Funding Our Future
Building a Post-Recession Business Model

July 16, 2014
Changing Business Models

• All companies must adjust their business models to adapt to external factors.
• Hot Springs Village’s business model was developed in the late 1960s and has not been significantly changed since that time.
• The recession has had major financial implications for community associations. Some have been forced into bankruptcy. Fortunately, the impact on Hot Springs Village, while significant with a 20 percent reduction in dues paying lots, can be countered if we take action now.
Cooper Years

Pre 2003 - Initial Sales Period

• Cooper marketed low rates and high levels of amenities.
• Subsidized assessments and fees from sales profit.
• Infrastructure and facilities were relatively young with low maintenance costs.
• Cooper ran operations and maintenance from their profits, assessments and fees.

When a developer leaves, communities must adjust the business model to replace funding from developer.
NRPI Years

2003 - 2008: After-Market Resale

- NRPI (an aftermarket sales corporation) had a large lot inventory and paid assessments.
- NRPI kept the collection rate artificially high postponing the need for business model change.
- New owner flow was high, growing amenity usage.
- 2007 Real Estate Bubble Collapses.
- NRPI Closed Operations in 2008, stopping assessment payment on approximately 5,000 lots.
- Some NRPI customers that had financed lots as investments abandoned the lots.
On our Own

2008 - 2013 POA Cost Cutting Reaction

• No sales programs other than “giveaways” for property being abandoned to the POA-owned.

• Collection rate fell to 79% as NRPI dumped inventory to Commission of State Lands.

• Abandoned lots primarily in areas with no amenities. No plans to add value to the areas.

• By 2013, 3.2 million annually was cut from budget.
Reduction In Paying Lots

• Initially, the majority of the lots abandoned were owned by NRPI. Then by smaller investors and now individual owners.

• A major factor individual owners reported for abandoning lots was not the amount of the assessment but the perceived unfairness of owners of unimproved lots paying the same assessment amount as owners of improved lots who live in HSV and receive the majority of the benefits.
Reduction In Paying Lots

- The Community did try to respond to the shortfall in 2010 with an across the board Assessment increase of $4.

- This was not an attempt to bring assessment to reflect the real cost increases the community faced. It was simply a small increase to try raise some of the lost revenues.

- If the adjustment would have been to meet actual increased costs. It would have been much higher.
Monthly Assessment Including Inflation

$12 (1971) = $36.68 (2014)

With Inflation, It Should Be

$12 (1971) = $70.49 (2014)

HSV Has Not Kept Up
Reduction In Paying Lots

• This across the board increase after the real estate bubble collapse, actually hurt the community by pushing many of the remaining small investor and individually held lots to abandon more lots.

• After 1 year, the across the board assessment rate increase was collecting approximately the same revenue the the previous lower rate and falling.
Current Assessments

• The original model had operations, facilities, and infrastructure maintenance funding set up by Cooper, assuming assessment collection from the 34,149 lots originally sold. This worked until 2006.

• The recession has left HSV with approximately 79% (2013) of assessment revenues needed – that’s about 7,000 lots not paying assessments, a total of 3.2 million assessments not paid in 2013.
Assessments Billed vs. Received from 2001-2013

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Receipts</th>
<th>% of Assessments Received to Billed</th>
<th>Billed Assessments for Year</th>
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<tbody>
<tr>
<td>2001</td>
<td>$10,100,570</td>
<td>90.94%</td>
<td>$11,107,150</td>
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<tr>
<td>2002</td>
<td>$10,653,361</td>
<td>94.68%</td>
<td>$11,251,800</td>
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<td>2003</td>
<td>$10,465,386</td>
<td>92.56%</td>
<td>$11,306,400</td>
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<td>2004</td>
<td>$10,996,144</td>
<td>95.58%</td>
<td>$11,504,503</td>
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<tr>
<td>2005</td>
<td>$12,716,662</td>
<td>96.71%</td>
<td>$13,149,346</td>
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<td>2006</td>
<td>$13,162,697</td>
<td>99.88%</td>
<td>$13,178,006</td>
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<td>2007</td>
<td>$12,895,645</td>
<td>98.00%</td>
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<tr>
<td>2008</td>
<td>$12,418,662</td>
<td>94.09%</td>
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<td>2009</td>
<td>$11,804,947</td>
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<td>2010</td>
<td>$12,398,883</td>
<td>83.48%</td>
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<td>2011</td>
<td>$11,993,957</td>
<td>80.86%</td>
<td>$14,832,720</td>
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<td>2012</td>
<td>$11,890,259</td>
<td>80.16%</td>
<td>$14,840,892</td>
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<tr>
<td>2013</td>
<td>$11,712,461</td>
<td>78.92%</td>
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Uncollectable Assessments

Total Uncollected Since 2006 $13,823,131
Funding Needs

• Since revenue began to decline in 2006, approximately $13.8 million in assessments have not been collected.

• This decline had to be incrementally removed from the HSV operating budget. The decrease in funding primarily resulted in deferring required maintenance.
Funding Needs

While there are a few specific projects in the 5 year plan, These will each be looked at to make sure the projects are what we need. These must be voted on individually and there is ample opportunity for public comment on these.

Balboa scheduled for 2015 for $2.7 million
Coronado scheduled for 2019 for $2.2 million
Desoto Pool scheduled for 2016 for $2.2 million
Funding Needs

The majority of the funding is simply to keep what we have.

We have 500 miles of roads so road paving and culverts must be prioritized.

Police cars, fire trucks, garbage trucks, tractors, and mowers.

Roofs, air conditioners, parking lots.
**Funding Needs**

- Funds necessary to maintain the health of 11 lakes.

- Golf courses periodically need to be renovated and worn out infrastructure (irrigation, parking lots, cart paths, drainage, etc.) replaced.

- All of the smaller recreation programs and facilities have similar needs.

- There are club houses, maintenance buildings, and pavillions that must be updated and renovated.
Funding Needs

We can and will debate the need of any particular renovation, but it does not negate the fact that we either maintain what we have or we decline.

Eliminating any particular project makes little difference to our funding needs long term.

If we simply let things decline so do our property values and our ability to attract new buyers.
Funding Needs

Revenue must be developed to perform required maintenance that has been deferred and allow the required future maintenance.

Maintaining what we have is our responsibility.
The Cost of Doing Nothing

• Since HSV has not been funding long term maintenance and capital needs, if nothing is done, we will run out of funds to continue maintaining all facilities, infrastructure, and programs at the current level starting in 2016. As vital services must be maintained to remain habitable, many nonessential services would need to be reduced or removed in order to continue operating our infrastructure.

• If these cuts were not made; by the year 2020, we would be $22 million in the red simply to continue existing programs and infrastructure.
The Cost of Doing Nothing

• Facing such revenue shortfalls, HSV would be forced to close facilities due to major staff reductions, reduce maintenance standards, and continue deferring repairs to roads, buildings, water and sewer systems.
• HSV would simply deteriorate as values continued to drop and more property was abandoned.

We can avoid this by simply changing our business model to a system that will work in post-recession era.
Future Funding Task Force
Base Case Outcome

Closing Cash Balance (millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Series 1</th>
</tr>
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<tbody>
<tr>
<td>2015</td>
<td>2</td>
</tr>
<tr>
<td>2016</td>
<td>-3</td>
</tr>
<tr>
<td>2017</td>
<td>-6</td>
</tr>
<tr>
<td>2018</td>
<td>-11</td>
</tr>
<tr>
<td>2019</td>
<td>-17</td>
</tr>
<tr>
<td>2020</td>
<td>-23</td>
</tr>
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</table>
How Did The Task Force Come Up With This Number?

- Performing lots continue to decline at a rate of 325 lots per year consistent with the last 3 years
- Assessment rates increase with the CPI at 1.5 percent per year

Operating Revenue

- Recreation revenue increases at the rate of 1.5 percent per year
- Golf rounds continue to decline by 5816 rounds per year consistent with the last 8 years’ trend. Golf fees have an average increase of 1.5 percent per year
- Public Works revenue increases at 1.5 percent per year
- All other revenue increases at 1.5 percent per year
How Did The Task Force Come Up With This Number?

Operating Expenditures

- Operating expenses increase at 2.5 percent per year with a productivity update of 1 percent a year
- Added Expense for deferred maintenance catch up of $350,000 per year 2015-2020 (no inflation)
- Operating capital will average $2,000,000 per year
- Paving expense increased by $600,000 per year for 2015 - 2020 with inflation

Major Capital

- Balboa scheduled for 2015 for $2.7 million
- Coronado scheduled for 2019 for $2.2 million
- Desoto Pool renovation scheduled for 2016 for $2.2 million
- Other capital expenditures in 2014 Budget and extended by staff
Planning a Solution

• The Base Case projection is based on no reaction to the issues and continued services at current levels.

• Our solution is based on appropriate reactions to the issues. The assumptions we use differ from the Base Case on several points:
  • Performing lots continue to decline at a rate of 325 until leveling in 2016.
  • Two-Tiered Assessment System to be enacted in 2015.
Planning a Solution

• Home Building Rate of 75 per year 2016 onward.

• Member golf rounds continue decline until leveling in 2016.

• Outside golf rounds will increase beginning 2016 until leveling at 25,000.
Planning a Solution

• $2.2M Desoto Club / Pool renovation scheduled for 2016 for $2,200,000 offset by $500,000 insurance.

• Capital Buy In Fee is enacted 2016 with the funds used for projects to add value to non-performing lots.
Our Course of Action

We have a course of action that looks at all aspects of our business model and will move us in a positive direction.

Three areas are addressed:

• Funding for Future Improvement.
• Maximizing Amenity Performance.
• Appropriate Assessment Levels.
1. Funding for Future Improvement

- We know the long term solution is to put non-performing lots back into private hands. This will take time and specific investment to build value back into those properties.
- In our solution, the capital funding to do this would be developed through new owners, allowing us to get the return on investment.
- It will create a new funding source for specific improvement projects not paid for by our existing membership.
Funding for Future Improvement

• We must continue to improve our community to remain relevant and competitive in the market.
• A common funding source for making future investments is a Capital Buy In Fee. This is a fee charged when a new owner purchases property.
• The model would create a fee payable upon purchasing into the community. There are several models but if the fees average $900 for a home and $150 for an unimproved lot, our fees would still be below those of similar communities.
• This would create approximately $650,000 per year which would be paid for by those moving to HSV rather than the existing membership.

• This estimate is based on 2013 sales. We are seeing improved sales in 2014 which would improve this estimate.
2. Amenity Performance

• Subsidizing different amenities and programs is what community associations were created for.
• This allows us to have many great amenities and programs collectively that would not be self sustaining alone.
• Amenities add to both our products: Quality of Life and Property Value.
• However it is important to subsidize appropriately and within your funding ability.
• We are evaluating all our programs and amenities to ensure the amount of funding is appropriate and at reasonable levels.
Amenity Performance

• Golf, due to the scale in HSV, represents a significant part of our annual budget.
• Currently our rounds from members have been decreasing annually as our community ages and fewer people are playing golf nationally.
• The FFTF-recommended goal is to reduce the annual golf subsidy from $2.5 million to $1 million by 2020 by seeking additional revenue markets and appropriate cost reductions.
Solution to Lowering Subsidies

• There are two ways to lower the golf subsidy: Reduce Costs and Increase Revenue.

• Staff will be assessing all operations and pending capital projects to seek ways to lower our costs while still meeting quality standards.

• HSV member golf will not continue to decline but should level off around 2016.

• Golfers are still moving to HSV but they may play once a week rather than 3 times per week. We will reduce some of the projected loss and the subsidy by approximately $500,000.
Solution to Lowering Subsidies

• We have had many discussions on becoming a destination community with significant numbers of outside guests paying to use facilities at rates that bring considerable revenue while being competitive. In order to lower the golf subsidy to a sustainable level, tapping this outside market is key.

• HSV has great golf courses but our business model was not set up to operate as a private club. Our golfers pay rates for golf not for exclusivity.

• Rather than put the major burden on our existing golfing population to reduce the subsidy being paid from assessments, we have set a target to have 12,500 additional outside rounds at a $40.00 average revenue per round by 2016. This will increase by 25 percent each year until we cap it at 25,000 new outside rounds in 2020.
New Golf Revenue Based on 12,500 New Outside Rounds Growing to 25,000 by 2020 (Average $40 per new round revenue in 2016)

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Outside Rounds</td>
<td>12500</td>
<td>15625</td>
<td>19531</td>
<td>24414</td>
<td>25000</td>
</tr>
<tr>
<td>Average Price / Round</td>
<td>$40</td>
<td>$40.60</td>
<td>$41.21</td>
<td>$41.83</td>
<td>$42.45</td>
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<tr>
<td>Revenue</td>
<td>$500,000</td>
<td>$634,375</td>
<td>$804,863</td>
<td>$1,021,170</td>
<td>$1,061,364</td>
</tr>
</tbody>
</table>
Solution to Lowering Subsidies

- While these targets are doable, it will take time and significant development of the market to bring consistent numbers of golfers to Hot Springs Village.
- It will also require us to be aggressive in marketing to regional and tourist markets.
- It will also allow significantly more of our target market to see and experience the community first hand.
- Most people buy only after several visits. This will not only bring us more golfers but also more buyers for properties.
3. Assessment Planning

- Of the three key planning areas, the assessment is the only area that can be implemented with immediate revenue results to allow the time necessary for the other two planning areas to develop.

- We currently have **NO** growth model for our assessment. As we grow, our funding does not increase.

- We must change our business model allowing new building and population growth to grow our budget without relying on assessment increases alone.
Assessments Model Objectives

Multiple options for assessments were studied. Any solution must meet the following objectives:

• Raise $3 million annually to replace the annual revenue lost to maintain existing assets
• Not incentivize additional lots to be abandoned
• Keep rate competitive with similar communities
• Monetize growth so that the budget grows with the population and the demand on services
• Fund maintenance needs until additional revenues can be developed by increasing the number of paying lots and the amenity revenues.
Assessments Options Considered

- Across the board assessment increase to all lots equally or special assessment.

- Tiered assessment system with differing rates for improved lots and unimproved lots.
Across the Board Increase and Special Assessments

- These would cause a further abandonment of undeveloped lots.

- Loss of additional paying lots would result in further loss of revenue.

- More abandoned lots are more lots to sell, increasing the time to restore them to paying status.
Tiered Assessment Factors

- Owners with improved lots* have significantly more invested into their personal property and more to lose should property values drop due to deteriorating conditions.
- Improved lots get the majority of benefit from and drive most variable costs of community assets.
- Rate increases would still place improved assessments significantly below comparable communities.

*Improved lots are those that have water taps.
Savanah Lakes: $1,475
Stonebridge: $1,372
Tellico Village: $1,280
Del Webb GT: $1,060
Creekmoor: $810
Hot Springs Village: $440
Lake Providence: $3,396
Bella Vista: $288
The Villages, FL: $1,740.00
On Top of the World, FL: $4,139.76
Assessment Recommendation

- Two-Tier Assessment Plan - improved properties and unimproved properties
- Increase improved properties’ monthly assessment to $65. No increase for unimproved properties
- Board retains discretion to apply COLA increases to both tiers
- Effective January 1, 2015
Monthly Assessment Including Inflation

$12 (1971) = $36.68 (2014)

With Inflation, It Should Be
$12 (1971) = $70.49 (2014)

HSV Has Not Kept Up
Meets Assessment Objectives

- Remedies the inequity of unimproved lots subsidizing improved lots and reduces incentive to abandon lots.
- Allows time to increase other revenues sources such as the Capital Buy In Fee and Golf Initiatives to reduce subsidy.
- Keeps rate below those of similar communities.
- Monetizes growth so that the budget grows with population and demand on services.
- Raises the required $3 million per year.
How Do These Plans Work Together?

Spurring Growth With the Capital Buy In Fee

• Creates an approximate $650,000 in new recurring annual funding to allow the value added projects that are necessary to engage investment and begin moving property back into paying status.

• Creates revenue without increasing costs to existing owners.

• Common in similar communities; does not impact competitiveness.
How Do These Plans Work Together?

Reducing Golf Subsidy

• Looks at current and planned expenditures to be sure they are best suited to meet our needs.
• Sets a targets of 25,000 new rounds developed from outside sources by 2020, resulting in approximately $1 million per year in new golf revenues.
How Do These Plans Work Together?

Two-Tiered Assessment

• Generates revenue needed to meet deferred and current capital and infrastructure needs.

• Allows funding while other planning areas continue to develop.

• Will allow assessment revenues to grow as new homes are built, eliminating reliance on assessment increases alone.
Ending Cash Projections With All Three Elements
(Assessment Increase, Golf Revenue and Capital Buy In Fee Revenues)
Ending Cash Projections With All 3 Elements v. Base Case (Doing Nothing)
Conclusion

• Since the recession, many organizations just like Hot Springs Village have had to change their business models to adjust to the new realities of real estate.

• We are fortunate that we can solve our needs and still have rates and fees that are well below that of our competitors.
Conclusion

There are 3 funding plans from different sources:
1. Capital Buy In Fee: Funding from property sales for specific projects aimed at attracting more new residents.
2. Outside Revenue: Funding from outside guests to directly offset subsidies.
3. Assessment Revenue from owners to maintain our current infrastructure, amenities, and services.
Conclusion

- Revenue shortfalls always are painful. Hot Springs Village has cut expenses and personnel, and deferred maintenance to continue services to our members, but that business model is not sustainable over time.

It’s time to change our business model and fund what is necessary to allow Hot Springs Village to remain an outstanding place to live.
Thank you