

September/October/November 2013

The purpose of this edition of FAQs is to provide information presented at the October board meeting regarding the Marina loan, the compensation study, the 2014 proposed budget, and information regarding obtaining an audit of the financial statements for 2013. Please send questions to HICFAQs@gmail.com.

IMPORTANT: Please remember that the FC makes recommendations to the Board, but we **DO NOT SET POLICY!** Our goal is to hash through possibilities, weigh the pros and cons of each, and present what we think are the best alternatives for Board consideration. The ideas communicated from the FC are not approved as statements of fact until the Board makes its final decisions and/or revenue and expenses are realized.

Question #1: What information was presented by Cynthia Petrie at the October 19, 2013, Board meeting regarding the marina loan?

Summary of Marina Loan as of 10/19/13 – From the Finance Committee

The loan will be converted to permanent financing with Foundation Bank mid-November 2013.

Beginning balance: \$1.9 million
Interest rate: 4.67%
Anticipated monthly payments: \$14,700/month

Goal #1: To have the principal balance paid down to \$500,000 or less by December 2018

Goal #2: To have the loan completely paid off by December 2023

Why is December 2018 important?

By the end of 2018, all marina assessments will be paid off with the exception of continuing payments of \$10,000/month from January 2018 through January 2024 from one owner of a substantial number of lots. The FC recommends that we aim to refinance in December 2018 so our required payments will match our assessment income receipts at that point.

How can we get there?

Beginning loan balance \$1,900,000

Marina assessments anticipated from
January 2014 through December 2018: \$1,360,400

Additional marina revenue for same period
applied to principal (\$20K/year) 100,000

Less interest (305,000)

Applied to principal on loan 1,155,000

Projected ending principal balance \$ 745,000

Goal \$ 500,000

GAP \$ 245,000

Why is there a gap? We've already been assessed for the Marina!

When the Marina project was initially envisioned and the budget planned, it was expected that the Puget Sound Yacht club would pay its 18% share of the marina improvement costs (not any expansion costs). However, PSYC would not pay up-front assessments, but requested that we send an accounting when the job was complete. Chuck did an exhaustive analysis and determined PSYC's share at around \$340,000. They have refused to pay anything reasonable, which leaves us with a unique opportunity to get our docks back! This is good news!

The extension of time to pay previously negotiated with one substantial lot owner also contributes to the gap since HIC will have to pay more interest on the loan over that extended five year period. In spite of these two shortfalls, our "gap" to break even is only \$245,000.

OK, so how do we fill the gap?

The FC has done extensive modeling of our marina accounts receivable, including the timing of payment receipts and a projection of how much will be "bad debt" and most likely not be paid. It appears to us that paying extra principal of \$40,000 to \$45,000 per year through the end of 2018 will let us meet our goal of having a \$500,000 balance as of December 2018.

Beginning loan balance	\$1,900,000
Marina assessments anticipated from January 2014 through December 2018:	\$1,360,400
Additional marina revenue for same period applied to principal (\$20K/year)	100,000
Additional principal payments for five years	220,000
Less interest	(280,000)
Applied to principal on loan	1,400,000
Projected ending principal balance	\$ 500,000

Why is having a \$500,000 balance critical?

If our loan balance is \$500,000 and we can refinance at an interest rate of 7.5% or less, our monthly loan payments can be \$10,000/month and we can have the loan paid off in five years. The ongoing marina assessment collections will be \$10,000/month from January 2019 through January 2024, which totals slightly over \$600,000. The interest on \$500,000 for five years at 7.5% is approximately \$100,000.

What does the need to raise \$40,000 to \$45,000 each year for the next five years mean to each of us who owns a lot?

Bottom line – the FC believes there will need to be an increase in assessments starting in 2014 of \$50 per lot, with that increase specifically designated as applied to loan principal.

How certain are these projections? Is the \$50/year increase absolutely set for the next five years?

Projections are just that – projections! The FC has used the facts we have and done our modeling. Our facts include the loan balance and current interest rate. Our various assumptions include total assessments that will be paid, the timing of those payments, that increased marina revenue will be \$20,000/year, and that we will be able to refinance in 5 years at 7.5% or less. All of this is subject to change! We plan to continually analyze receivables, keep tabs on the loan balance, and keep everyone in the loop. At this point, we anticipate 5% to 8% of our assessments will not be collected, and that assumption is built into the modeling. If more or less

are collected, or if we experience significant delays in collections, the loan balance will be more or less than our current projections.

This is why we are not recommending a set special assessment to cover the next five years. The amount required will need to be part of our annual budgeting process for the next five years.

Final note: *As Cynthia explained at the Board meeting, all of the projected amounts shown above are rounded estimates. The factual amounts are the \$1.9 million starting point of the loan, the 4.67% starting interest rate, and the \$14,700 starting monthly payment. The chances of any other amount detailed above being 100% accurate is slim to none.....and "slim" just left!*

Question #2: What information was presented by Madeline Progner at the October 19, 2013, Board meeting regarding the compensation study?

Note: Below is a significantly shortened synopsis. The entire compensation study was provided to the Board subsequent to the meeting.

The objective of the compensation study was to analyze and evaluate Hat Island Staff Positions, develop and provide recommendation based on current market for salary ranges and salary/merit increase guidelines. The study includes an analysis and review of benefits/perks in comparison to the industry and provides related recommendations. Madeline and Jann Kaufmann spent approximately 250 hours in total on this effort. They developed detailed job descriptions/skill requirements for each of our 10 employee positions and obtained multiple comparables for each one. Based on these comparables, employee positions were grouped into five key positions and three salary ranges (Min/Mid/Max) were developed for each job position.

HIC has 10 employees. The analysis indicates that:

- 3 employees are paid below the minimum range.
- 4 are paid within minimum ranges
- 2 are paid within midpoint ranges
- 1 is paid above maximum ranges. Note: This last position is the substitute ferry captain and the committee feels this salary is justified given the difficulty of filling the position due to the unique circumstances.

The FC recommends bringing two employees up to minimum salary range, and that the compensation study be approved and adopted with an annual review, for future use in providing management with market ranges of salaries for recruiting and retaining employees.

Question #3: What information was presented by Cynthia Petrie at the October 19, 2013, Board meeting regarding the proposed budget for 2014?

The role of the FC is to gather information and requests from management and other committees to develop a proposed preliminary budget to present to the Board. The FC recommends a proposed 2014 budget that is essentially the same as the prior year with the following exceptions:

- \$50 per year annual assessment increase per marina loan info detailed above – to be applied 100% to loan principal
- \$100 annual fee per car/pickup truck (excludes golf carts and commercial vehicles)
- \$50 increase to annual water maintenance fee
- \$20,000 increase to annual marina income (see Marina Committee report for details) – to be applied 100% to loan principal
- Increase salaries for ferry captain, maintenance operator and bookkeeper
- Add back half-time position eliminated 3 years ago
- Increase first mate and deck hand salaries up to minimum salary range as noted above

- Add one-month overlap salary for new island manager transition (end of 2014)
- Increased property insurance to cover new docks
- Increased utilities due to PUD assessment

Line item details were provided at the Board meeting to reflect a balanced budget. Please contact one of the Board members if you would like a copy.

Question #4: Do we expect the Board to approve this proposed budget?

No -- as noted above, the proposed budget is just that – a proposal. The FC anticipates the Board will adjust this budget for presentation to HIC at the November board meeting. So stay tuned!

Question #5: What information was presented by Cynthia Petrie at the October 19, 2013, Board meeting regarding an audit of the financial statements for 2013?

There has been a lot of information being spread informally, i.e., via emails and verbally, indicating that the FC has audited the HIC financial records. That is not true. As stated in prior FAQs, the FC has not, cannot, and will not audit the HIC financial records.

It has also been stated that other people may have been auditing the HIC financial records. That is also not true.

HIC voted in December 2012 to waive an audit of the 2012 financial records. Based on that vote, HIC has not engaged an independent CPA firm to perform an audit of the 2012 financial records.

The purpose of a financial audit is to obtain reasonable assurance about whether the internally generated financial statements are free of material misstatements. Audits are performed by independent CPA firms. Auditors perform testing of selected financial records to confirm the existence and accuracy of the transactions. They also may confirm cash balances, material accounts receivable and payable balances, and the existence of other assets, such as our docks, ferry, and water systems. They analyze and comment on internal controls, which we know to be problematic for all small businesses, including HIC.

Audits of financial records would not include an opinion of the efficiency and effectiveness of operations, although the auditor does need to understand the business to assess the risks of material misstatement and to design audit procedures specific to the engagement. Also, audits are not designed to uncover intentional misstatements and/or misappropriations of assets, although any auditor finding evidence of material misstatements, whether intentional or unintentional, or misappropriations would disclose that information. Audits may compare actual income and expenses to budgeted amounts for the period as part of the auditor's analytical review.

Washington state law requires that our homeowner's association obtain an audit of the financial records each year, unless the community votes to waive that requirement. Therefore, the community must vote again on this issue in December 2013. If the requirement to obtain an audit is not waived, the FC recommends a mid-year assessment to cover the actual cost of the audit, which we believe would be approximately \$20,000 to \$30,000. This cost equates to \$20 to \$30 annually per lot.

Question #6: How do I get my questions to the Finance Committee for future editions of the FAQs?

Please continue to send inquiries to HICFAQs@gmail.com, including how to contact you if we need more info to address your question. There is a link to the FAQs email address and past editions of the FAQs on the HIC home page under the Document Library. We will always acknowledge receipt of your questions. If you sent in a question and did not receive a response, please send it to us again.

Via future FAQs, we will continue to update the status of the marina loan and expenses, accounts receivable project, and other FC activities at least quarterly. Also, our fearless leader, Cynthia Petrie, is continuing to provide updates regarding FC activities at each Board meeting.