

## Four Seasons at Charlottesville Community Association

### Use of the Clubhouse to Generate Additional Income

#### Authority to Generate Income

The Association currently holds the deed to the common area in Phase I of the Property constituting its Common Area. The Declaration of Covenants, Conditions, and Restrictions (DCCR) for the Property gives the Association the right and responsibility to manage the Area of Responsibility as defined in Section 1.3.

The 2011 Covenant Regarding the Property and Amendment to the DCCR (2011 Amended DCCR) restates that the Clubhouse Parcel is common area for the entire Property and that the Association is granted the right to manage it until there is a Master Association that is ready to own and maintain the Clubhouse Parcel and other designated common areas. The Association is to be a member of that Master Association whenever it is incorporated.

The Clubhouse Parcel (and the Clubhouse constructed on the parcel) is currently in the Area of Responsibility for the Association. Therefore, the Association is responsible for maintaining the Clubhouse Parcel per Sections 5.1 (i) and (j) of the DCCR and Section 3 of the 2011 Amended DCCR. In the sense that the Clubhouse Parcel is common area for the Property and the Association is managing it as common area for the entire Property, the rights stated in Section 2.1 of the DCCR are applicable for the Clubhouse Parcel as long as the Association is managing the Clubhouse Parcel. These rights include:

- 2.1(f) *The right of the Board to impose reasonable membership requirements and charge reasonable admission or other use fees for the use of any recreational facility situated upon the Common Area;*
- 2.1(g) *The right of the Board to permit use of any Common Area by non-Residents upon payment of the use fees established by the Board;*
- 2.1(j) *The right of the Association to rent, lease, or make available, with or without charge, for any purpose, any portion of any clubhouse and other recreational facilities within the Common Area to any Person approved by the Board for such uses as may be approved by the Board, including, without limitation, the leases referred to in Section 2.7 hereof;*

Section 2.7 of the DCCR states that "Any and all proceeds from leases, easements, licenses, concessions or other rights received by the Association with respect to the Common Area shall be used to pay the Common Expenses".

Moreover, DCCR Section 5.1 also states:

*The Association may also maintain other property that it does not own, including, without limitation, property dedicated to public use, if the Board determines that such maintenance is necessary or desirable to maintain the Community-Wide Standard and if otherwise permitted by applicable law.*

*Except as hereinafter provided in this Section, the costs of maintenance, repairs and replacement of the Common Area and Areas of Common Responsibility shall be Common Expenses.*

Section 3 of the 2011 Amended DCCR states that "*The manager of the Clubhouse and the Clubhouse Parcel ... shall maintain the Clubhouse and the Clubhouse Parcel in good repair, shall operate the Clubhouse in a commercially reasonable manner, shall collect all dues, assessments and other revenues associated with the Clubhouse and the Clubhouse Parcel, shall pay all Clubhouse Expenses*".

Section 3.c of the 2011 Amended DCCR states that "*the Manager shall have the right to (i) adjust the Clubhouse hours or reduce the services available in order to cut down on the Clubhouse Expenses, and/or (ii) notwithstanding the provisions of Section 3a above, rent the Clubhouse and/or Clubhouse Parcel (or portions thereof), subject to a schedule to be established by the Manager, to others for special events, such as weddings and anniversary or retirement parties;*" and also that "*The rental rates and fees associated with the foregoing item (ii) shall be set by the Manager, with the rental rates and fees paid for such use being used first to fund any deficits related to the Clubhouse, the Clubhouse Parcel, and/or the Joint Phase One Common Areas*".

Section 3.g of the 2011 Amended DCCR states that "*Clubhouse Expenses shall mean all costs and expenses of maintaining, repairing and operating the Clubhouse and the Clubhouse Parcel, including but not limited to costs for cleaning, insurance, salaries of Clubhouse employees, repairs, utilities, security, landscaping, trash collection, equipment maintenance*".

### **Specification of Need to Generate Additional Income**

The Association is currently charging fees for any special use of the Clubhouse. These fees are considered income to the Association and are subject to IRS rules for taxation as is the earned interest on Association investments. However, all of the income from collected usage fees is being used to offset the deficit in the Association's annual total net income. The Association is now operating with an annual deficit of about \$15K on average which is being covered with Cash-on-Hand. It would certainly be quite reasonable to generate additional Clubhouse usage (rental) fees to help cover that deficit. The Association has additional Clubhouse maintenance expenses that could be performed, if only the available income was larger. The Association is currently very conservative on Clubhouse repairs and replacements and has foregone upgrades and improvements due to lack of funds.

Until the number of Dwelling Units in the Association that pay Base Assessments (or new Dwelling Units in the Additional Land that will pay the Association a contribution towards maintenance of the common areas) starts to increase, rental fees for special usage of the Clubhouse by Resident-sponsor or Board-sponsored users could be used to offset the Association's Common Expenses. Section 3.g of the 2011 Amended DCCR also states that all such collected fees are to be used to fund deficits in maintaining the Clubhouse and the Joint Phase One Common Area. In the very unlikely situation that such rental fee income would be in excess of what is used to maintain those areas, an "Amenity Account" for capital funding is required. However, the Association is extremely unlikely to generate that level of income, as the sole purpose for increased rental fee income is just to help defray the operating deficit. Besides, the expiration date for even funding such an "Amenity Account" is set for September 30, 2020.

Therefore, the Association is only interested in having additional income from Clubhouse special use rental fees, by Resident or Board sponsored non-residents, until there are enough Dwelling Units contributing Base Assessment income to offset the operating deficit.

## Income Taxes

The Association is filing its income taxes as an exempt homeowners association per IRC Section 528 using IRS Form 1120-H since

- 1) 100 percent of the Dwelling Units are used as residences.
- 2) Nearly 95% of current income for the Association is from Base Assessments. This is more than the 60 percent required from gross income.
- 3) More than 90 percent of the Association's expenses are exempt as they are used for operating and capital expenses that directly affect the Association's Area of Common Responsibility.
- 4) No residual income is used to benefit members.

Budgeted Clubhouse usage fee income could be increased from the current \$1-2K per year up to about \$20-25K per year which could help eliminate the depletion of Cash-on-Hand. The Association might even collect a larger amount of usage fees given that there are additional needed repairs and improvements for the Clubhouse. The level of Clubhouse maintenance that is now unaffordable could be increased without affecting our tax filing status. It is certainly accepted that the Association might need to pay some additional income taxes due to the increase in collected fees and earned interest. However, this should not affect the income tax filing status, as the amount of usage fees will still be a small fraction of the annual income for the Association.

Because there are only 120 residential units in a community zoned for 600 or more units and a recreational center built to accommodate a fairly large community, a temporarily limited increase in the usage fees for Clubhouse special use events would generate a level of income that could then be used to benefit the members in a way that would not violate the fourth provision of IRC Section 528.

## Market Rate Fee Schedule

The Association is promoting increased normal Clubhouse usage by the residents and does not prefer to add additional costs for such regular usage. The current Clubhouse Special Use Event Policy, as stated in Appendix A of the Rules and Regulations, requires that all such events have a resident sponsor or have Board approval. While keeping fees reasonable for normal residential usage, the current schedule of fees could be adjusted to better match the regional market rate for similar special events and the available assets of the Clubhouse. There may need to be maximum limits set for the number of events and the amount of usage fee income that is permissible each year. For example, a single wedding might generate \$3-5K and other smaller events might be \$1K or less. After adjusting for any additional expenses incurred, the YTD total net income from sponsored events could be used as a limiting factor in granting permission for any additional events involving non-residents in a fiscal year.

## Rules

Of course, all special use events must adhere to the Clubhouse Special Use Event Policy as stated in Appendix A of the Rules and Regulations. Most events, especially those with non-resident guests,

will be required to make a damage deposit and pay a cleaning fee and will need to provide liability insurance and ABC licensing as required. The Clubhouse is already in compliance with basic federal ADA standards. The projected increased use of the Clubhouse to generate additional income to offset operating deficits should have minimal impact on current residents, given the existing rules of the Association. However, any unanticipated negative impact of such events will be dealt with by the Board and new rules can be enacted.

## **Management of Events**

The Association has a Clubhouse management contract with MSC (in addition to the property management contract). The MSC staff already manages Clubhouse special use events and the current Clubhouse Manager even has a private practice doing weddings. There should be no problem staffing such events. The Association might even consider changing the level of compensation for MSC staff managing some large non-Association events.

## **Summary**

In summary, the Association, is managing the Clubhouse for the Property as a whole, in the absence of a Master Association, and is already collecting special usage fees for non-Association events sponsored by a Resident. Since the Association is currently operating with a negative net income, a move to temporarily increase the income from the special use of the Clubhouse for non-Association events sponsored by a Resident, or by the Board, could help to maintain, or improve, the level of maintenance of the Association's Area of Common Responsibility with an adequate level of income to help the Association reduce or avoid a net operating deficit.