA neighborhoods paid dues that were insufficient to adequately maintain the common infrastructure. For the most part, funds were only available to perform essential maintenance. Whenever possible, the community had to defer maintenance. SEHOA dues are now substantially higher than historic levels. These increased dues are sufficient to pay for ongoing expenses, but a large backlog of deferred maintenance, as well as planned restoration/replacement, still represent unfunded liabilities.



Basic maintenance functions such as irrigation, mowing, repairs, and insurance require a budget of $155K. We have minimal cash balances. Our unfunded liabilities could be as much as $2.6 million... half for our infrastructure, half for unknown but possible water rights expenses.



The original developer of our neighborhood invested several million dollars to establish our common areas. That infrastructure lost value as time passed, symbolized by the downward sloping blue area above. Eventually, pumps wear out, pond liners fail, monuments need to be rebuilt and so forth.

A well-run HOA analyzes that rate of deterioration and sets aside a growing amount in a Reserve Fund so the resources are available to replace assets as needed. This growing reserve is symbolized by the increasingly large purple area above. Had sufficient reserves accumulated, we would not need additional funds now.

Unfortunately, the historic rules governing our combined neighborhoods made it impossible to accumulate a growing reserve. Setting aside water rights issues, "Unfunded Liabilities" related to our infrastructure amounts is approximately $1.3M.

The term “Percent Funded” is widely used term to assess the financial condition of HOA Reserve Funds. If the accumulated Reserve Fund is equal to the community’s accumulated Deterioration, the community is said to have a “100% Percent Funded” Reserve. For some assets, we assume periodic complete replacement; for others, we assume periodic major repairs that are less than 100% replacement (concrete sidewalks, monuments, walls, etc.).

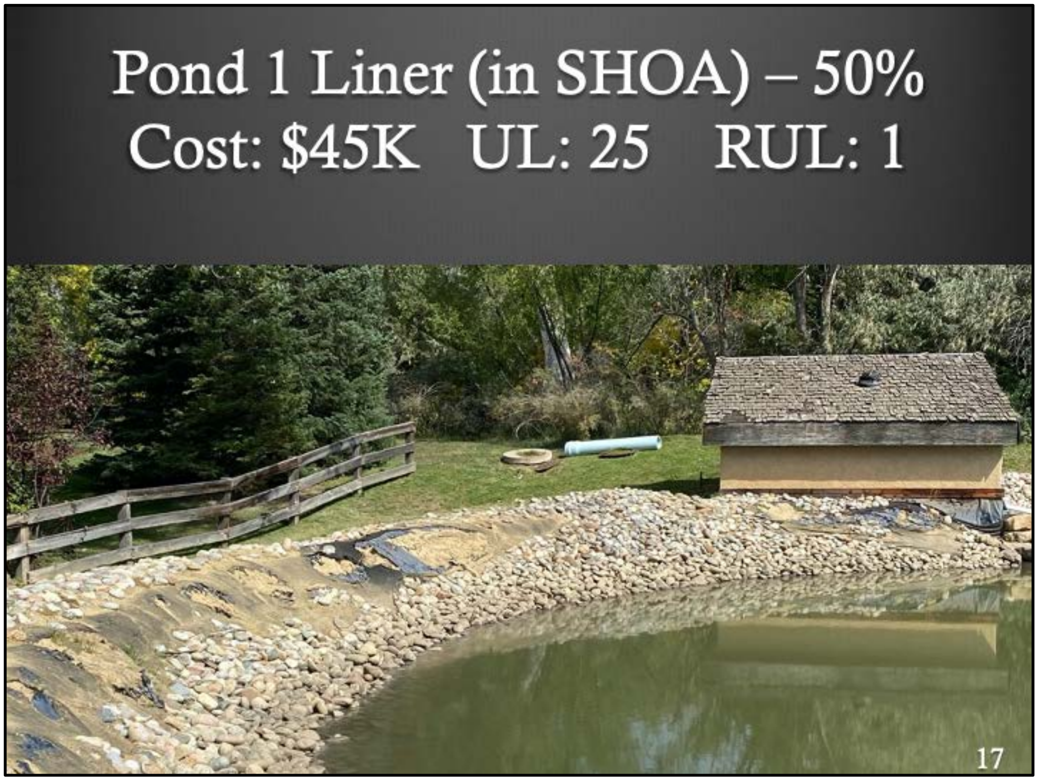
An association which is 100% Funded is termed Ideal. An organization at 70% Funded is classified as being in "GOOD" condition. Between 30% and 70% an organization is deemed "FAIR". Below 30% is "POOR". SEHOA is at 4%... Very poor.

This graph shows the relationship between Percent Funded (horizontal axis) and likelihood of needing a Special Assessment (vertical axis). Organizations that maintain reserves of less than 30% of their Ideal Fund Strength, are at a high risk of needing Special Assessments to address their needs. This is inefficient, exposes homeowners to surprise demands for funds and reduces the resale value of homes. SEHOA has less than 4% of its Ideal Reserve, which means we do not have sufficient standby funds to accommodate sudden failures of assets. This was recently exemplified by the failure of the Pond 8 liner, which consumed much of our cash on hand.

Here are the steps we took to understand and assess our situation.

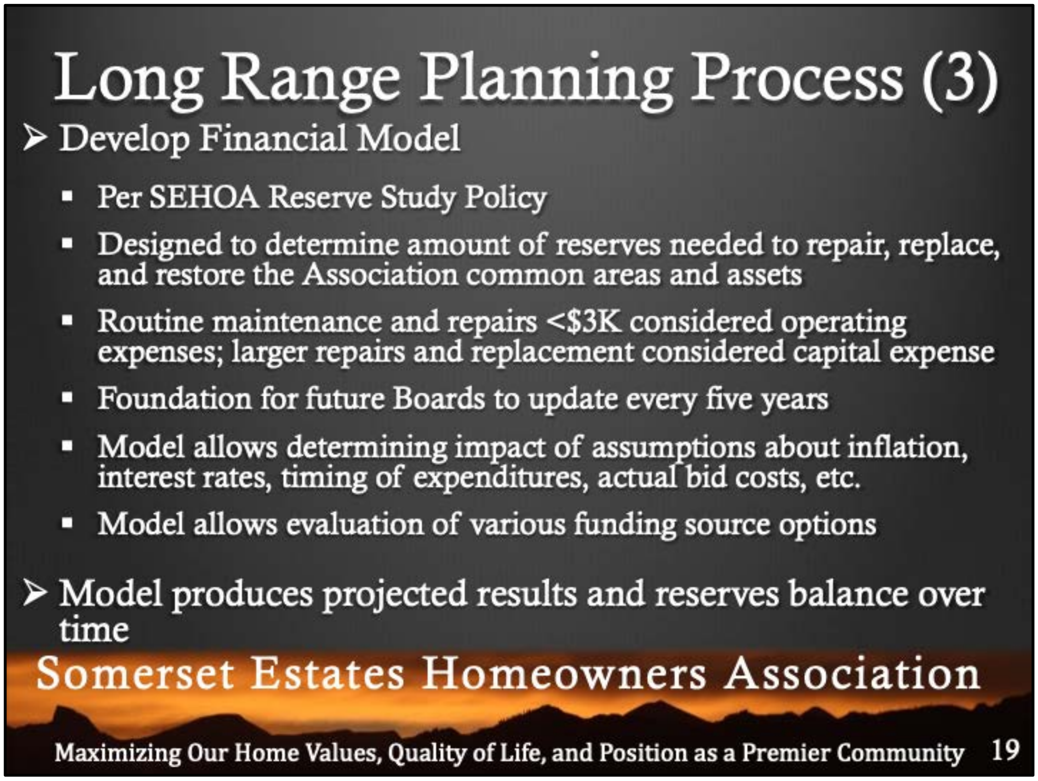
Our community assets are grouped into six general categories. Previous records and the 2014 Reserve Study were updated to reflect an accurate listing of current community assets.

This effort produced an updated and expanded Reserve Study which includes more than 250 assets. Taken together, these assets constitute our common property. For each item, a determination was made regarding its Replacement Cost, Useful Life and Remaining Useful Life.



One such asset, for example, is Pond 1. It is critical to the functioning of the entire irrigation system. If it were to fail during the summer, we'd have no water in SEHOA. It is well past its useful life and we need to have the funds available to reline it. Assuming an agreement is reached with SHOA, we expect half of the relining cost ($45K) to be an obligation in the next year.

Pond 2 is another example of a community asset. Like Pond 1, all SEHOA's irrigation water flows through Pond 2. The liner of this pond is nearing the end of its useful life and will need to be replaced. We know from recent experience (Pond 8) this is a significant undertaking. A funded long-range plan will help us accumulate funds in anticipation of large expenses like this.



Starting with the updated Reserve Study, we created a comprehensive financial model. This allows us to test and evaluate a variety of model inputs. *

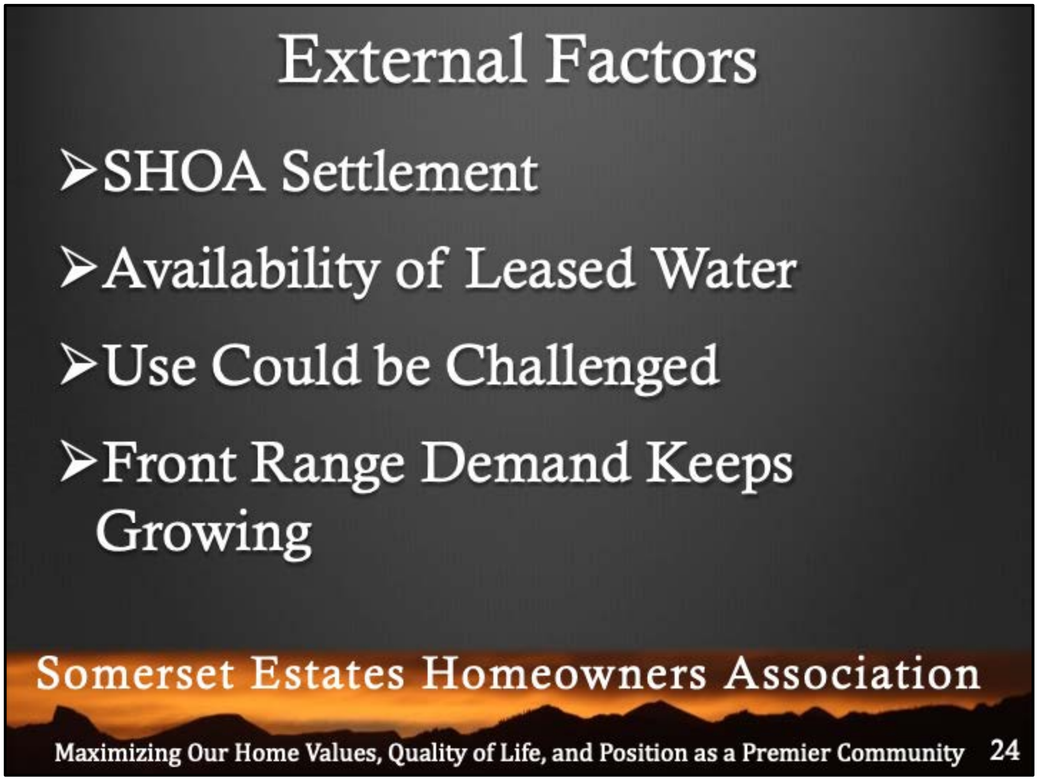
Until such time as new designs for the community are adopted, the board is charged with maintaining the assets currently in place. For the purpose of establishing a viable long-range financial plan, the current plan assumes no changes to the current common property. That doesn't necessarily mean that every asset must be replaced exactly as originally installed.

At some future time, the community may want to Rethink SEHOA, including potential changes to the design and operation of our common areas as part of an updated look for our community, but those considerations are not a part of this Long-Range Planning effort.

Our Long Range Plan is a planning tool and represents our best guess regarding ongoing financial needs to support our current common areas. That said, approval and funding of a LRP does not equate to a firm commitment for each line item of the budget. Future boards will need to review and update this plan to keep it current.

Due to the unpredictability of future timing and amount of resources needed to secure water rights, the LRP does NOT include significant allocations to address water rights acquisition or perfection.

Although the LRP does not allocate resources to fully address future Water Rights costs, it is important for homeowners to have a sense of this potential unfunded liability.



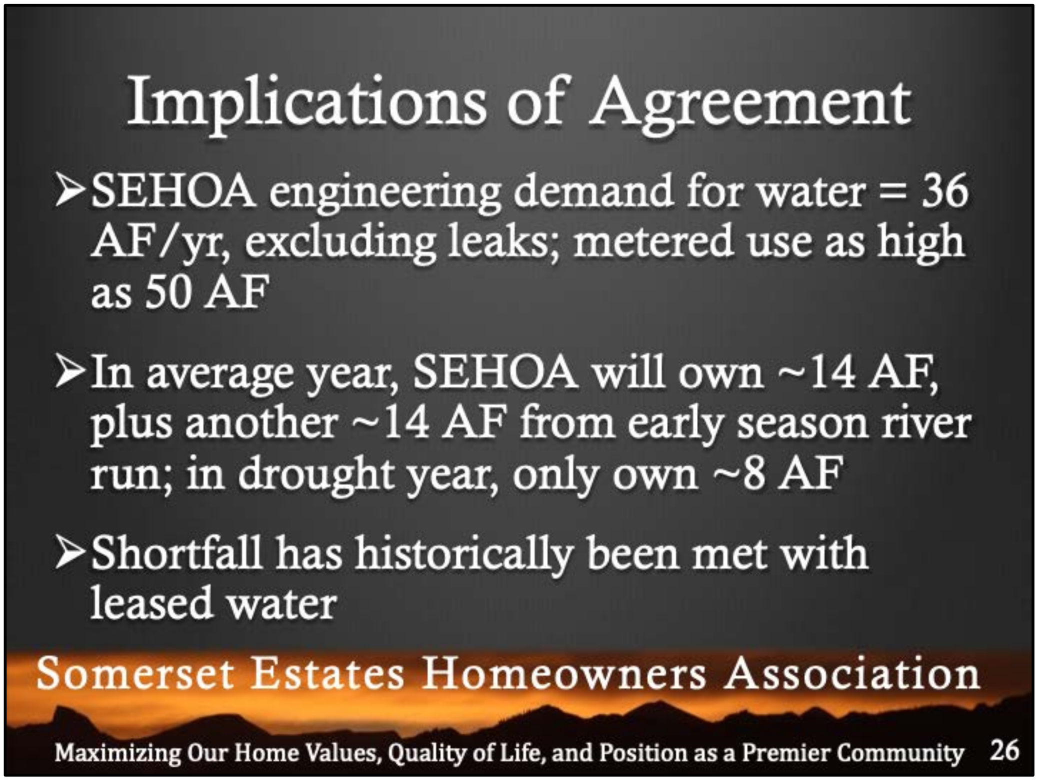
The association's current water supply comes from the irrigation ditches which run along the northern boundary of SEHOA. This is a different source than the supply we each obtain from Left Hand Water District for our individual homes.

There are four concerns regarding the water supply currently used by SEHOA. First, we are close to, but do not yet have a settlement agreement with SHOA to allocate the historic water rights between the separate communities. Second, we need to lease supplemental water rights each year and these are not always available. Third, water rights in Colorado are complex and certain aspects of our current usage could be challenged, so there is an ongoing risk that we may not be able to continue to use the ditch water. Fourth, demand for water along the Front Range continues to increase and the overall supply is not growing at a comparable rate.

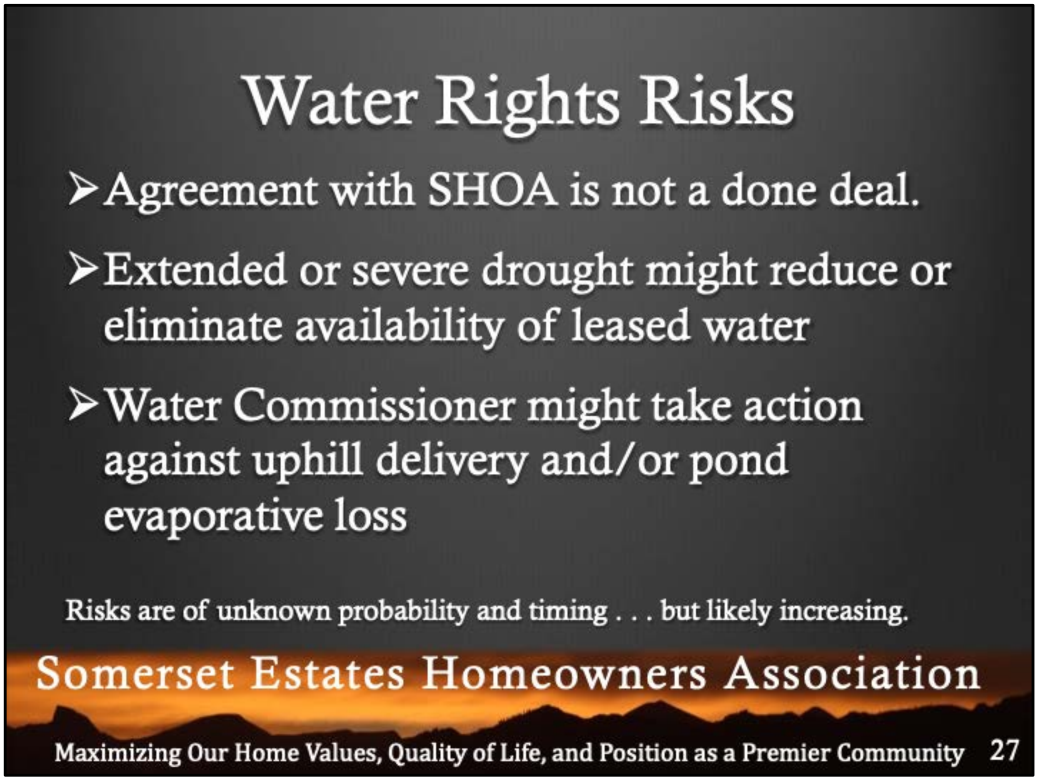
SEHOA's water committee presented an initial draft term sheet to SHOA in January 2020. SHOA asked for certain changes that we accommodated in a revised term sheet in early September and we agreed to convert these terms into a legal agreement for execution. We anticipated execution in November, but SHOA is now engaging a new attorney and expert to evaluate the terms.

The LRP model includes a new transfer line and associated infrastructure at SEHOA's expense, as well as 50% of cost of a new pond 1 liner and a new meter from ditch. Assuming an agreement is executed, SEHOA will be obligated to these capital costs which are near-term and non-negotiable yet necessary for our irrigation.

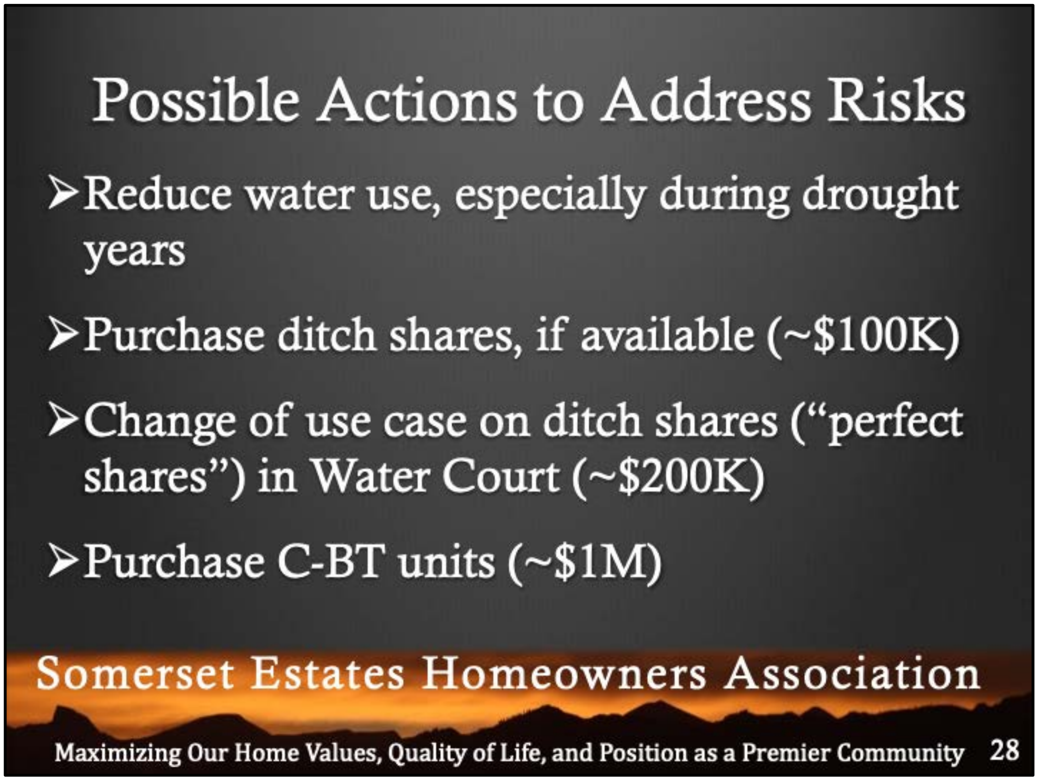
The existing MOU (which covers ongoing operations) expires 12/31/2020 and the existing Tolling Agreement (which postpones litigation) expires 3/30/2021. If negotiations fail in spite of our best efforts, SEHOA may need to litigate against SHOA to resolve the matter.



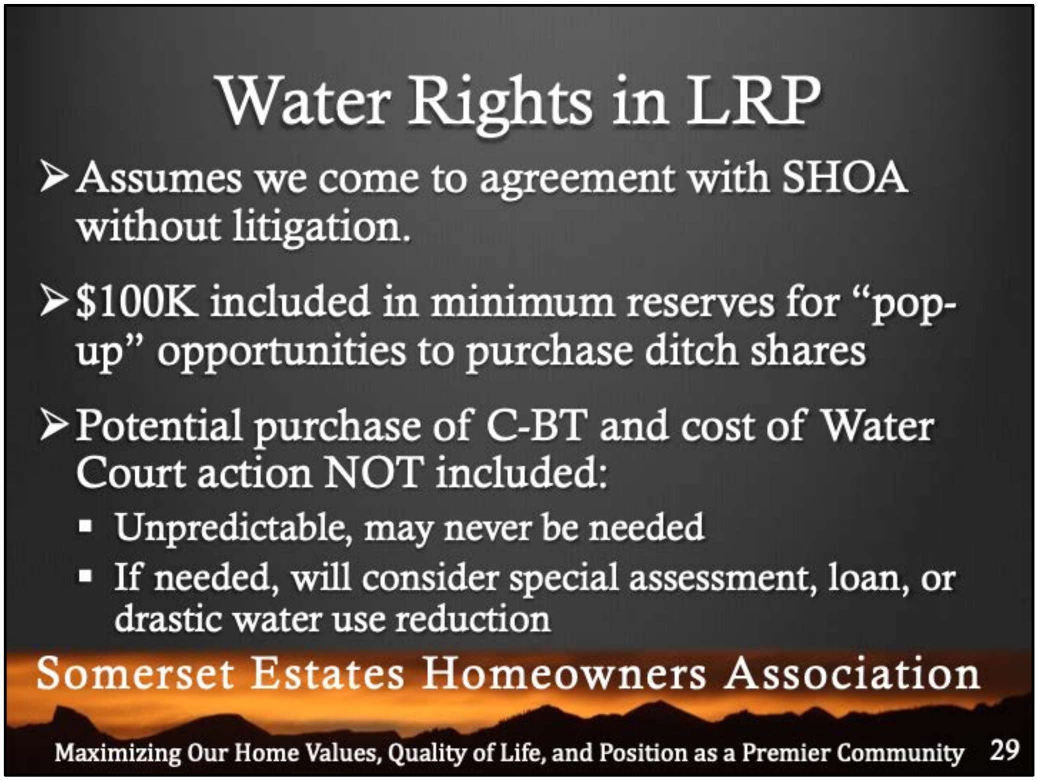
With this agreement, SEHOA will have explicit ownership of water rights that yield a variable amount of water, depending on rainfall. As in prior years, the yield from these rights will be insufficient to meet our needs and we will have to continue leasing additional water rights to augment these basic rights. Fortunately, in most years, leased water is readily available and relatively cheap.



In addition to an uncertain outcome of our SHOA negotiation, risks may grow if Colorado experiences an extended drought. Currently, the entire state is in drought, about half considered “extreme”. Boulder County is in “severe drought”. We also have another risk of action by the water commissioner based on our water use. We don’t know the probability of either risk or the exact cost implications. It is possible leased water could become more expensive or disappear all together in future years. It is also possible the water commission could require minor or major changes to the way we take and use ditch water.

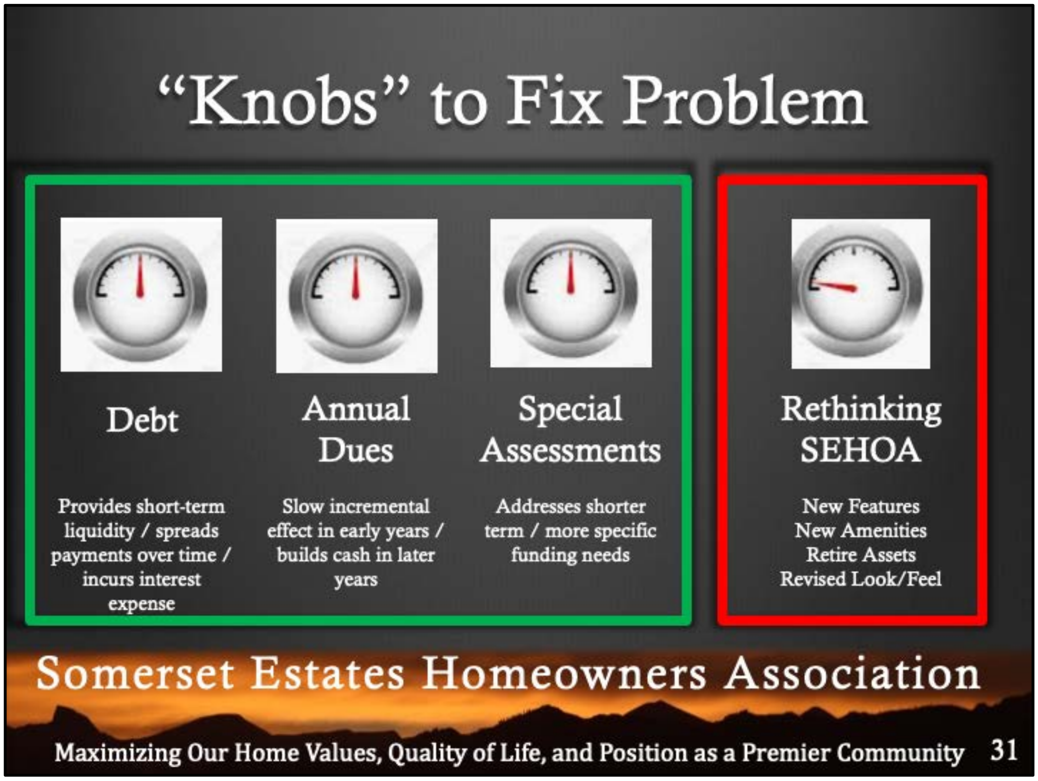


Future responses, if necessary, span a broad range of costs from modest to large. Reducing water use is obviously worth considering, especially in terms of fixing leaks, etc. We have a high water use type of landscaping (irrigated grass, water features, etc.) which is part of what makes our neighborhood nice. In the future, our community may need to make difficult decisions about our neighborhood's "look and feel" if water becomes unavailable. One of the best options is to buy more ditch shares, but these are only rarely available. The most flexible water source available is C-BT (Colorado Big Thompson), but the price of these shares has increased dramatically over the last decade.



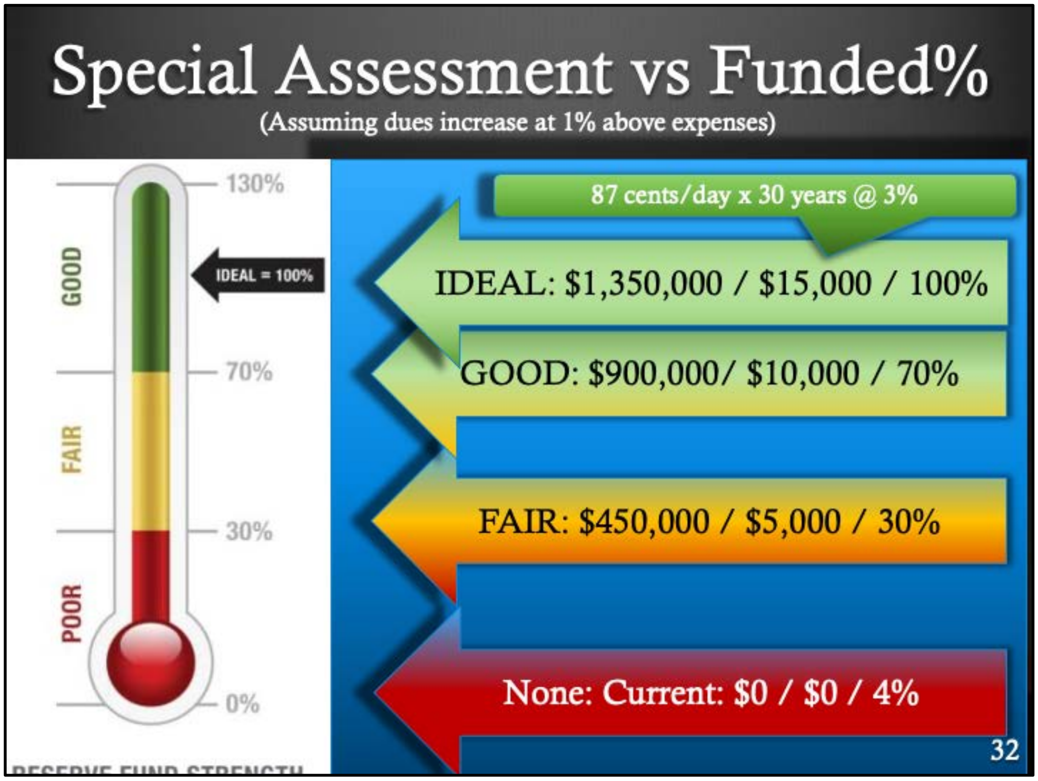
The board spent a lot of time considering how to handle potentially large future water-related costs. Notwithstanding the recent mixed messages coming from SHOA, the plan assumes successful negotiation will obviate the need for litigation. We decided to include $100,000 in minimum reserves (in addition to another $100,000 minimum reserves for other possible emergency expenditures) so we can immediately act on any opportunities to buy ditch shares. We did not include the very large amount needed to buy more C-BT units or for legal fees related to Water Court. It didn't make sense to assess current homeowners to have money sit in the bank given that we don't know if, when or how much we will need. But homeowners need to be aware that there is the potential for one or more future special assessments related to water rights.

With the foregoing process and premises in mind, we considered how best to address our needs.



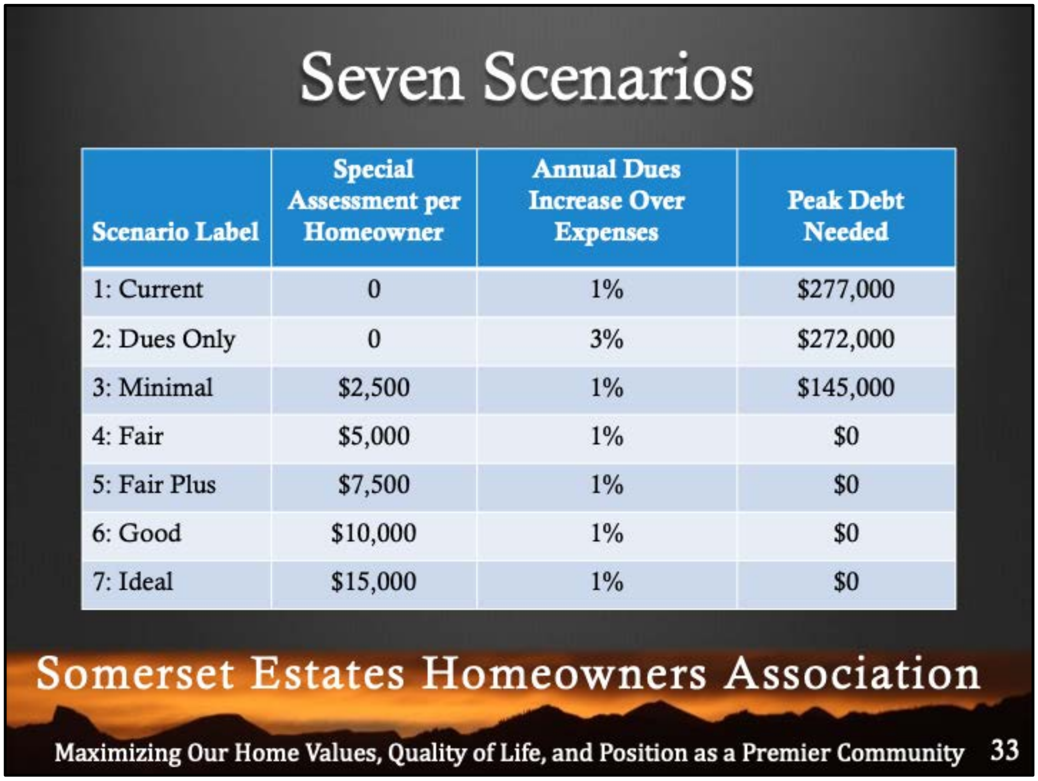
Fundamentally, there are four "knobs" to turn to fix our problem of unfunded liabilities. Debt will be needed if our cash needs exceed our available cash. Debt is costly in terms of interest and may not be available when needed. Compounded growth of our Annual dues can keep us ahead of inflation and will help us accumulate funds in the future but does relatively little in the early years. A special assessment immediately improves our "Percent Funded" status but requires payment by homeowners in the near term.

The scope of this exercise is limited to achieving financial security with respect to our current assets. Altering the community's assets can increase or decrease unfunded liabilities. A more elaborate entrance, for example, would increase funding requirements… while removing the waterfall would decrease future funding requirements. The following charts assume no changes in community assets and therefore demonstrates the effect of only turning three of the four "knobs" above.



Our updated Reserve Study shows approximately $1.3M of unfunded liability. Having 100% on hand would be an "Ideal Funded Percent". Today, we have less than 4%. Increasingly large Special Assessments would remedy this historic shortfall: $5,000...30%, $10,000...70%, $15,000...100%

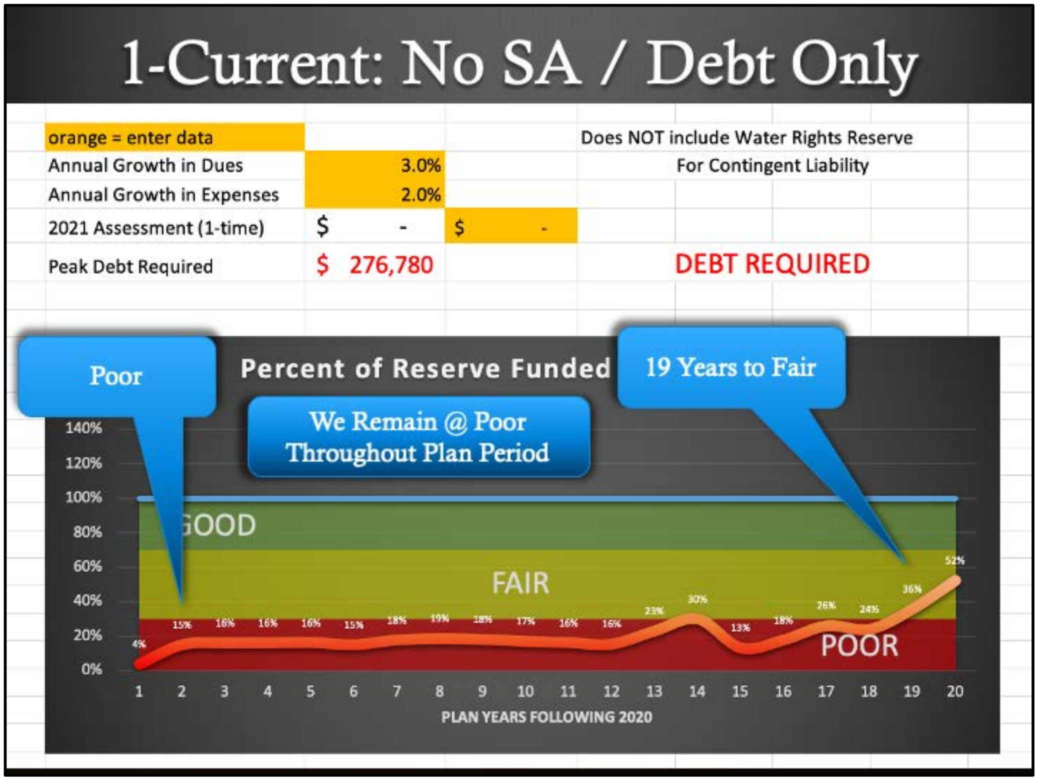
Had the original declarations permitted reasonable dues increases, the cost to remain at 100% Funded would have cost homeowners less than a dollar per day over the last 30 years.



Seven Scenarios

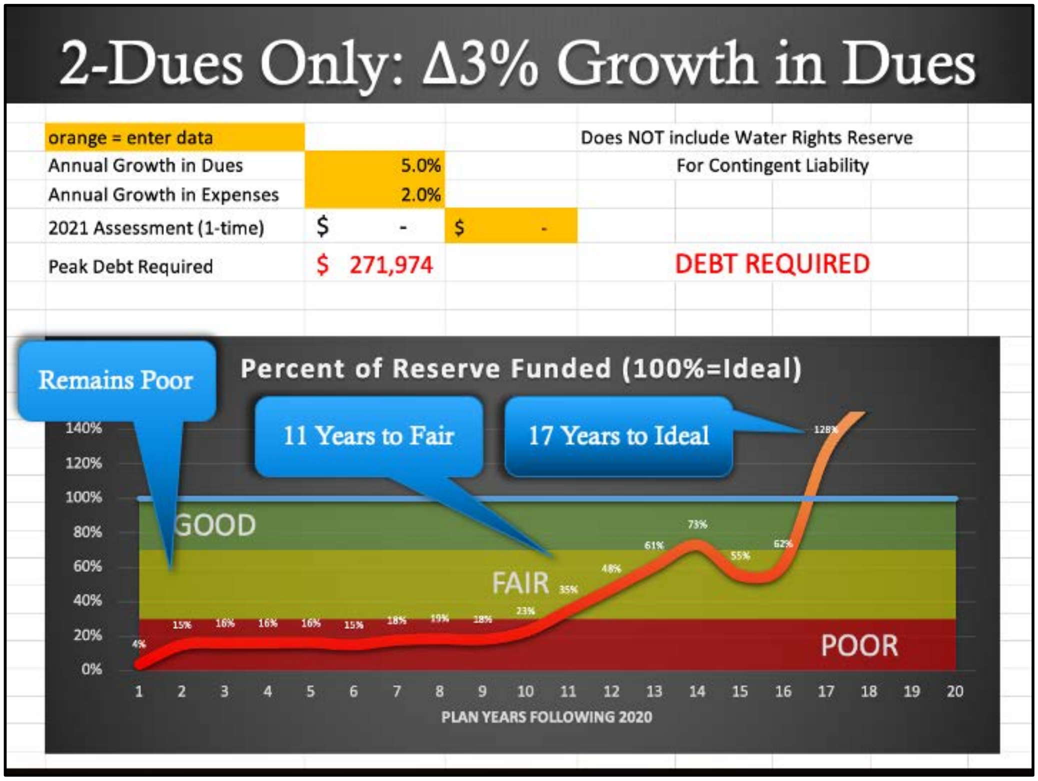
Scenario Label	Special Assessment per Homeowner	Annual Dues Increase Over Expenses	Peak Debt Needed
1: Current	0	1%	$277,000
2: Dues Only	0	3%	$272,000
3: Minimal	$2,500	1%	$145,000
4: Fair	$5,000	1%	$0
5: Fair Plus	$7,500	1%	$0
6: Good	$10,000	1%	$0
7: Ideal	$15,000	1%	$0

We considered numerous scenarios that partially or fully addressed the community’s shortfall. The following slides illustrate seven scenarios ranging from doing nothing ("Current") to fully funding in one step ("Ideal"). For each scenario, the model calculated the projected need for debt and the resulting level of Percent Funded year-by-year over the next 20 years. *

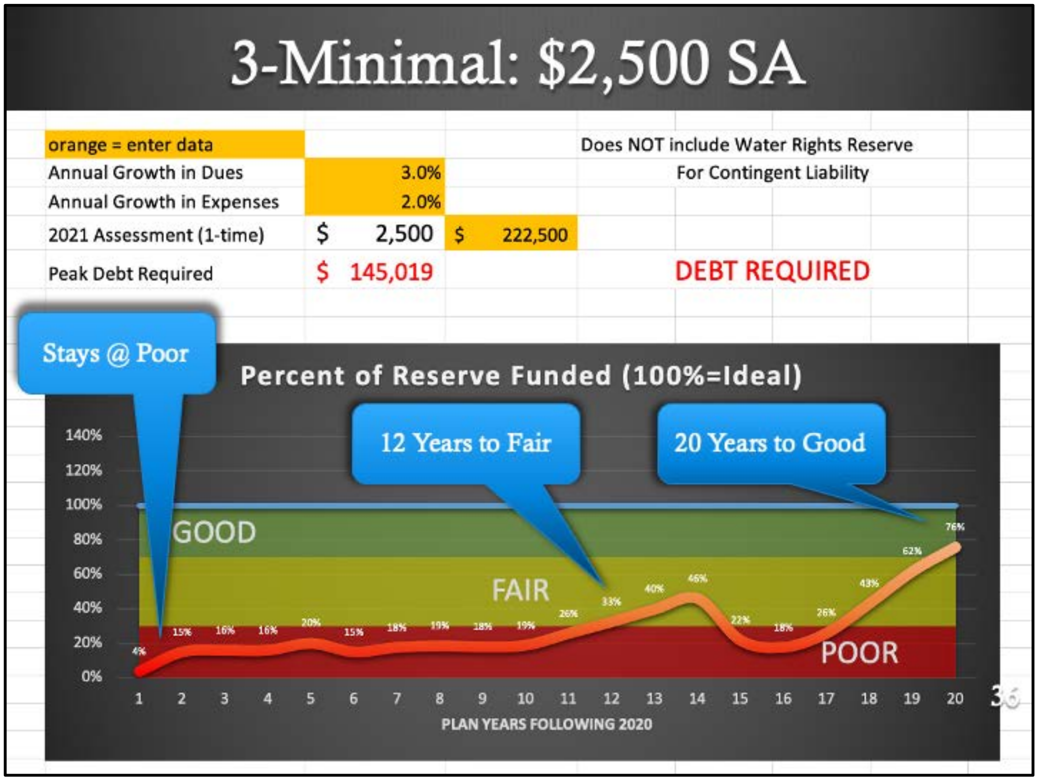


Each of these graphs show the projected consequence of different "knob" settings in terms of Funded% year-by-year.

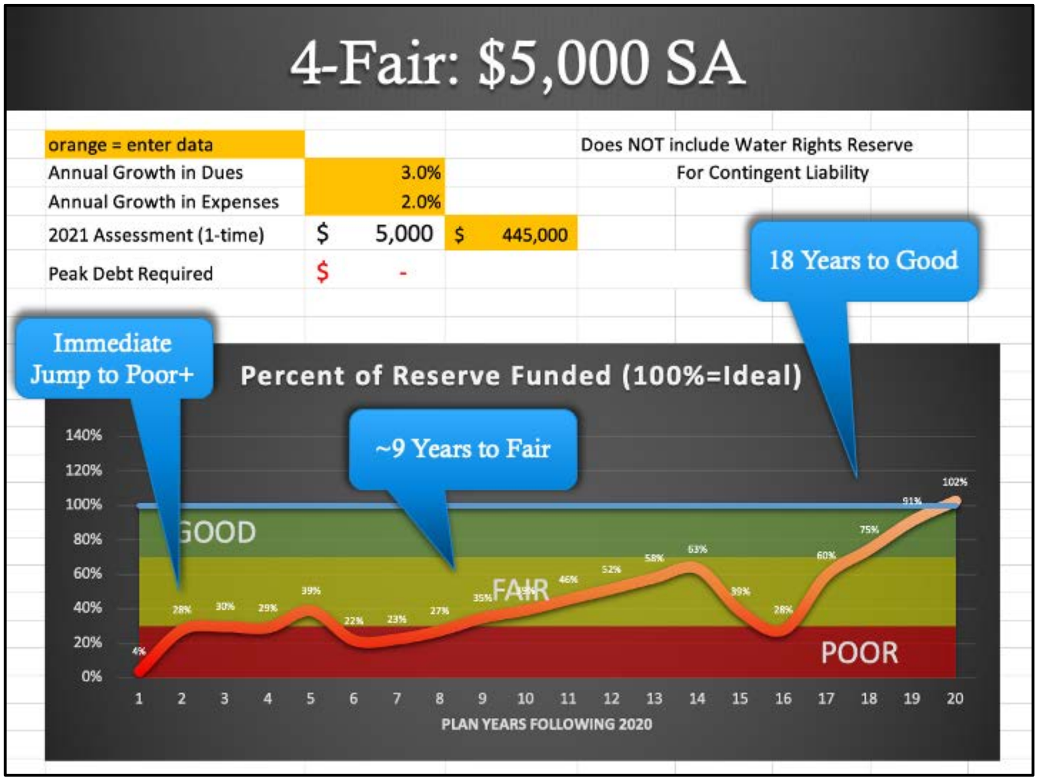
In this scenario, dues increase by 1% per year above inflation, but we have no special assessment. What happens? Answer – With no additional funding, our Percent Funded remains Poor and we will be forced to borrow money to meet our projected needs. If debt is unavailable, we would need to let our neighborhood decay as assets fail.



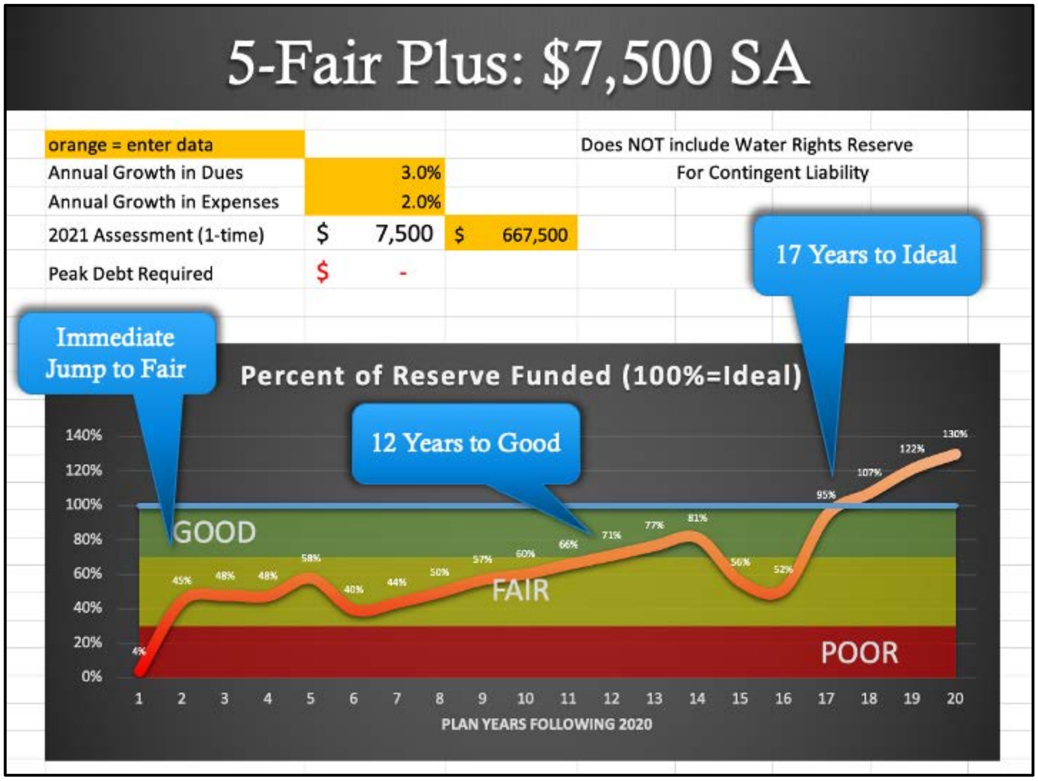
Can we rely solely on increasing dues year to year? No, it will not address our needs in the early years. We will still have to borrow funds or allow our assets to deteriorate further. In later years, the compounding would produce excess reserves.



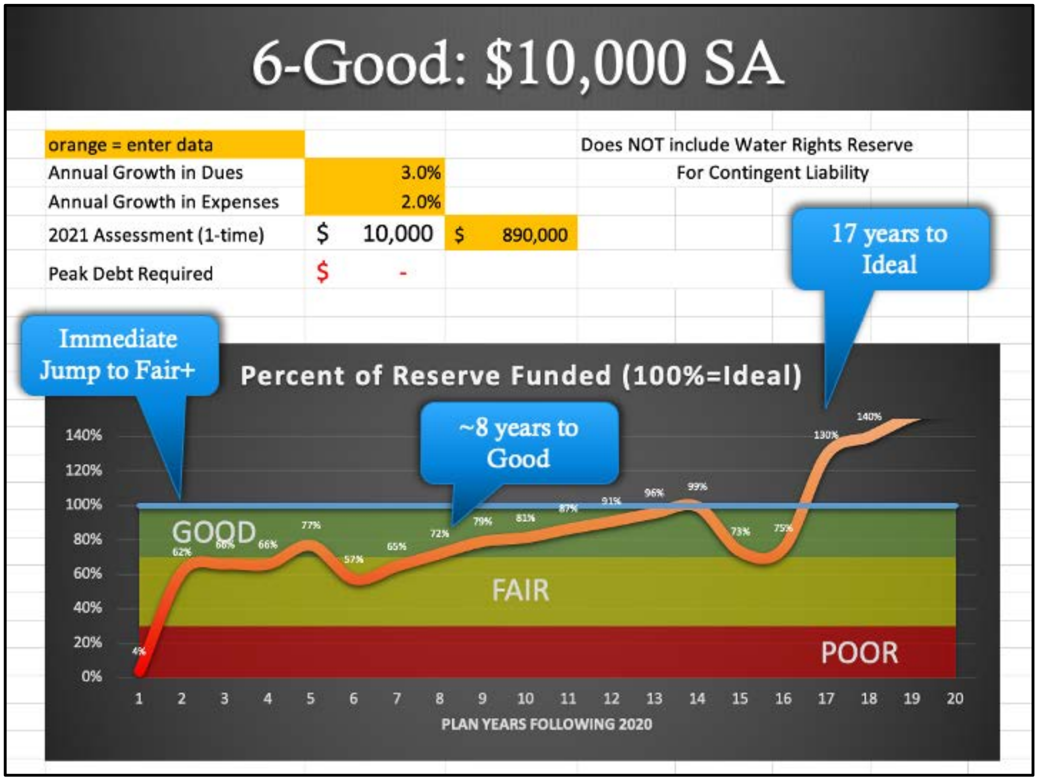
A special assessment of $2,500 would lessen our deficit, but we would remain in a "poor" financial condition for more than a decade and we would still need to borrow funds to meet our projected expenses.



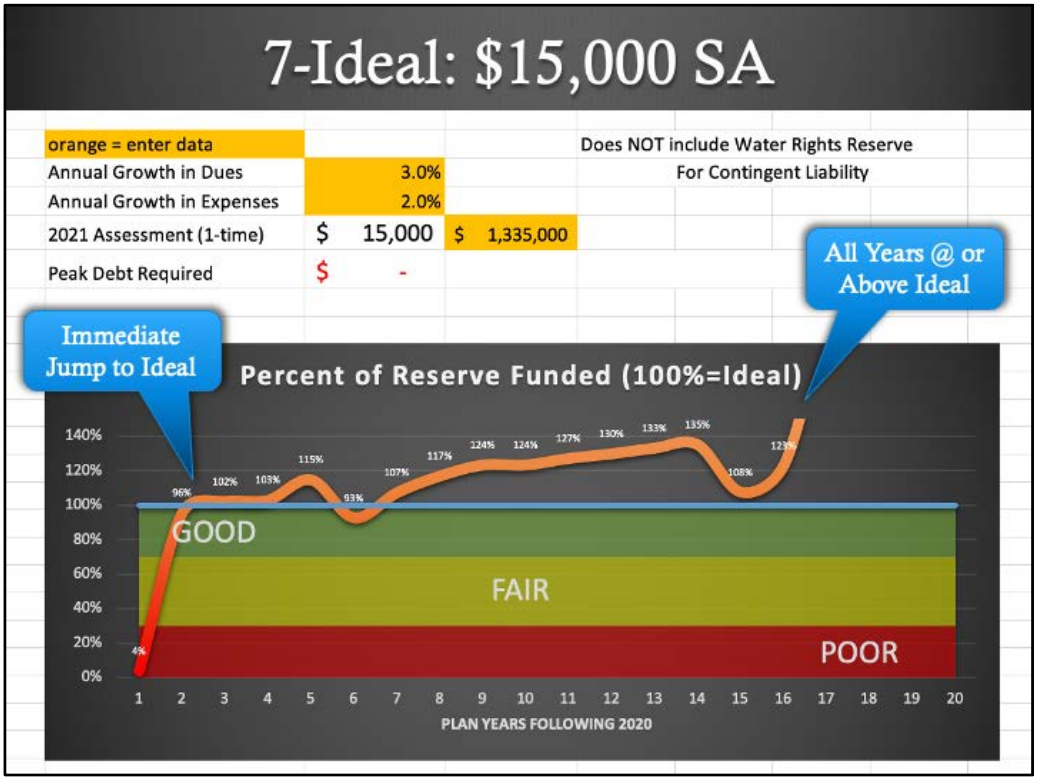
A $5,000 special assessment will improve our financial condition to the upper range of “Poor”. After nine years, we would slowly improve to “Fair”. After 18 years, we would improve to “Good”.



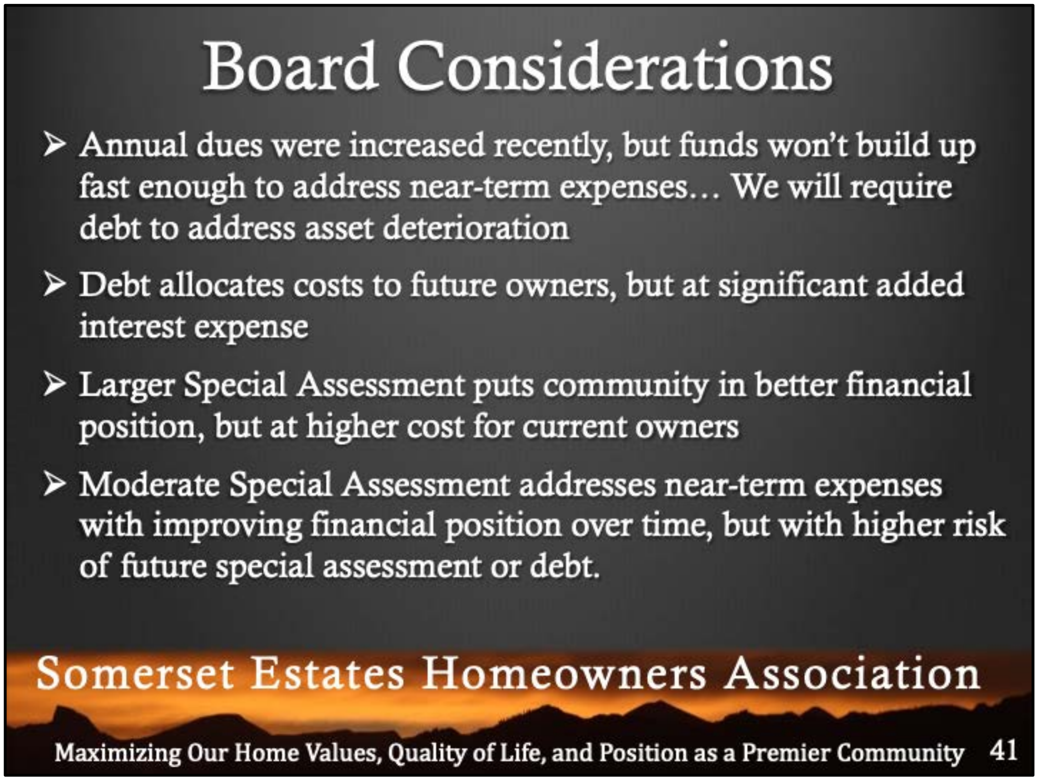
A $7,500 special assessment will improve our financial condition to “Fair”. After twelve years, we would slowly improve to “Good”. After 17 years, we would improve to “Ideal”.



A $10,000 special assessment would improve our financial condition to the upper range of “Fair”. After eight years, we would improve to “Good”. After 17 years, we would improve to “Ideal”.

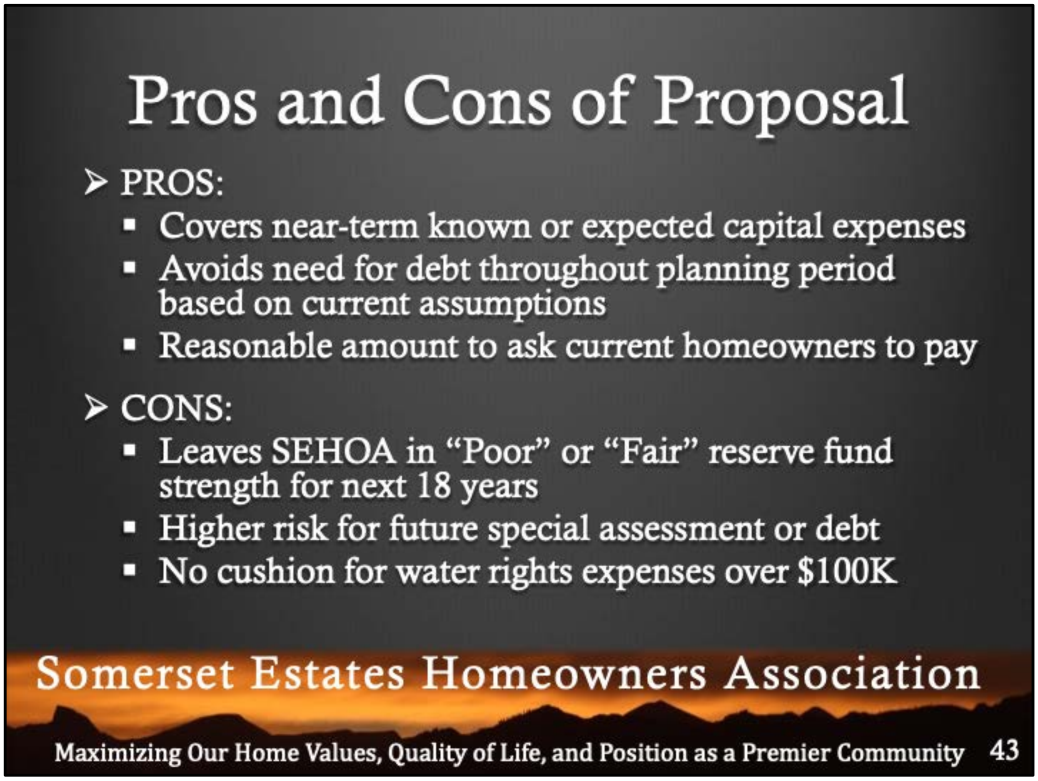


A $15,000 special assessment would improve our financial condition to “Ideal”, fully remedying our historic shortfall. We would remain at or above “Ideal”, thereafter.

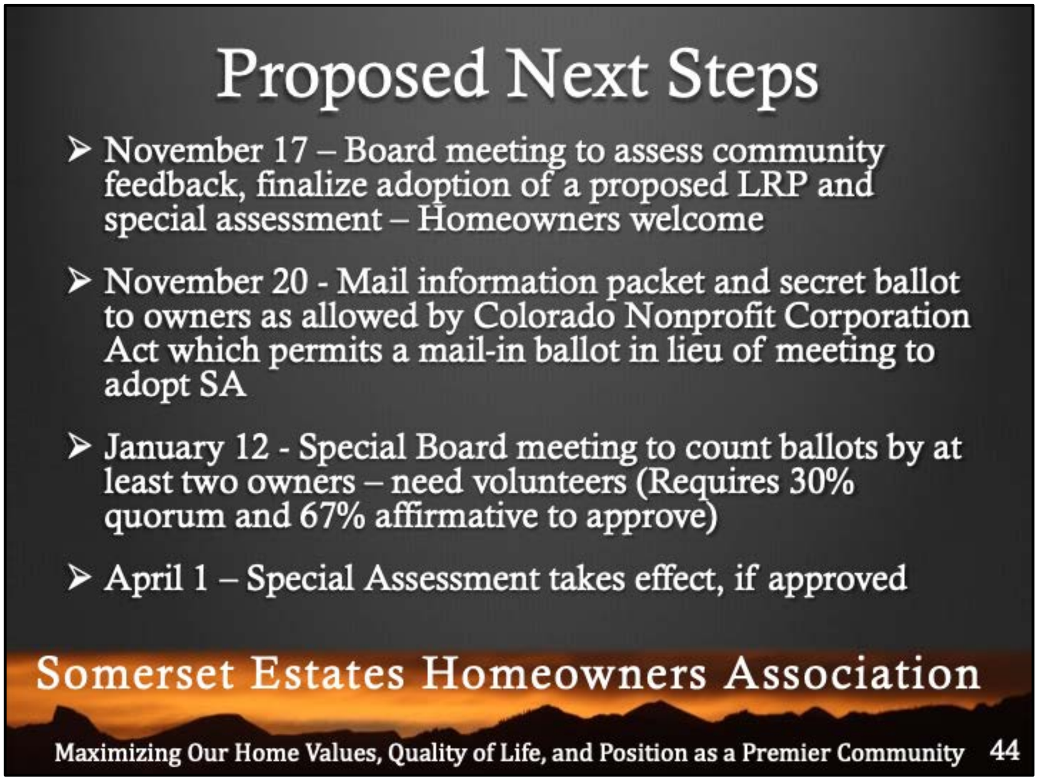


The board is cognizant of the trade-offs associated with each funding mechanism. Each has a benefit, but at a cost. *

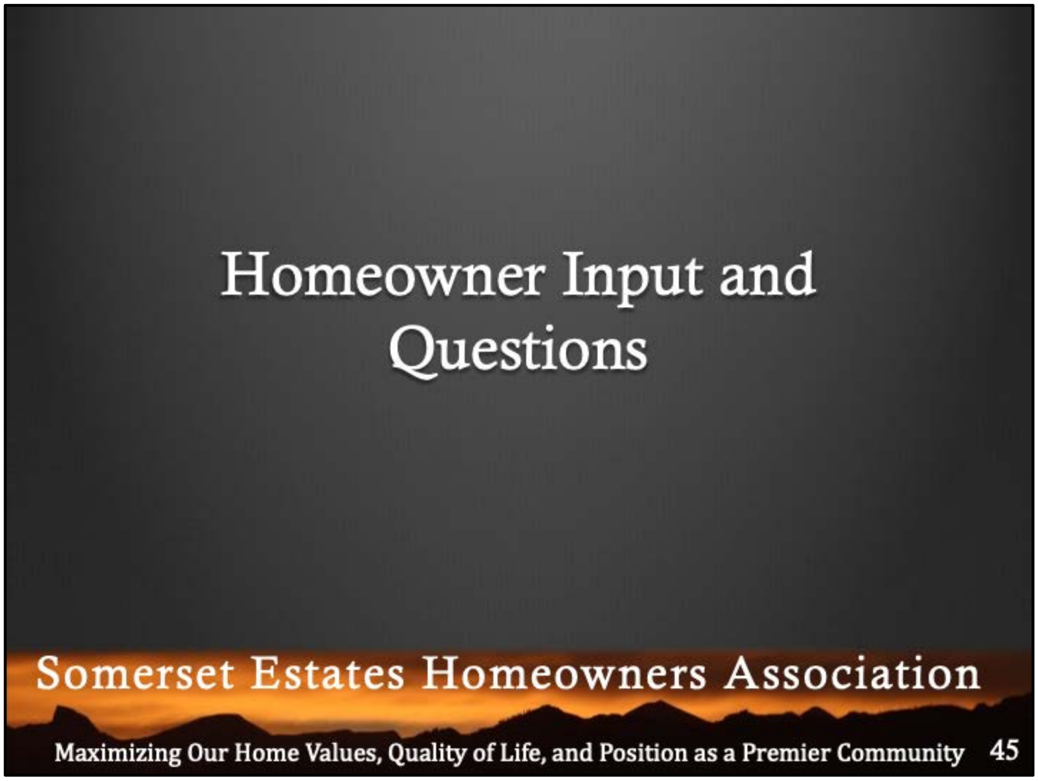
Based on a review of the situation, we recommend an assessment of $5,000, which is at the lower end of the spectrum, yet is a good step in the right direction. *



There are always trade-offs. We look forward to homeowner input before we undertake a formal action to implement the LRP. *



The timeline outlined above is designed to provide our SEHOA homeowners ample opportunities to become familiar with our financial condition, provide input to the planning process, understand the board's recommended actions and ultimately participate in a vote to approve the resulting plan.


Homeowner Input and Questions
Somerset Estates Homeowners Association
Maximizing Our Home Values, Quality of Life, and Position as a Premier Community
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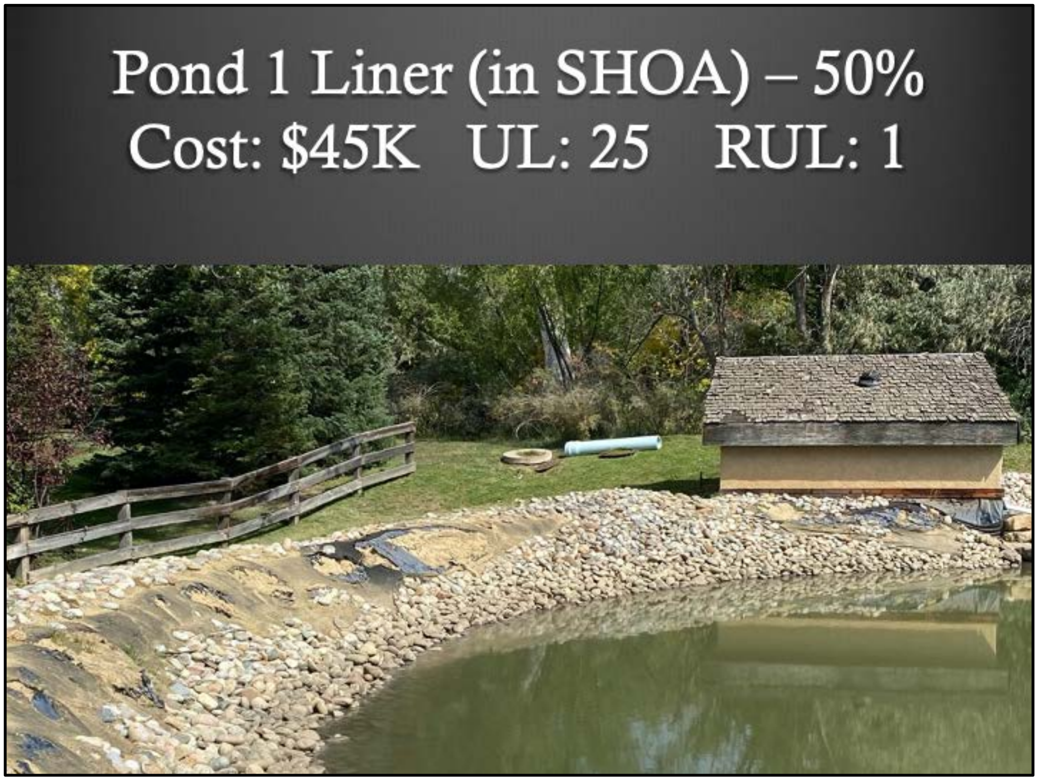
Appendix
Asset Examples

Near Term Expenses (2021-22)
Selected Examples



Pond 1 is critical to the functioning of the entire irrigation system. If it were to fail during the summer, we'd have no water in SEHOA. It is well past its useful life and we need to have the funds available to reline it. Assuming an agreement is reached with SHOA, we expect half of the relining cost ($45K) to be an obligation in the next year.

This meter is needed because we believe that current measuring system greatly overstates water taken from ditch, replacing should give combined HOAs significantly more water.

The existing pipe that runs from Pond 1 to Pond 2 carries ALL the irrigation water for SEHOA. It is undersized and well beyond its useful life. Installing a dedicated transfer line has been in the works for 10 years, and some of the equipment is in place. This project needs to be completed in 2021 to replace this critical piece of infrastructure and to fully separate the SEHOA water use from SHOA.

Normal wear and tear causes deterioration. A planful replacement of this asset is needed to preserve the appearance and function of our neighborhood.

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Mid Term Expenses (2023-28)
Selected Examples

The waterfall is driven by several pumps that are approaching the end of their useful life. Resources are needed to find and repair leaks in this area.

All SEHOA's irrigation water flows through Pond 2. It is a critical piece of our infrastructure. The liner of this pond is nearing the end of its useful life and will need to be replaced. We know from recent experience (Pond 8) this is a significant undertaking.

Reline Pond 3
Cost: $55K UL: 25 RUL: 3

Normal wear and tear causes deterioration. A planful replacement of this asset is needed to preserve the appearance and function of our neighborhood.

Reline Pond 7
Cost: $105K   UL: 25   RUL: 5

Normal wear and tear causes deterioration. A planful replacement of this asset is needed to preserve the appearance and function of our neighborhood.

Reline Pond 9
Cost: $60K   UL: 25   RUL: 5

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Long Term Expenses (>2028)
Selected Examples

Somerset Estates Homeowners Association

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