

December 2016

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Birch Pointe Current Financial Position Paper and Future Outlook

I. Introduction

Fellow Owners and Residents,

We put down our thoughts today as a representation of both the Birch Pointe Board's overall position as well as a reflection of individual board member experiences over the past few years.

Our view on Birch Pointe has naturally evolved over the years and this has been a very positive, if sometimes challenging experience.

We have always viewed Birch Pointe as part business and part government as we operate in various capacities. We try to operate as a business when it comes to negotiating pricing with vendors and creating contracts, maximizing the benefits to the community while minimizing the costs. On the other side, Birch Pointe's only major source of revenue is your monthly condominium dues. While we have some ancillary income from interest, re-certification income, investor fees and credit payment reward discounts, the vast majority, more than 95% of Birch Pointe's costs are covered by the monthly condo fee.

Birch Pointe provides a great number of services to members of the community including Common Area Electricity and Lighting, Expanded Basic Cable TV, Water and Sewer, Trash Removal, Ongoing Maintenance of Common Areas, Insurance, Pest Control, etc., while simultaneously ensuring that capital improvements are addressed on an ongoing basis, both reactively and proactively.

In effect, an individual unit owner in Birch Pointe enjoys much of the same amenities and services, if not more in some cases, as are often found in luxury rental communities. These amenities and services are facilitated and administered through the work of a small set of volunteers that want to ensure that Birch Pointe is a great place to live for all of us.

II. Capital Improvement achievements since mid 2000

We realize that many of you who are reading this may be new to community, or may be looking to buy a property in Birch Pointe. Considering this, we would like to provide you with a retrospective on the capital improvements that have happened over the past 10-15 years.

The following capital improvements have happened and are completed:

- Original interior pipe replacements (2004)
- Siding on building exteriors throughout the community (2007)
- Building Bridges throughout the community (2002-2007)
- Roofs throughout the community (~2008-2011)
- Common area carpet replacement (2008-2010)
- Roadways throughout the community (partially funded by the State / County funds) (2010-2015)
- Complete common area hallways painting throughout the community (2012)
- Gutters and downspout replacements (2013-2014)
- Chimney chase covers (2014-2015)
- Exterior building cleaning (2013 & 2016)

The following capital improvements are ongoing:

- Intercom replacement throughout the community (started 2015)
- Balcony replacement throughout the community (started ~2008)
- Various concrete work on walkways and curbs (ongoing)
- Window replacement in common areas to allow for airflow / improved air quality (ongoing)

With that in mind, we also know that items like Siding and Roofs, Roadways, Bridges, etc. all have a limited useful life. In order to get a better idea exactly when we should anticipate their replacement again and not have it be a surprise or emergency, the Board has committed to having a Capital Reserve study done by the Falcon Group, an Engineering firm specializing in Condominium projects. Looking at it objectively, we do anticipate major expenses to start hitting the community around 2025 through 2030.

While those may appear as far out dates to some if not all of you, it would be irresponsible to not be aware of them and at least work to plan for them accordingly, something that did not always happen in the past.

An item to note is that historically, Birch Pointe's condo fees had been comparatively low until the first wave of capital improvement spends became necessary. At that point, the then-sitting Board went the route of special emergency assessments (\$3000/unit in 2001, \$5600/unit in 2004) and eventually debt financing to fund those projects (\$2.04M loan over two stages until 2007, which would have equated to almost \$7000/unit in special assessments).

We definitely want to plan with clarity as we move into 2018 and beyond on how to best begin funding those foreseeable, recurring, capital expenses.

III. Operational cost achievements since 2011

Since early 2011, the Board has taken several steps to reduce total operational expenditures and negotiate aggressively with vendors wherever possible. At the same time, the overall expectations in the community have gone up with respect to curb appeal and aesthetic appearance of the community, which the Board has tried to address in meaningful and considerate ways.

Some highlights of accomplishments since 2011.

1. Birch Pointe had taken out a loan in the amount of \$2.04 Million around 2007 to fund several capital projects in lieu of a large special assessment at the time. This loan was taken out at a 7.75% annual interest rate over 15.5 years and had a monthly payment of approximately \$18,870. This loan was subsequently refinanced in May of 2012 to \$1.55M (the remaining balance) at a 4.54% annual interest rate over 8 years with a \$19,335 monthly payment. This refinancing cut off about 1.5 years of payments and saved approximately \$300,000 in total interest to the community while keeping the monthly payment almost the same.
2. Birch Pointe renegotiated its waste removal contract with Waste Management several times since 2011, introducing recycling containers and cutting the size of some containers to more closely match actual loads. This resulted in lowering monthly costs at that time. The Board also evaluated other waste removal contractors but decided that none provided enough of an incentive to switch at that time. This evaluation will continue once the current contractual commitment is over.
3. Birch Pointe installed energy efficient lighting throughout the common areas to deflect increases to our monthly electricity spend.
4. Birch Pointe worked with Comcast on a one-time monthly fee reset with a capped annual 3% increase thereafter. It should be noted that Comcast is the only provider for Cable TV services in the area; Verizon has stopped all existing community FIOS build-outs indefinitely.
5. Birch Pointe had launched several attempts at collecting long past due accounts while working closely with owners that recently fell delinquent and intervene early wherever possible.
6. Birch Pointe started using a cash-back credit card for all expenses that could be charged to such a card without an additional fee (e.g. Comcast bill, Waste Management bill, etc.). This move has resulted in approximately a \$220/month (~\$2700/year) cash-back discount.

The above is by no means an exhaustive list of operational improvements, but merely a few of the highlights of recent Board accomplishments.

At the same time, Birch Pointe has worked diligently to improve services throughout the community, most visibly those of aesthetic nature, while dealing with several structural concerns caused by floods and other unforeseeable events. As Birch Pointe has attracted new owners, we have seen an increase in requests for landscaping cleanup and beautification as well as overall visual appearance improvements.

Not all of those requests could be fulfilled, and while more work is left to be done, the Board is generally pleased with the progress the community has made with respect to appearance, which drive near term property value increases.

IV. Operational cost future outlook

While the aforementioned accomplishments are all very positive and have actively contributed to keeping the condo fee stable since 2008 at \$330/month, we have effectively optimized everything that could be optimized without cutting or reducing services.

To illustrate this, please review the following two figures:

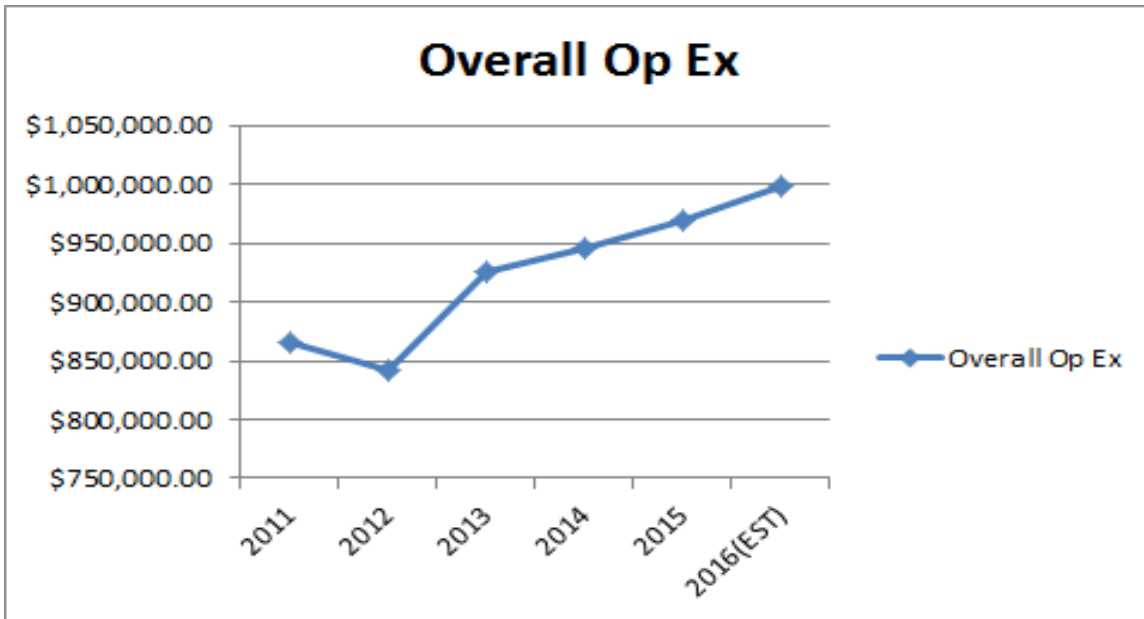


Figure 1

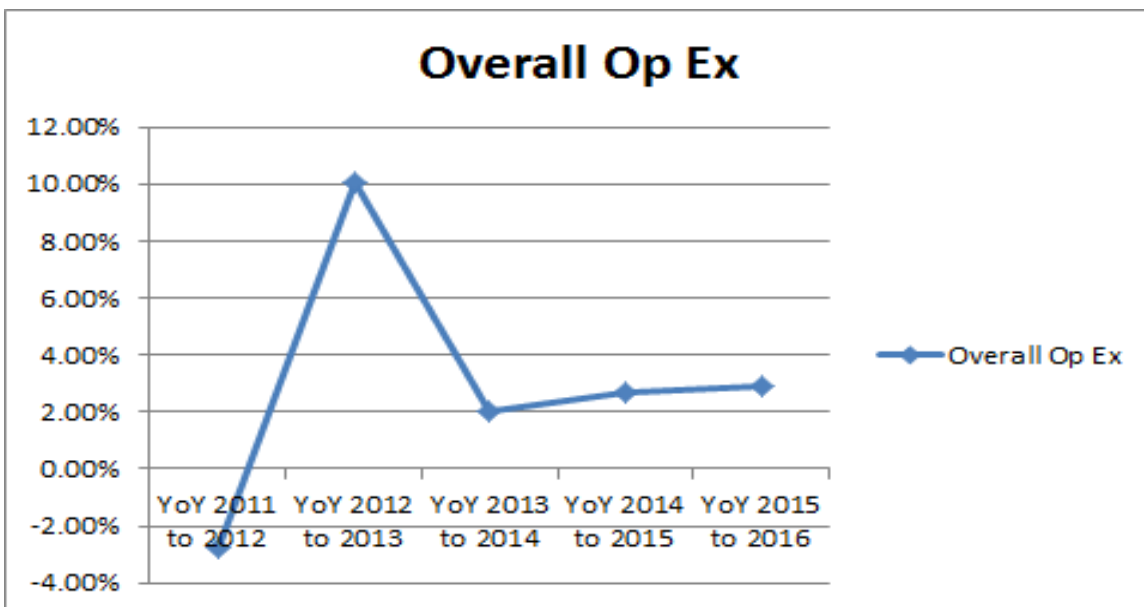


Figure 2

Figure 1 represents our absolute annual operational expenses as we incur them. Figure 2 represents the year over year increase or decrease percentages to that number.

These numbers include everything other than capital improvements (e.g., roofs, balconies, durable concrete work, etc.).

The drop in 2012 is explained by the previously mentioned one-time resets and renegotiation efforts, as well as a very favorable winter that year with minimal snow removal costs.

While some expenses fluctuate from year to year, most notably snow removal and landscaping, the majority is very stable and increasing steadily.

Below are the aggregate annual operating spends by major category

	2011	2012	2013	2014	2015	2016(est.)
Maintenance Labor	\$121,463.78	\$123,211.81	\$125,441.67	\$123,961.07	\$146,706.57	\$163,933.55
Comcast	\$107,226.15	\$102,917.41	\$116,704.13	\$121,020.52	\$124,647.55	\$127,885.19
Water & Sewer	\$101,990.37	\$103,218.04	\$101,454.69	\$103,271.82	\$114,973.68	\$109,784.67
Insurance	\$105,626.00	\$105,491.00	\$114,381.00	\$110,851.00	\$110,041.00	\$111,000.00
Electricity	\$24,520.00	\$24,979.47	\$24,275.92	\$26,132.97	\$25,833.58	\$26,586.71
Waste Removal	\$23,868.27	\$23,976.80	\$21,277.41	\$22,500.51	\$23,316.18	\$25,000.00
Accounting & Audit	\$16,300.75	\$17,014.00	\$16,936.50	\$16,653.00	\$16,585.00	\$16,982.00
Cleaning	\$16,491.00	\$19,805.00	\$15,800.00	\$15,750.00	\$20,150.00	\$15,600.00
Landscaping	\$24,701.25	\$33,880.00	\$47,718.75	\$49,068.75	\$36,146.25	\$65,000.00
Snow removal	\$36,482.90	\$5,290.00	\$36,988.00	\$65,884.50	\$65,850.00	\$40,000.00

Table 1.

What we can derive from this is that at the current conservative pace of 2% cost increases per year that we will mostly consume our current approximate annual receivables of about \$1.1 Million by 2020.

While Birch Pointe's 100% collections of \$330 per month for every unit would equate to \$1.164M per year, it has been historically difficult to get to 100% on-time collections (See Table 2 for details on actual projections). Great strides have been made to increase our collections percentages, in large part due to the tireless efforts of the Board volunteers and by using all legal options available with respect to uncooperative accounts and this will continue. Furthermore, the Board has also found that prevention of delinquencies in the first place is best achieved by signing up owners for ACH. The probability of an owner falling behind in their dues once on ACH is very low and significantly lower than when owners are paying by other means.

It should also be pointed out that our current loan payment obligations of about \$232,000 per year will be satisfied in June 2020, just in time for our projected end of an operating surplus.

While this may appear as a reason to breathe relief, must be pointed out that we have been using the majority of the available operating surplus to perform capital improvements, most notably on the rapidly deteriorating balconies on the 2nd and 3rd floor throughout the community.

As of the end of 2016, we have replaced 82 2nd and 3rd floor balconies in the “open style” modern format and another 60 2nd and 3rd floor balconies in the old “closed style”. This leaves 54 2nd and 3rd floor balconies that need to be replaced for safety and structural reasons as soon as possible. Each balcony costs an average of \$14,000 to replace, or about \$756,000 for all of them.

While not immediately necessary, the 60 previously replaced 2nd and 3rd floor balconies in the “closed style” will eventually need to be updated in the same way as they will be prone to the same problems as the original design and will experience similar safety issues over time. These are of lower priority compared to the remaining 54 original 2nd and 3rd floor balconies, but will need to be addressed at some point. Finally, the Board has not reviewed options for the 1st floor balconies as they pose minimal safety concerns, but would certainly benefit the aesthetics of the community if updated to the same style.

The Board expects other capital projects such as the intercom replacements, various concrete work and other smaller capital improvements in the near term to consume at least \$250,000 over the course of the next 5 years, or about \$50,000 per year.

If we extrapolate based on the outlined figures, Table 2 represents what our operating surplus would look like over the next 5 years starting with 2017.

	2017	2018	2019	2020	2021
Annual Operating income (\$330 fee, 95% collection)	\$1,106,000	\$1,106,000	\$1,106,000	\$1,106,000	\$1,106,000
Annual Operating expenses (2% avg annual increase)	\$1,020,000	\$1,040,400	\$1,061,208	\$1,082,432	\$850,432
Annual Operating surplus	\$86,000	\$65,600	\$44,792	\$23,568	\$255,568

Table 2.

Note that the lowered operating expenses in 2021 reflect the satisfied loan obligation and subsequent freeing of funds.

Table 2 represents about a \$475,000 operating surplus over the next 5 years at the projected levels, which is approximately half of the \$1M (\$756,000 for balconies plus \$250,000 for other smaller capital expenditures) projected cost of finishing the remaining 2nd and 3rd floor balconies that have never been replaced and the \$250,000 in projected miscellaneous capital expenditures. We would be projecting an approximate \$525,000 shortfall.

It should also be noted that if we can achieve 100% monthly fee collection starting in 2017, we could collect an additional \$58,000 per year, or about \$290,000 over the 5 years, narrowing the shortfall to \$235,000.

Finally, if we could collect all outstanding back fees owed above and beyond getting every owner to pay the regular monthly fee, we would effectively eliminate the entire shortfall. This, however, is known to not be possible due to bankruptcies, sheriff sales, foreclosures and abandoned units without any contact information.

The Board continues to work on collecting as much as possible from those accounts, wherever legally possible and sensible.

V. 2017 Condo Fee (\$350) and electronic payment discount program

First, let us state that the Board has extensively deliberated the move to \$350/month in base condo fee as well the \$20/month perpetual discount program for all owners that are signed up for ACH, or are current on their payments and sending payment to Birch Pointe electronically without generating a paper check, which effectively keeps an owner's costs constant going into 2017.

ACH facilitates the electronic recurring monthly collection of condo fees by Birch Pointe.

The Board has asked for a legal opinion from Morris James, our primary legal counsel, and has received favorable feedback from them that this program is both legal from a Delaware State Law perspective as well as in compliance with Birch Pointe's existing by-laws.

Furthermore, we have researched other businesses that give preferential pricing to customers based on specific payment methods, and our approach is consistent with what other businesses are doing.

The ACH program has been in existence since late 2012 and has been very successful with over half the community already participating. This program provides several benefits to both Owners and Birch Pointe.

Benefits to Owners:

- No need to write checks or worry about making payments on time
- Know exactly when funds are drawn versus check processing delays
- Guaranteed on-time payment of condo fees
- Ability to stop ACH at any time if necessary

Benefits to Birch Pointe:

- Funding forecasting accuracy (3 monthly draw dates, >99% success when drawing)
- Elimination of check collection, transportation and accounting
- Electronic record of payment, electronic payments cannot be lost or delayed in the mail
- Prevention of account delinquencies
- Timely notification when owners move / units turn over

VI. History of the Condo Fee and Go-Forward Strategy

We would like to close out this position paper by providing a brief history of the more recent monthly condo fee as well as a summary of all points made.

Mid 90's	2004-2005	2005-2006	2006-2008	2008-2016	2017+
\$165	\$248	\$270	\$300	\$330	\$350

Table 3.

The above is a table of the monthly fees per unit that are known based on current records available to the Board.

You may note that the longest stretch of constant fees has been in the past 8 years from 2008 to 2016, a time during which self-management was in effect.

It should also be noted that prior to 2008, fees kept increasing almost annually for several years in a row.

In summary, in the near term, the community was and is faced with the following options:

1. Increase existing monthly payment performance by owners
2. Increase the regular monthly condo fee
3. Decrease services offered / provided through the regular monthly condo fee

The Board is in strong agreement that #1 is a priority and has been stepping up its efforts to collect past due accounts, some of which accumulated in the tens of thousands of dollars in back fees. At the same time, and even somewhat more importantly, we have been working to get every owner to contribute at least the monthly fee going forward. We have also found that prevention of delinquency in the first place has the highest return on investment with respect to time and eventual legal fees spent.

Knowing this, the Board feels strongly that a moderate increase of the condo fee to \$350, with a perpetual discount of \$20/month for those owners signed up for ACH allows the community to continue enjoying good services at the same rates in 2017.

Longer term, we definitely need to consider option #3 and evaluate the changing demographics in Birch Pointe. Cable service, for instance, as an included service has different value to different residents in Birch Pointe today and those looking to buy properties in Birch Pointe. Other options include scaling back landscaping efforts and the level of service we receive for snow removal. The Board attempted to change both in the past year with mixed results-: you may recall the lack of timely grass cutting in 2015 and the poor snow removal service earlier in 2016. The Board has found that vendors who meaningfully undercut costs when bidding will generally not be able to provide the level of service that the community expects, resulting in "clean-up" necessary after those vendors to be even more expensive.

Finally, with the Reserve Analysis under way in early 2017, we hope to get clarity on the necessary capital expenditures through 2030, which depending on the findings may necessitate a gradual increase to the monthly condo fee over time to build up necessary reserves.