



HIGHLANDS RANCH

COMMUNITY ASSOCIATION

HRCA Fund Management & Reserve Study Policy

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Table of Contents

SECTION 1 - OBJECTIVES AND GUIDING PRINCIPLES	3
1.1 Objectives	3
1.2 Guiding Principles.....	3
SECTION 2 - FUNDS	4
2.1 Operating Funds.....	4
2.1.1 Administrative Functions Operating Fund	5
2.1.2 Recreation Functions Operating Fund	6
2.1.3 Backcountry Operating Fund.....	6
2.2 Reserve Funds.....	6
2.2.1 Reserve Study Policy.....	6
2.2.2 Administrative Functions Reserve Fund	7
2.2.3 Recreation Functions Reserve Fund	7
2.2.4 Backcountry Reserve Fund	7
2.3 Capital Funds	8
2.3.1 Recreation Capital Improvement Fund	8
2.3.2 Backcountry Capital Improvement Fund (a.k.a., OSCA Fund)	8
2.4 Bond Funds.....	8
2.4.1 Debt Service Fund	8
SECTION 3 - ADMINISTRATION	9
3.1 Fund Contributions	9
3.2 Minimum and Maximum Fund Balances.....	9
3.3 Internal Borrowing	9
3.4 Fund Expenditures	9
3.5 Responsibilities	10
3.6 Guide and Transition	10
3.7 Definitions	10
3.8 Supplement.....	11
3.9 Deviations	11
3.10 Amendment.....	11
SECTION 4 - GLOSSARY	12
APPENDIX "A" – NONPROFIT OPERATING RESERVES INITIATIVE 2011 (NORI)	13
APPENDIX "B" – RESERVE/UNDESIGNATED FUND BALANCES SUMMARY	14

SECTION 1 - OBJECTIVES AND GUIDING PRINCIPLES

1.1 Objectives

The Highlands Ranch Community Association, Inc. (“HRCA”, “Community Association”, “Association”) objectives, in terms of its various funds (operating, reserve, and other), and their corresponding fund balances (undesignated and designated) are set out in this Fund Management & Reserve Study Policy (“Policy”). HRCA will measure progress of all funds as outlined in this Policy on a yearly basis during the budget cycle to ensure financial stability and will continually measure progress toward achieving those objectives.

1.2 Guiding Principles

The following principles form the basis for this Policy:

- Healthy reserves and undesignated fund balance levels are important in achieving community goals including financial health and stability;
- Actual reserves and undesignated fund balances should be benchmarked with best business practices, other similar community organizations, HOA’s, or municipal jurisdictions and with pre-determined targets on an ongoing basis to gauge whether financial health is being achieved;
- Reserves and undesignated fund balance goals need to be consistent with and supportive of realistic longer-term financial plans;
- Reserves and undesignated fund balance appropriations need to conform to the statutory/legal requirements of the Colorado Common Interest Ownership Act (“CCIOA”), the Community Declaration for Highlands Ranch Community Association, Inc. (“Community Declaration”), the Bylaws of the Association, and Generally Accepted Accounting Principles (“GAAP”) recommendations.

SECTION 2 - FUNDS

The Community Association is authorized to collect three types of assessments at an amount set annually by the HRCA Board of Directors ("Board"):

- Administrative Functions Common Assessments (AFCAs)
- Recreation Functions Common Assessments (RFCAs)
- Public Functions Common Assessments (PFCAs)

Section 8.1 of the Community Declaration, "Maintenance Funds to be established," requires the Community Association to establish the following funds:

- Administrative Functions Operating Fund
- Administrative Functions Reserve Fund
- Recreation Functions Operating Fund
- Recreation Functions Reserve Fund
- Public Functions Operating Fund, if Public Functions are ever established
- Public Functions Reserve Fund, if Public Functions are ever established

To date, no Public Functions are offered by the Community Association, so the Public Functions funds have not been established. Each type of assessment collected must be deposited into funds established for that type of assessment. Assessments deposited into an established fund may not be commingled with any other type of fund (i.e., AFCAs must be deposited into Administrative Functions funds and RFCAs must be deposited into Recreation Functions funds).

Section 8.2 of the Community Declaration, "Establishment of Other Funds," provides that the "Association may establish other funds as and when needed" and "If the Community Association establishes any additional funds, the Board shall designate an appropriate title for the fund to distinguish it from other funds maintained by the Community Association."

The following funds have been established for the purpose(s) so identified:

2.1 Required Funds: Operating Funds

All operating funds, regardless of the Function they support, reflect the general activities of their respective Functions. The net surplus/deficit of these activities results in fund balances that are not restricted as to use and therefore available for spending for operating purposes (i.e., "Undesignated Fund Balance").

General Purpose: Current and Accumulated Undesignated Fund Balances – For transparency, current period operating surpluses/deficits are disclosed separately from the accumulated undesignated fund balance in HRCA's internal financial statements although these funds serve the same purpose. HRCA needs to maintain Accumulated Undesignated Fund Balances to provide working capital and to fund operating expenditures before assessments, program revenues, and other administrative/facility revenues are collected. Maintaining minimum working capital levels (see Appendix A) eliminates or reduces the need to borrow externally and/or internally for operations.

Primary Purposes:

For Unexpected/Unbudgeted Expenses –Unforeseen and unbudgeted expenditures may arise (e.g., contractual issues, opportunistic purchases) that require immediate funding.

To Offset Unrealized Revenues - Some of the HRCA’s revenue sources are subject to downturns in the economy.

Other Purposes:

For Major Emergent Operating Issues / Insurance Reserve - HRCA may be exposed to major non-recurring costs related to various emergency events or situations, e.g. inclement weather, environmental hazards, etc. This undesignated fund balance provision has been established to offset the cost of insurance claims, coinsurance limits for business income and deductibles, the magnitude and timing of which is often indeterminable. HRCA’s insurance exposure is in part due to the fact that the HRCA is subject to a 50% coinsurance provision for business income. These emergent situations cannot be anticipated and budgeted for and it is not feasible to absorb the cost of such events in other budget areas in any given year. HRCA may also be subject to cash flow shortages from time to time dependent on cash requirements.

To Offset Unrealized Revenues - Some of the HRCA’s revenue sources are subject to downturns in the economy. HRCA tries to anticipate economic downturns by budgeting for a base dollar amount of these revenues in its general operations. Despite its best efforts, HRCA is exposed to the possibility of unrealized revenues and/or to declines in base revenues from year to year which could result in a net deficit for that year. HRCA cannot always count on budgetary savings or other revenues to offset these shortfalls.

HRCA may also require emergency funds from time to time, from any one of its Undesignated Fund Balances, for unforeseen costs or net deficit. When this occurs the Association needs to rely upon sufficient funds being available in the applicable Undesignated Fund Balances. For this purpose the Finance Committee has recommended that the Association maintain between one and three months of average operating expenses (excluding programming operating expenses and depreciation, in-kind, and other non-cash expenses) as an Undesignated Fund Balance in the Administrative and each Recreation Operating Fund. The minimum and maximum recommended amounts will be calculated annually during the budgeting process using the prior 3 years of actual expenses.

2.1.1 Administrative Functions Operating Fund

Funding Sources – include Administrative Functions Common Assessments, Sub-Association Management revenue, Community Improvement Services revenue, and other general administrative operating fund revenues as budgeted.

Designated funds within the Administrative Functions Operating Fund include the “Special Projects” sub-fund. The Special Projects sub-fund contains non-assessment revenue generated from various promotional agreements with Association vendors. Expenditures from this sub-fund are at the discretion of the Board.

2.1.2 Recreation Functions Operating Fund

Funding Sources – include Recreation Functions Common Assessments, Recreation Program revenue, grants and other general recreation operating fund revenues as budgeted.

2.1.3 Backcountry Operating Fund

Funding Sources – include annual budgeted allocations transferred from the Recreation Functions Operating Fund, Backcountry Program revenue, land lease revenue, grants and other general backcountry operating fund revenues as budgeted.

2.2 Required Funds: Reserve Funds

General Purpose: It shall be the Board's responsibility to create and maintain adequate reserves to provide for the orderly and timely repair and replacement of the common area components so as to minimize the risk to the membership of special assessments, deferred maintenance, or unfunded losses. As such, reserve funds represent the Board designated funds set aside to cover such timely repair and replacement needs of the community. The timing and amount of reserve funding is based on an externally prepared reserve study.

Pursuant to Section 8.19 "Funding of Reserve Funds" of the Community Declaration, the Board shall endeavor, whenever possible, to fund the Administrative Functions Reserve Fund, each Recreation Function Reserve Fund and the Public Functions Reserve Fund, if any, by regularly scheduled payments, included as part of the Common Assessments, rather than by large Special Assessments. In this way, the Association will establish a reserve fund for a specified purpose and direct that money to be placed to the credit of the reserve fund.

The reserve study is to establish a schedule of anticipated repair and replacement projects and recommend a reserve contribution rate, as stated in the Reserve Study Policy (see section 2.2.1)

Primary Purpose: To fund major repair and replacement of capital assets in accordance with the Reserve Study. Examples of such capital items for each Function are identified below.

2.2.1 Reserve Study Policy

Pursuant to Section 38-33.3-209.5 of the CCIOA, HRCA is required to adopt policies, procedures and rules and regulations concerning the preparation of reserve studies. This Reserve Study Policy, together with the terms of the Community Declaration and the Bylaws of the Association, is intended to comply with such requirement.

2.2.1.1 Reserve Study. The Board shall conduct a reserve study at such times as in its sole discretion it determines is necessary but at least every five years to determine the necessity and amount of reserves required to maintain, repair, replace and restore the Community Association Properties. The Board shall cause the reserve study to be conducted by a third party reserve study professional, who has a good reputation, sound credentials and appropriate levels of insurance, for the services that are provided to the Association. The reserve study shall be based on a physical analysis and financial analysis. The Board shall, in its discretion, have the authority to and shall make any adjustments deemed necessary to maintain reserves.

2.2.1.2 Reserve Item Threshold. Only repair and replacement items over \$3,000 shall be considered as part of the Reserve Study analysis and funded from the Reserve Funds. Items that are purchased in bulk that cost less than \$3,000 apiece may be considered in the reserve study if the combined total is greater than \$3,000.

2.2.1.3 Funding Plan and Sources. Reserve Funds will be maintained in accordance with the schedule of anticipated repair and replacement projects in the reserve study. The Reserve Fund shall be funded primarily from Common Assessments and the generation of investment income from the Reserve Fund, in accordance with such funding plans, as are established by the Board. The Finance Committee will review and recommend to the Board an annual contribution to maintain the recommended fund balance each year during the budgeting process.

2.2.1.4 Reserve Expenditures. Reserve funds may be used for:

- a. Projects or purchases pre-approved in the annual budget;
- b. Projects or purchases anticipated in the Reserve Study but not in the annual budget as set forth in Section 3.4 of this Policy "Fund Expenditures".

2.2.1.5 Fund Designation. Reserve funds for the Community Association Properties shall be maintained in a Reserve Fund and shall be used for major capital repairs, replacements, maintenance, care, restoration and improvements.

2.2.1.6 Reserve Fund Investments. The Reserve Fund assets will be invested in accordance with the Association's Statement of Investment Policy.

2.2.2 Administrative Functions Reserve Fund

Funding Sources – Annual budgeted allocations transferred from the Administrative Functions Operating Fund.

Primary Capital Asset Items - computers, software, furniture and equipment related to the Administrative Function.

2.2.3 Recreation Functions Reserve Fund

Funding Sources – Annual budgeted allocations transferred from the Recreation Functions Operating Fund.

Primary Capital Asset Items - facility equipment, building and property improvements, and furnishings related to the Recreation Facilities.

2.2.4 Backcountry Reserve Fund

Funding Sources – Annual budgeted allocations transferred from the Backcountry Operating Fund.

Primary Capital Asset Items - trails, vehicles, fences and office equipment related to the Backcountry.

2.3 Other Funds: Capital Improvement Funds

General Purpose: Capital improvement funds are internally designated funds set aside to fund general capital projects not specifically funded from other established Reserves or Undesignated Fund Balances. These improvements are typically not part of the Reserve Study.

Primary Purpose: Capital projects that will be funded from this reserve are budgeted within the HRCA's long-term Five-Year Capital Plan. Capital Funds may be utilized to fund or partially fund large projects that have been planned and designated as major organization project priorities by the Board.

2.3.1 Recreation Capital Improvement Fund

Funding Sources – Annual budgeted allocations transferred from Recreation Functions Operating Fund.

2.3.2 Backcountry Capital Improvement Fund (a.k.a., OSCA Fund)

Funding Sources – Transactions of the Association related to the Open Space Conservation Agreement (OSCA) with Shea Homes.

2.4 Other Funds: Bond Funds

General Purpose: Bond funds are established in accordance with existing bond covenants and are therefore restricted to the exclusive use of retiring outstanding bond obligations.

2.4.1 Debt Service Fund

Funding Sources – Monthly budgeted allocations transferred from Recreation Functions Operating Fund.

The Debt Service Fund has been established for the following purposes:

To accumulate funds that are utilized to retire the three bond obligations established in 1995, 1999, and 2005 which funded the original construction of Recreation Centers. HRCA must comply with the specific bond covenants, including a requirement to deposit one-twelfth of the annual principal and interest due for the fiscal year to the Bond Fund each month.

SECTION 3 - ADMINISTRATION

3.1 Fund Contributions

All contributions to Reserve and Capital Funds shall be predetermined and specific to each function, as approved by the Board through the annual financial planning/budgeting process and as recommended by external Reserve Studies.

3.2 Minimum and Maximum Fund Balances

The purpose, source(s) of funding and minimum and maximum fund balance guidelines are shown for HRCA's Funds in the attached Appendix "B". The minimum balances ensure that the respective balances are not depleted to the degree that those balances are no longer able to serve their intended purpose(s). The maximum balances ensure that the Association's guiding principles are achieved and that the respective balances do not grow beyond their intended purpose(s) and thus create idle assets that could be otherwise utilized for other organization priorities. A formal comparative review of actual, minimum and maximum fund balances shall be undertaken annually during the budgeting process. The Finance Committee will recommend actions to the Board of Directors for any fund with actual or reasonably projected year end balances below the minimum or above the maximum.

3.3 Internal Borrowing

Internal borrowing from specific Reserve Funds and Accumulated Undesignated Fund Balances shall be permissible, if a clearly defined and attainable repayment plan, including payment of reasonable interest (based on the Association's ability to invest in short-term investments per the Statement of Investment Policy), is in place. Internal borrowing is more cost effective than external borrowing and allows for more flexibility in establishing fiscally prudent repayment terms.

3.4 Fund Expenditures

The Board has the authority to make or to authorize disbursements from any Operating Fund, Capital Improvement Fund or Reserve Fund per Section 8.7 of the Community Declaration. The Board will use the following procedures for the authorization of these expenditures.

- All expenditures are reviewed and approved as a part of the annual budget process.
- Budgeted capital improvement and reserve expenditures will not require a Delegate presentation unless the expenditure variance is more than 10% or greater than \$20,000 over the original budgeted amount.
- Non-Budgeted capital improvement or reserve expenditures over \$10,000 will require a business case to be reviewed by the Finance Committee, a presentation to Delegates, and approval by the Board.
- Quarterly, as a part of the Facilities Update at Delegate meetings, staff will provide a presentation to the Delegates of all budgeted capital expenditures over \$10,000 that were

made in the previous quarter as well as a forecast of projected projects for the upcoming quarter.

3.5 Responsibilities

HRCA's Finance Director shall be responsible for:

- Recommending the necessary contributions and transfers so that HRCA's Fund Balances are maintained in accordance with this Policy;
- Conducting an annual review of all Fund Balances including comparing actual levels with the established minimum and maximum levels within this Policy and with other jurisdiction benchmarks, and reporting the results of such a review to the Finance Committee and Board;
- Recommending changes to the minimum and maximum balance guidelines shown in this Policy; and,
- Recommending any revisions or amendments to this Policy, as may be required from time to time, as a result of changes in applicable statutes, accounting standards, economic conditions, etc.

HRCA's Finance Committee shall be responsible for:

- Measuring the progress of objectives and making appropriate recommendations to the Board.

HRCA's Board of Directors shall be responsible for:

- Providing direction for changes to this Policy;
- Reviewing and approving/disapproving recommendations from the Finance Director and the Finance Committee; and
- Adopting any future revisions or amendments to this Policy.

3.6 Guide and Transition

The minimum and maximum fund balance guidelines shown in this Policy serve as a guide in moving HRCA toward the goals or targets it wishes to attain, in terms of individual fund balances. It is recognized that HRCA's fund balances may not be between the minimum or maximum levels at the time of enacting this Policy, however, HRCA is transitioning toward meeting the recommended targets.

3.7 Definitions

Unless otherwise defined in this Policy, capitalized terms or terms defined in the Community Declaration shall have the same meaning herein as set forth in the Community Declaration.

3.8 Supplement

The provisions of this Policy shall be in addition to and shall supplement the terms and provisions of the Community Declaration, the Bylaws, and the laws of the State of Colorado governing the Association.

3.9 Deviations

The Board may deviate from the procedures set forth in this Policy if, in its sole discretion, such deviation is necessary under the circumstances.

3.10 Amendment

The Board may amend this Policy from time to time.

SECTION 4 - GLOSSARY

The following terms are used in this Policy and are defined as follows:

- 1) **“Current YTD Undesignated Fund Balance”** - means the excess of revenues over expenditures for the current budget year which has not been set aside for specific purposes. It could also be referred to as current year deficit or surplus.
- 2) **"Accumulated Undesignated Fund Balance"** - means the accumulated excess of revenues over expenditures from prior years which has not been set aside for specific purposes.
- 3) **“Reserve Funds”** - means funds that are set aside for a specified purpose by the Board pursuant to the Community Declaration. These reserves are established via an independent Reserve Study that is to be conducted in accordance with the “Reserve Study Policy.”
- 4) **“Reserves”** - means all of the HRCA’s Reserve Funds.
- 5) **“Reserve Study”** - There are two components of a reserve study:
 - A ***physical*** analysis performed by a reserve provider who evaluates information regarding the physical status and repair / replacement cost of the Association’s major common area components.
 - A ***financial*** analysis only assesses HRCA’s reserve balance (measured in cash or as a percent funded) to determine a recommendation for an appropriate reserve contribution rate (funding plan). The Finance Committee recommends to the Board an appropriate reserve balance and reserve contribution.
- 6) **“Working Capital”** - means operating reserves as calculated in accordance with the methodology outlined in Appendix A.

APPENDIX “A” – NONPROFIT OPERATING RESERVES INITIATIVE 2011 (NORI)

The undesignated fund balance minimum and maximum amounts for operating funds were established using an assessment process recommended by NORI.

Operating Reserve Calculations

The NORI Workgroup recommends operating reserves of 25% or about 3 months of the annual operating expense budget adjusted for risk factors depending on the organization’s needs. There is no single correct solution or benchmark – one size simply does not fit all when it comes to setting the amount for Operating Reserves. HRCA auditors have recommended higher operating reserves of 6 to 9 months.

The formula can be calculated in terms of:

- A **percentage** (Operating reserves divided by annual operating expense):

$$\text{Ex. } \$75,000 \text{ (available)} \div \$600,000 \text{ (annual expense)} = 0.13 \text{ or } 13\%$$

- Or **number of months** (Operating reserves divided by 1/12th of the annual operating expense):

$$\begin{aligned} \text{Ex. } \$600,000 \text{ (annual expense)} \div 12 &= \$50,000 \text{ per month} \\ \$75,000 \text{ (available)} \div \$50,000 \text{ (1/12th annual expense)} &= 1.5 \text{ or } 1 \frac{1}{2} \text{ months} \end{aligned}$$

** The prior year actual expenses are generally used to calculate amounts.*

Risk Factors Impacting Operating Reserve Requirements

1. Revenue volatility factors (such as economic health of the community, issues that could adversely affect current or future revenues and likelihood of severe weather or natural disasters that would affect the organization).
2. Spending flexibility factors (such as the organization’s importance in the community for crisis situations, the extent to which economic downturns or other types of events may affect demand for services (either up or down), balance of permanent full time staff vs. temporary part-time, the extent of funding commitments made for longer than one year and the amount of unsecured debt carried by the organization).
3. Governance & management factors (such as planning and budgeting processes).

The Finance Committee determined HRCA’s revenue volatility risk is minimal, our spending flexibility risk is low to medium and our governance and management risk is also very low. For these reasons a 1 to 3 month range of operating reserves was determined to be sufficient.

APPENDIX “B” –MAXIMUM AND MINIMUM FUND BALANCES SUMMARY

Fund(s)	Purpose	Funding Source(s)	Minimum Amount (2017)	Maximum Amount (2017)	12/31/17 Balance	Rationale for Levels Established
Administrative Functions Operating Fund Undesignated Fund Balance	For working capital purposes within the Administrative Functions and for unforeseen general operating emergency expenditures.	Any excess Administrative Functions revenues (including assessments) over expenditures and transfers at the end of each fiscal year.	\$249,000	\$747,000	\$786,088 ⁽¹⁾ ⁽¹⁾ Includes residual impact of one-time foreclosure, tax lien and other proceeds.	Minimum: One month of adjusted operating fund expenditures. Maximum: Three months of general operating fund expenditures.
Special Projects Sub-Fund	For special projects designated by the Board.	Non-assessment revenue generated from various agreements with vendors of the Association (e.g., Qwest, Pro Disposal).	N/A	N/A	\$276,282 ⁽²⁾ ⁽²⁾ Includes proceeds from sale of the sub-association business.	As directed by the Board.

Fund(s)	Purpose	Funding Source(s)	Minimum Amount (2017)	Maximum Amount (2017)	12/31/17 Balance	Rationale for Levels Established
Administrative Functions Reserve Fund	To fund major repairs and replacement of Administrative Fund fixed assets (e.g., computers, furniture and office equipment.)	Annual budgeted allocations from general operating fund (including assessments).	\$92,000	\$184,000	\$178,023	<p>Minimum: One year of average administrative reserve expenditures.</p> <p>Maximum: Two years of average administrative reserve expenditures.</p> <p>Average expenditures calculated based on a forward rolling 5 year average.</p>

Fund(s)	Purpose	Funding Source(s)	Minimum Amount (2017)	Maximum Amount (2017)	12/31/17 Balance	Rationale for Levels Established
Recreation Functions Operating Fund Undesignated Fund Balance	For working capital purposes within the Recreation general operating fund and for unforeseen general operating emergency expenditures.	Any excess Recreation general operating fund revenues (including assessments) over expenditures and transfers at the end of each fiscal year.	\$1,217,000	\$3,651,000	\$1,526,925	<p>Minimum: One month of adjusted operating fund expenditures.</p> <p>Maximum: Three months of general operating fund expenditures.</p>

Fund(s)	Purpose	Funding Source(s)	Minimum Amount (2017)	Maximum Amount (2017)	12/31/17 Balance	Rationale for Levels Established
Recreation Functions Reserve Fund	To fund major repairs and replacement of Recreation Fund fixed assets (e.g., rec facility repairs, equipment repairs and replacement).	Annual budgeted allocations from general operating fund (including assessments).	\$2,470,000	\$4,940,000	<p>\$2,304,928</p> <p>+ \$937,500 on loan from OSCA Fund</p> <p>= \$3,242,428</p>	<p>Minimum: One year of average recreation reserve expenditures.</p> <p>Maximum: Two years of average recreation reserve expenditures.</p> <p>Average expenditures calculated based on a forward rolling 5 year average.</p>

Fund(s)	Purpose	Funding Source(s)	Minimum Amount (2017)	Maximum Amount (2017)	12/31/17 Balance	Rationale for Levels Established
Recreation Capital Improvement Fund	To fund future Recreation facility capital projects or improvements deemed necessary by the Board. This list of Capital Improvements is not specifically funded from other established Reserves.	Annual budget allocation from Recreation Operating Fund (includes assessments).	N/A	N/A	\$59,746	\$625,000 budgeted for both 2017 and 2018 budget years, but future contributions to be identified by Board five year plan. Additionally, this fund was utilized in full during 2017 to offset the cost of the Northridge Renovation, and will be utilized in full again during 2018 to offset the cost of the Northridge Tennis Pavilion.

Fund(s)	Purpose	Funding Source(s)	Minimum Amount (2017)	Maximum Amount (2017)	12/31/17 Balance	Rationale for Levels Established
Backcountry Operating Fund Undesignated Fund Balance	For working capital purposes within the Backcountry general operating fund and for unforeseen general operating emergency expenditures.	Any excess Backcountry general operating fund revenues over expenditures and transfers at the end of each fiscal year.	\$64,000	\$192,000	\$232,751 - \$225,132 for Non-liquid Assets = \$7,619	Minimum: One month of general operating fund expenditures. Maximum: Three months of general operating fund expenditures.
Backcountry Reserve Fund	To fund major repairs and replacement of Backcountry fixed assets (e.g., trail, vehicle, and fence maintenance, and office equipment).	Annual budgeted allocations from general operating fund (transfer from Backcountry operating budget).	TBD	TBD	\$402,455 - \$243,209 for Non-liquid Assets = \$159,246	As directed by the independent Reserve Study. Additional criteria will be assigned in future years, as the Backcountry Reserve Fund, concurrent with forward looking planning for the Backcountry Wilderness Area.

Fund(s)	Purpose	Funding Source(s)	Minimum Amount (2017)	Maximum Amount (2017)	12/31/17 Balance	Rationale for Levels Established
Backcountry Capital Improvement Fund (a.k.a., OSCA Fund)	To fund major improvements to the Backcountry (e.g., new trails, vehicles, fences, and amenities).	Transactions of the Association related to the agreement with Shea Homes, the declarant.	N/A	N/A	\$5,526,634 - \$937,500 on loan to Recreation Reserve Fund = \$4,589,134	As directed by agreements with Shea Homes.
Debt Service Fund	To accumulate funds for the repayment of bonds used to finance construction of recreation centers.	Semi-annual payments as directed by the three bond series obligations (includes assessments).	N/A	N/A	\$4,503,426	As directed by the Bond Covenant requirements. The remaining two bonds will be retired in 2020 and 2024 respectively.