

2011 BUDGET GUIDELINES

I. Base Operating Budget

It is essential that the base operating budget for each year is carefully developed by analyzing the past spending and revenue pattern and accurately estimating expenditures and income for the remainder of the year.

The base operating budget for each year is not automatically the budget approved for the previous year, nor does it represent an entitlement. Instead, as noted above, the base budget should represent a careful analysis of past and projected spending and revenue trends. In every case where the base budget represents a 3% increase or a 3% decrease over combining the first six months' 2010 actual figure and second six months' estimated (calculated based on six months' actual figure from 2009 plus 3%), a written justification is required. Percentage comparisons of variance can be made at the category summary level (i.e., the administrative expense level, not the line item level of "telephone" which is part of administrative expense). Increases in personnel cost of greater than 3% will require explanation and justification. Changes in budget lines that occur because of changes in categories, account reporting or organization will contain notes that allow comparison to previous years. New position requests will require justification, estimated costs and draft job descriptions. The budget format will include a column to show the projected annual expenses for the current year in each category. The base budget will also include known 2010 salaries and 2010 depreciation expenses. Benefit adjustments will be based on estimated 2011 costs.

A. Components of Cost: The operating cost for each department or activity will include all costs identifiable to that cost center, including labor, supplies, depreciation, lease costs, utilities, etc. Minor repairs such as painting, road patching, replacement of a vehicle fuel pump, etc., are routine maintenance and thus are operating costs funded through the annual operating budget.

Operating costs do not include major repairs to or replacement of facilities or requests for additional or expanded facilities. Major repairs or renovation of facilities are addressed in the Reserve budget. Requests for new or expanded facilities are addressed in the New Initiatives budget. Operational repairs and replacements are defined as expenses for repair and replacement of items of less than \$1,000.

B. User Fees/Price Structures: User fees/price structures are established for certain amenities when the amenity is available to all property owners but is used primarily by only a segment of the property owners. A primary goal is that user fees/price for an amenity shall be established at a level that will cover 100% of the proposed 2011 operating costs for the amenity. The budget recommendation must provide a fee/price structure that will sustain membership, not detract from member use of the facility and must recommend additional funding sources outside of fees as appropriate to meet two criteria: 1) to sustain membership and 2) meet verified recommended levels of repair and maintenance. Any consideration of less than full cost recovery fee/price structure must include the analysis of fee/price structures used by comparable amenities in the geographic area.

C. Priorities: The overall priority for the base operating budget development will be operational costs first, initiatives that generate income are second, last are initiatives that generate no income.

II. Reserve Budget

Major repairs and replacements (repair of a roof on a building, replacement of worn carpeting, replacement of an engine block, etc.) add substantial value to or add significantly to the useful life of an asset, or replace an asset that has surpassed its useful life. Such items are funded through the Reserve budget. The LMOA Reserve Study required under the POAA every five years and adjusted annually based on recommendations from staff and the Building, Roads and Grounds Committee on the serviceable life of capital components is the basis of the Reserve budget.

The Reserve Budget will provide the following information as part of the annual budget in a clear manner for items over \$1,000.

A. Reserves Accounts will be accounted for separately from operations. The Major Repair and Replacements Reserve (MR&R) Account is a repository for funds set aside for reserve purposes. The Reserve Accounts and their sub accounts will be separate sections under the Reserve Budget. This will provide a clear picture of the sources of funds for reserve accounts and the annual balances after reserve expenditures. The purpose is to provide the board with a tool to be accountable in providing responsible funding to meet reserve requirements for the current and future fiscal years. The goal is to meet the reserve expenditure recommendations in the LMOA Reserve Study as modified by annual reevaluation conducted according to LMOA policy. Income sources for the Reserve Accounts include dues, assessments, fees and investment income, and other income generated from operations. Funds held in the Reserve Accounts shall be available for allocation for reserve expenditures or balances as set forth in the Annual Budget and in accordance with the Budget-funding plan. Funds that are allocated to specific reserve accounts shall show the source and amount of the allocation. In times when the Board of Directors considers these funds' resources inadequate, a special assessment may be needed.

B. The Reserve Accounts are Major Repairs and Replacements Reserve (including Road Reserve and Lake Reserve); Special Reserves include the Amenity Improvement Reserve (formally the Pool Account), Lake Health and Storm Water Management Reserve and Improved Property Fund.

Restricted Accounts include, New Home Construction Fees, Property Transfer Fees, Owner's Escrow, Cable Provider Payments, Emergency Reserve Account (Principal) and Emergency Reserve Account (Dividends and Interest).

C. All Reserve Accounts as well as any other cash asset accounts residing in the Short Term Operating and Restricted Funds Account (STORFA) must be shown in the annual budget. Their beginning and ending balances, any additions or subtractions to the accounts, and the source or destination as appropriate must be shown in accordance with AICPA guidelines.

An Annual Reserve Review of physical assets will be conducted by the Buildings, Roads and Grounds Committee in coordination with staff to estimate replacement cost of items to be addressed in the 2011 budget. To arrive at a recommended list of items and amounts, the committee will review the estimated remaining life and estimated useful life of the reserve components.

The Finance Committee, in conjunction with the Buildings, Roads and Grounds Committee, shall review the Reserve Study, using cost data supplied from the independent reserve study

contractor which reflect changes in market conditions, and recommend updates and amendments for the Annual Reserve Review by the July regular meeting of the Board of Directors; and the Finance Committee shall develop a plan to fund the reserve contributions determined necessary in accordance with the Reserve Study or its updated reviews.

The Reserve Budget should be used as a primary guide by those planning the major repair and/or replacement of assets. In addition to being fully justified, any request for funds for major repair or replacement of an asset must also be consistent with the Reserve Study.

III. Revenues

Revenues include all dues and fees collected by LMOA. These include but are not limited to annual dues, fees, investment income, and other revenues.

IV. Loans and Leases

Any new leases or loans will require a current and projected income to debt assessment, along with a recommendation to the board whether the planned schedule for payments match anticipated annual revenue streams or available reserve balances. The purpose of the assessment is to measure the extent to which the new lease or loan matches current income and assets. No one ratio provides all information, but the following are suggested at a minimum: 1) Debt to Equity Ratio and 2) Debt Service Ratio. When entering into or terminating a lease, or when an equipment purchase is funded with debt, appropriate cash flow considerations must be made in order to budget for debt payments and lease obligations. Leases should not be taken on items of less than \$10,000 in value.

V. New Initiatives

A new initiative may be a capital purchase which is not a replacement purchase, one-time funding of an outside service (non-capital), expansion of LMOA provided services (operating) or a change to any income or operating expense that is not offset elsewhere in the Operating Budget.

A. Capital New Initiatives: Capital new initiatives are initiatives that add to or substantially improve the amenities, facilities or common area of the Association.

Examples:

- 1) New or expanded playgrounds, parking areas, buildings, equipment, etc. that have not been a part of the amenities, facilities or common areas and exceed \$1,000 in value.
- 2) Adding an additional heat pump to a building.
- 3) Installing a wall to divide a large room into two or more smaller rooms would be a capital new initiative as would removing a wall to create a larger room.
- 4) Replacing the furnishings in a building for purely aesthetic reasons (i.e. while the furnishings still have substantial useful life) would be a capital new initiative.

B. Non-Capital, Non-Operational New Initiatives: This category is for new initiatives which are non-depreciable in nature and will not affect the operating budget in future years (non-repetitive).

Examples:

- 1) Funding for a one-time study of the potential of a facility.
- 2) Buy-out of leased equipment.

- 3) Purchase of a piece of equipment costing less than \$1,000.
- 4) Upgrading a road surface from tar and chip to asphalt.

C. Operating Budget Expansion New Initiatives: Operating Budget Expansion would cover programs that are intended to be provided as continued income and/or services and supplies in future years as well as in the year being budgeted.

Examples:

- 1) Additional manpower.
- 2) Increased employee-training programs.
- 3) Utilities and supplies necessary to support a new facility such as restrooms.

D. Operating Changes to Budget (no program changes): These changes will have been identified during the operational review in Part I. Included are inflationary changes that could not be offset elsewhere in the base operating budget, changes in anticipated volume of use resulting in decreased income, and changes to line item expenses that are historically shown to have been budget deficient and cannot be offset elsewhere in the base budget.

E. New Initiative Justifications: Any new initiative (categories A-D above) must be fully justified. The full scope of the proposed initiative must be explained to include the specific tasks that must be undertaken to achieve the objective:

- a. State the objective of the initiative;
- b. Document the benefits to be derived from the initiative;
- c. Identify the specific tasks and resources that are necessary to achieve the initiative;
- d. Discuss the alternatives considered;
- e. Explain why the proposed solution is recommended; and
- f. Reference the goal(s) and objective(s) from the LMOA Strategic Plan.

In the review of the budget requests, the focus of the Finance Committee and the Board is on the benefits and costs of an initiative and on determining how that initiative compares in importance to other initiatives proposed.

F. New Initiative Program Emphasis: Each proposed new initiative must be presented in program terms rather than by the traditional line items. For example, an initiative to increase the number of security checks would be justified by explaining why additional checks are necessary and what will be achieved through the additional security checks. The estimated cost of the initiative would be a compilation of the additional man-hours, gasoline, vehicle maintenance, etc. that would be necessary to achieve the increased number of checks. The Security Department and the Safety and Security Committee would identify the need, consider solutions, define costs, and estimate benefits before proposing the initiative.

G. New Initiative Priorities: Since there are never enough funds to accomplish all of the things that could be done, the following criteria will be used in establishing priorities.

- 1) **Safety** and protection of Lake Monticello residents, visitors and employees and of both common and private property
- 2) **Maintenance** and care of infrastructure and amenities
 - Repairs
 - Preventive maintenance
- 3) **Improvement of infrastructure** and amenities

- Expansion of infrastructure to meet increased needs
 - Restoration of common property
- 4) **Improvement of recreational and cultural opportunities** for residents

The proposed budget must include a listing of all LMOA proposed program changes (all new initiatives) in order of priority. Grouping of program changes by categories (e.g. "A," "B," etc. or "high/medium/low") is not acceptable.

Any 2010 New Initiatives that are not anticipated to be complete or under contract by the end of 2010 will not be automatically added to the 2011 New Initiative requests. Such items should be resubmitted as original for the 2011 New Initiative Budget and must be in compliance with all the requirements listed above.

VI. Budget Work Flow:

The priority and order of budget development, consistent with the Budget Calendar, will be the reserve budget first, the base operating budget second, initiatives that generate income are third, last are initiatives that generate no income.

VII. Five Year Budget Projection

A five-year projection of all income and expenses shall be presented. The projection should be based on currently approved programs and contain reasonable assumptions based on the anticipated growth and demographics of the residential community. The projection will show the Reserve requirements and funding stream, and identify any assessments or dues increases required to meet shortfalls, if any.

The annually updated 5-year Reserve Study shall be used to create a 5-year LMOA Reserve Budget that estimates expenditures and sources of funds.