



THIRD LAGUNA HILLS MUTUAL

Financial Statements and Supplementary Information

December 31, 2021 and 2020

(With Independent Auditors' Report Thereon)

THIRD LAGUNA HILLS MUTUAL

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Independent Auditors' Report

The Board of Directors
Third Laguna Hills Mutual:

Opinion

We have audited the financial statements of Third Laguna Hills Mutual (the Mutual), which comprise the balance sheets as of December 31, 2021 and 2020, and the related statements of operations, changes in members' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Mutual as of December 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Mutual and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Mutual's ability to continue as a going concern for one year after the date that the financial statements are available to be issued.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.



In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Mutual's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Mutual's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Required Supplementary Information

U.S. generally accepted accounting principles require that the information included in schedule 1 on future major repairs and replacements be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by the Financial Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

Irvine, California
April 20, 2022

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Balance Sheets

December 31, 2021 and 2020

Assets	2021	2020
Cash and cash equivalents (note 3)	\$ 198,457	1,785,431
Accounts receivable and interest receivable, net of allowance for doubtful accounts of \$463,566 in 2021 and \$854,522 in 2020, respectively	218,076	172,270
Receivable from Golden Rain Foundation of Laguna Woods (note 5)	479,350	354,178
Income tax receivable (note 4)	31,029	26,005
Prepaid expenses	2,818,713	3,290,396
Total current assets	3,745,625	5,628,280
Investments and restricted cash (note 3)	28,949,011	29,206,870
Beneficial interest in Golden Rain Foundation of Laguna Hills Trust (note 2(g))	5,055,140	5,189,637
Equity Interest in Golden Rain Foundation of Laguna Woods (note 2(g))	41,073,262	39,594,122
Total assets	\$ 78,823,038	79,618,909
Liabilities and Members' Equity		
Liabilities:		
Accounts payable and accrued expenses	\$ 3,429,091	3,641,829
Amounts payable for accrued compensation	596,103	548,292
Assessments and charges paid in advance	684,426	759,755
Total current liabilities	4,709,620	4,949,876
Total liabilities	4,709,620	4,949,876
Members' equity	74,113,418	74,669,033
Total liabilities and members' equity	\$ 78,823,038	79,618,909

See accompanying notes to financial statements.

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Statements of Operations

Years ended December 31, 2021 and 2020

	2021	2020
Revenue:		
Member assessments:		
Operating	\$ 34,631,177	33,526,024
Golden Rain Foundation of Laguna Woods restricted funds (note 5)	1,391,256	1,757,376
Restricted funds (note 3)	13,632,138	12,935,046
Total member assessments	49,654,571	48,218,446
Other revenue:		
Chargeable services revenue	738,934	401,033
Laundry	214,443	198,525
Investment income	88,640	443,266
Lease and resale processing fees	460,398	384,333
Income tax benefit (note 4)	5,024	—
Miscellaneous	279,977	210,427
Total other revenue	1,787,416	1,637,584
Total revenue	51,441,987	49,856,030
Expenses:		
Reimbursement to managing agent for compensation and related costs	12,915,986	12,367,602
Operating materials and supplies	1,420,625	1,015,170
Utilities and telephone	5,821,810	5,370,908
Professional fees	67,881	216,775
Legal fees	382,074	678,562
Repairs and maintenance	9,078,503	10,659,604
Insurance (note 9)	6,491,514	2,829,407
Income taxes (note 4)	—	16,295
Golden Rain Foundation of Laguna Woods operating expenses	15,039,359	14,742,872
Payments to Golden Rain Foundation of Laguna Woods restricted funds (note 5)	1,391,256	1,757,376
Other	266,911	265,165
Total expenses	52,875,919	49,919,736
Net loss before other changes	(1,433,932)	(63,706)
Other changes:		
Realized (loss) gain on available-for-sale investments (note 3)	(15,377)	41,318
Unrealized (loss) gain on available-for-sale investments	(450,949)	437,409
Unrealized gain from voting interest in Golden Rain Foundation of Laguna Woods	1,479,140	1,845,066
Loss from beneficial interest in Golden Rain Foundation of Laguna Hills Trust	(134,497)	(134,876)
Net (loss) income	\$ (555,615)	2,125,211

See accompanying notes to financial statements.

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Statements of Changes in Members' Equity

Years ended December 31, 2021 and 2020

	Memberships		Changes	Total members' equity
	Number	Amount		
Members' equity, December 31, 2019	6,102	\$ 610,200	71,933,622	72,543,822
Net income	—	—	2,125,211	2,125,211
Members' equity, December 31, 2020	6,102	610,200	74,058,833	74,669,033
Net loss	—	—	(555,615)	(555,615)
Members' equity, December 31, 2021	<u>6,102</u>	<u>\$ 610,200</u>	<u>73,503,218</u>	<u>74,113,418</u>

See accompanying notes to financial statements.

THIRD LAGUNA HILLS MUTUAL

Statements of Cash Flows

Years ended December 31, 2021 and 2020

	2021	2020
Cash flows from operating activities:		
Net (loss) income	\$ (555,615)	2,125,211
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Loss from beneficial interest in Golden Rain Foundation of Laguna Hills Trust	134,497	134,876
Unrealized loss (gain) on available-for-sale investments	450,949	(437,409)
Amortization of investment premium and discount, net	—	111,066
Unrealized gain from voting interest in Golden Rain Foundation of Laguna Woods	(1,479,140)	(1,845,066)
Effect of changes in operating assets and liabilities:		
Accounts and accrued interest receivable	(45,806)	234,478
Prepaid expenses	471,683	(2,483,287)
Receivable from Golden Rain Foundation of Laguna Woods	(125,172)	334,440
Payable for accrued compensation	47,811	(81,242)
Accounts payable and accrued expenses	(212,738)	1,212,232
Member assessments paid in advance	(75,329)	99,819
Income taxes receivable	(5,024)	(26,005)
Income taxes payable	—	(80,710)
Net cash used in operating activities	(1,393,884)	(701,597)
Cash flows from investing activities:		
Purchases of held-to-maturity investments	(4,499,871)	(13,997,717)
Maturities of held-to-maturity investments	8,499,765	23,850,594
Proceeds from sales of available-for-sale investments	100,187,839	4,309,546
Purchases of available-for-sale investments	(80,431,853)	(12,509,833)
Net cash provided by investing activities	23,755,880	1,652,590
Net increase in cash and cash equivalents and restricted cash	22,361,996	950,993
Cash and cash equivalents and restricted cash, beginning of year	1,785,431	834,438
Cash and cash equivalents and restricted cash, end of year (note 2b)	\$ 24,147,427	1,785,431

See accompanying notes to financial statements.

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Notes to Financial Statements

December 31, 2021 and 2020

(1) Organization

(a) General

Third Laguna Hills Mutual (the Mutual), a nonprofit mutual benefit corporation, was formed to manage, operate, and maintain 6,102 condominium housing units (manors or common property) for the benefit of its members. These manors are a part of Laguna Woods Village, Laguna Woods, California (the Village), a housing development consisting of 12,736 manors and various community facilities.

The Mutual is a corporate member of Golden Rain Foundation of Laguna Woods (GRF), a nonprofit mutual benefit corporation. The individual Mutual members have a right to the use of facilities owned or held in trust by GRF, appurtenant to their membership in the Mutual. GRF, as trustee, holds title to certain community facilities in trust for the benefit of all Mutuels that are a part of the Village (the Village Mutuels).

The Mutual is a member of Village Management Services, Inc. (VMS), an affiliated California nonprofit mutual benefit corporation. VMS was formed to provide management services under contract for GRF and the Mutuels. No management fee is paid to VMS (note 5).

(b) Assessments

The Mutual receives, on a monthly basis, assessments from its members (member assessments) to conduct its operations and to fund certain reserve accounts as discussed in note 2(f). For 2021 and 2020, the members were assessed Mutual basic monthly assessments of \$672.22 and \$652.22, respectively, per manor per month, for direct and Mutual shared operating costs, Mutual reserve contributions, and GRF shared operating expenses and restricted funds. The Mutual basic monthly assessment does not include surcharges for those manors with common laundry facilities, elevators, and/or Garden Villa recreation rooms.

The total assessed to the members of the Mutual for Mutual basic costs and surcharges and GRF costs was \$49,654,571 and \$48,218,446, respectively, in 2021 and 2020.

(2) Significant Accounting Policies

(a) Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting.

(b) Cash and Cash Equivalents

For purposes of reporting cash flows, the Company considers all highly liquid investments with an original maturity of three months or less to be cash and cash equivalents. The total balance of cash and cash equivalents at December 31, 2021 and 2020 is \$198,457 and \$1,785,431, respectively.

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Notes to Financial Statements

December 31, 2021 and 2020

The table below provides a reconciliation of cash, cash equivalents, and restricted cash reported on the balance sheet that sum to the total of those same amounts shown in the statement of cash flows:

	<u>2021</u>	<u>2020</u>
Cash and cash equivalents	\$ 198,457	1,785,431
Restricted cash	<u>23,948,970</u>	<u>—</u>
	<u>\$ 24,147,427</u>	<u>1,785,431</u>

(c) Investments

The Mutual accounts for investments and restricted funds under the provisions of ASC Topic 320, *Investments – Debt and Equity Securities*. This statement requires the Mutual to classify and account for investments in equity securities that have readily determinable fair values, and for all debt securities, into three categories: (1) debt securities that the Mutual has the positive intent and the ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost; (2) debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings; and (3) debt securities not classified as held-to-maturity securities or trading securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses excluded from earnings and reported as other comprehensive income. Equity securities including mutual funds not classified as held-to-maturity securities or trading securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses included in earnings during the years ended December 31, 2021 and 2020.

The Mutual restricts a portion of member assessments to finance reserves set aside as restricted funds. Disbursements from restricted funds may be made only in accordance with the purpose established. Interest income earned on restricted funds is retained within the respective fund. Additions to the funds are determined each year as outlined in the annual business plan.

(d) Fair Value Measurements

The Mutual has adopted the provisions of ASC Topic 820, *Fair Value Measurements*, for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction among market participants at the measurement date. ASC Topic 820 also establishes a framework for measuring fair value and expands disclosures about fair value measurements (note 3).

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Notes to Financial Statements

December 31, 2021 and 2020

(e) Property

The Mutual has adopted the provisions of ASC Topic 972, *Real Estate – Common Interest Realty Associations, Subtopic 360, Property, Plant and Equipment*, for the accounting for common real property acquired. As such, common real property directly associated with units is expensed when incurred. Common real property not directly associated with units are capitalized when the Mutual can dispose of the property, at the discretion of its board of directors or when the property is used to generate significant cash flows from members on the basis of usage or from nonmembers.

(f) Future Major Repairs and Replacements

A study was conducted by the Mutual in 2021 to estimate the remaining useful lives and current replacement costs of certain major components of common property. This study also considered future replacement costs of these certain major components based on the estimated useful lives, assuming a 3.0% inflation factor. The board of directors has a policy to plan additional fund contributions over the estimated useful lives of the components (on a current-cost basis) based on an annual analysis of the adequacy of the funds. Under the assumption that certain buildings would not be completely replaced within the next 30 years, replacement funds are not provided for those community facilities. Actual replacement costs when expended may vary from the estimated future expenditures considered in the fund analysis, and the variations may be material. If additional monies are needed, the Mutual has the right to adjust the monthly assessment, impose special assessments, or delay expenditures as appropriate.

(g) Interests in Golden Rain Foundation of Laguna Woods and Golden Rain Foundation of Laguna Hills Trust

The Mutual reports its 47.91% interest in GRF based on the non-Trust net assets of GRF to reflect the significant influence the Mutual exercises over GRF through its voting interest in accordance with ASC Topic 323, *Investments – Equity Method and Joint Ventures*. Such interest totaled \$41,073,262, or 47.91% of \$85,727,477, and \$39,594,122, or 47.91% of \$82,640,239, at December 31, 2021 and 2020.

The Mutual also has a beneficial interest in Golden Rain Foundation of Laguna Hills Trust (the Trust), which holds certain community facilities in trust for the Village Mutuals. The Mutual's beneficial interest is calculated based on the Mutual's "trusteed sums," defined as the original contribution amounts as stated in the trust agreement adjusted for earnings (loss), and totals \$5,055,140 and \$5,189,637, respectively, at December 31, 2021 and 2020.

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Notes to Financial Statements

December 31, 2021 and 2020

The Third Laguna Hills Mutual's interest in Golden Rain Foundation and Golden Rain Foundation Trust consists of its respective ownership of the following:

	2021	2020
Cash and cash equivalents	\$ 2,581,444	2,520,519
Receivables from Laguna Woods Mutuals	571,084	—
Receivables	1,285,950	1,719,097
Income tax receivable	10,000	—
Other current assets	2,837,515	2,859,369
Restricted funds and investments	29,406,430	24,509,316
Property and equipment, net	57,359,627	59,109,271
Community facilities, net	10,517,803	10,850,965
Intangible assets, net	143,580	189,781
Total assets	\$ 104,713,433	101,758,318
Accounts payable and accrued liabilities	\$ 7,204,521	5,741,894
Payables to Laguna Woods Mutual	533,196	1,333,179
Deferred income	556,287	471,840
Income tax payable	10	546,062
Total liabilities	8,294,014	8,092,975
Members' equity in Golden Rain Foundation of Laguna Woods	85,727,477	82,640,239
Noncontrolling interest in consolidated trust	10,691,942	11,025,104
Total equity	96,419,419	93,665,343
Total liabilities and equity	\$ 104,713,433	101,758,318
	2021	2020
Third Laguna Hills Mutual's 47.91% interest in Golden Rain Foundation of Laguna Woods	\$ 41,073,262	39,594,122
Third Laguna Hills Mutual's Equity in noncontrolling interest in consolidated trust	5,055,140	5,189,637
Total interest in Golden Rain Foundation and Golden Rain Foundation Trust	\$ 46,128,402	44,783,759

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Notes to Financial Statements

December 31, 2021 and 2020

(h) Income Taxes

The Mutual provides for income taxes in accordance with ASC Topic 740, Income Taxes. ASC 740 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a threshold of more likely than not for recognition of tax benefits of uncertain tax positions taken or expected to be taken in a tax return. ASC 740 also provides related guidance on measurement, derecognition, classification, interest and penalties, and disclosure. Management believes that no uncertain tax positions requiring accrual or disclosure existed at December 31, 2021 and 2020.

(i) Concentration of Credit Risk

The Mutual had cash balances of \$198,457 and \$1,412,574, and restricted cash balances of \$3,768,611 and \$0 at December 31, 2021 and 2020, respectively, maintained in a commercial bank and that consist of cash on deposit. At December 31, 2021 and 2020, all noninterest-bearing deposit transaction accounts were Federal Deposit Insurance Corporation (FDIC) insured up to a maximum of \$250,000, per depositor, per insured bank, for each account ownership category.

The Mutual also maintained money market fund balances of \$0 and \$372,857, and restricted money market fund balances of \$20,180,359 and \$0 at December 31, 2021 and 2020, respectively. At December 31, 2021, the Mutual held money market funds in IntraFi Network Deposits with all funds fully insured by the FDIC. At December 31, 2020, the money market funds were Securities Investor Protection Corporation insured up to a maximum of \$500,000 per institution.

(j) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(k) Current Environment

In March 2020 the World Health Organization declared the novel coronavirus (COVID-19) a pandemic. The outbreak led to a dramatic loss of life worldwide and affected travel, commerce and financial markets globally, including the United States. The spread of COVID-19 adversely affected Mutual operations and the ability to conduct maintenance on major components as planned. Commencing March 2020 and continuing through December 31, 2021, certain community and corporate facilities within the Village were closed to resident use. While some staff worked in corporate facilities adhering to social distancing programs, many employees were furloughed for a period of four months from April 2020 through July 2020. As of December 31, 2021, uncertainty remains over the progression of the virus and the changing governmental directives. By the issuance date of this report, Mutual operations have largely returned to normal levels.

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Notes to Financial Statements

December 31, 2021 and 2020

(3) Cash and Cash Equivalents, and Investments

The Mutual's investments and restricted cash are presented as follows on the accompanying balance sheets at December 31, 2021 and 2020:

	2021	2020
Restricted cash and cash equivalent:		
Restricted cash	\$ 3,768,611	—
Restricted money market	20,180,359	—
Total restricted cash	23,948,970	—
Restricted investments:		
Available-for-sale (at fair value):		
Certificate of Deposit Account Registry Service	5,000,041	—
Index funds	—	25,206,976
Total restricted investments at fair value	5,000,041	25,206,976
Held-to-maturity (at amortized cost):		
U.S. Treasury notes	—	3,919,872
Total restricted investment at amortized cost	—	3,919,872
Total restricted cash and restricted investments	28,949,011	29,126,848
Unrestricted investments:		
Held-to-maturity (at amortized cost):		
U.S. Treasury notes	—	80,022
Total restricted cash and investments	\$ 28,949,011	29,206,870

The Mutual follows the provisions of ASC 820 for fair value measurements for financial assets and liabilities and nonfinancial items that are recognized at fair value in the financial statements on a recurring basis. ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical investments that the Mutual has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the investment, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the investment.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level of input that is significant to the fair value measurement.

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Notes to Financial Statements

December 31, 2021 and 2020

The Mutual's cash and cash equivalents and investments that are measured at fair value on a recurring basis as reflected on the accompanying balance sheets at December 31, 2021 and 2020 are as follows:

		2021		
		Level 1	Level 2	Total
Cash and cash equivalents	\$	198,457	—	198,457
Investments and restricted cash:				
Restricted cash		23,948,970	—	23,948,970
Available-for-sale:				
Certificate of Deposit Account Registry Service		5,000,041	—	5,000,041
Total cash and cash equivalents, available-for-sale investments and restricted cash	\$	29,147,468	—	29,147,468
		2020		
		Level 1	Level 2	Total
Cash and cash equivalents	\$	1,785,431	—	1,785,431
Investments and restricted cash:				
Available-for-sale:				
Index funds		25,206,976	—	25,206,976
Total available-for-sale investments and restricted cash		25,206,976	—	25,206,976
Total cash and cash equivalents, available-for-sale investments and restricted cash	\$	26,992,407	—	26,992,407

In November 2019 the Board of Directors approved a revised Investment Policy allowing bond holdings at investment grade ratings and directing the Mutual's Investment Manager to convert individual holdings of U.S. Treasury notes, GNMA's, and corporate bonds to a portfolio of index funds. In December 2020 the sale of previously owned holdings was executed and all proceeds were used for the immediate purchase of index funds. The valuation of the index fund portfolio used quoted prices in active markets for identical investments and are classified as Level 1 in the fair value hierarchy. Fair value of such investments totaled \$0 and \$25,206,976 at December 31, 2021 and 2020, respectively.

In April 2021 the Board of Directors directed the sale of previously owned index funds and the immediate purchase of U.S. Treasury notes. In September 2021 the board directed the sale of all U.S. Treasury notes and the immediate purchase of money market funds in IntraFi Network Deposits with all funds fully insured by the FDIC. In December 2021 the board directed the sale of money market funds in the amount of \$5,000,000 and the immediate purchase of a Certificate of Deposit Account Registry Service (CDARS) with all funds fully insured by the FDIC.

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Notes to Financial Statements

December 31, 2021 and 2020

Investments available-for-sale were comprised of CDARS of \$5,000,041 at December 31, 2021 and of index funds of \$24,756,027 at December 31, 2020. Fair value of available-for-sale investments were \$5,000,041 and \$25,206,976 at December 31, 2021 and 2020 respectively and were considered Level 1 in the fair value hierarchy. Investments held-to-maturity comprised of U.S. Treasury notes, totaling \$3,999,894 and were carried at cost at December 31, 2020. Fair value of held-to-maturity investments totaled \$3,999,894 at December 31, 2020 and were considered Level 1 in the fair value hierarchy.

The Mutual's investments are classified as either available-for-sale or held-to-maturity and are summarized as follows:

		<u>Purchase/ amortized cost</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized loss</u>	<u>Estimated fair value</u>
At December 31, 2021:					
Available-for-sale	\$	5,000,041	—	—	5,000,041
		<u>Purchase/ amortized cost</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized loss</u>	<u>Estimated fair value</u>
At December 31, 2020:					
Available-for-sale	\$	24,756,027	941,075	(490,126)	25,206,976
Held-to-maturity		3,999,894	63	—	3,999,957

The Mutual determines realized gains and losses based on the specific-identification method. In 2021 realized gains and realized losses were as follows in 2021 and 2020:

<u>Available-for-sale</u>		<u>2021</u>	<u>2020</u>
Realized gain	\$	255,681	203,037
Realized loss		(271,058)	(161,719)
Realized (loss) gain on available-for-sale, net	\$	<u>(15,377)</u>	<u>41,318</u>

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Notes to Financial Statements

December 31, 2021 and 2020

Restricted investments consist of the following reserve funds:

	<u>Replacement funds</u>	<u>Garden Villa Recreation Room fund</u>	<u>Disaster fund</u>	<u>Unappropriated expenditures fund</u>	<u>Total</u>
Balances, Dec 31, 2019	\$ 16,078,437	72,953	9,069,489	3,625,771	28,846,650
Member assessments	11,130,048	85,698	1,133,508	585,792	12,935,046
Net investment income and other contributions	505,591	2,295	284,884	113,983	906,753
Expenditures	<u>(9,988,044)</u>	<u>(71,246)</u>	<u>(3,502,311)</u>	<u>—</u>	<u>(13,561,601)</u>
Balances, Dec 31, 2020	17,726,032	89,700	6,985,570	4,325,546	29,126,848
Member assessments	11,130,048	85,698	1,830,600	585,792	13,632,138
Net investment income and other contributions	25,555	59	16,319	3,244	45,177
Expenditures	<u>(9,523,425)</u>	<u>(70,119)</u>	<u>(3,248,706)</u>	<u>(1,012,902)</u>	<u>(13,855,152)</u>
Balances, Dec 31, 2021	<u>\$ 19,358,210</u>	<u>105,338</u>	<u>5,583,783</u>	<u>3,901,680</u>	<u>28,949,011</u>

(a) Replacement Reserve Funds

Replacement funds were established to provide reserves for replacement of common property, roofs, elevators, and certain equipment that were originally included in the cost of individual manors purchased by the residents. Monthly member assessments for these funds are included in member assessments restricted funds in the accompanying statements of operations.

(b) Garden Villa Recreation Room Fund

This fund was established to provide funds for maintaining the Garden Villa recreation rooms. Monthly member assessments for this fund are included in member assessments-restricted funds in the accompanying statements of operations.

(c) Disaster Fund

The disaster fund was established to reserve for contingencies and emergency expenditures or catastrophic damages not covered by insurance, including insurance policy deductibles. Monthly member assessments for this fund are included in member assessments-restricted funds in the accompanying statements of operations.

(d) Unappropriated Expenditures Fund

The unappropriated expenditures fund was established to provide funds for payment of authorized expenses not specifically provided for in the annual business plan. Monthly member assessments for this fund are included in member assessments-restricted funds in the accompanying statements of operations.

THIRD LAGUNA HILLS MUTUAL

Notes to Financial Statements

December 31, 2021 and 2020

(4) Income Taxes

The Mutual is considered a homeowners' association for federal and state income tax purposes and is liable for tax on nonexempt function net income. The provision for income taxes for the years ended December 31, 2021 and 2020 consists of the following:

	2021	2020
State taxes – current	\$ 10	10
Federal taxes – current	(5,034)	16,285
Total tax (benefit) expense	\$ (5,024)	16,295

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2021 and 2020 are presented below:

	2021	2020
Deferred tax assets:		
IRC Section 277 loss carryforwards	\$ 388,894	388,894
Net operating loss carryforwards	655,200	621,747
Capital loss carryforwards	72,604	68,302
Total gross deferred tax assets	1,116,698	1,078,943
Less valuation allowance	(1,116,698)	(1,078,943)
Total deferred tax assets	\$ —	—

The valuation allowance for deferred tax assets as of December 31, 2021 and 2020 was \$1,116,698 and \$1,078,943, respectively. The net change in the total valuation allowance for the years ended December 31, 2021 and 2020 was a increase (decrease) of \$37,755 and \$(13,096), respectively. Based upon the level of historical taxable income and projections for future taxable income over periods, deferred tax assets are deductible, management believes it is more likely than not that the Mutual will not realize the benefits of the deductible differences. As such, the Mutual recorded a full valuation allowance against the deferred tax assets at December 31, 2021 and 2020.

At December 31, 2021, the Mutual has federal and state net operating loss carryforwards of \$193,927 and \$6,950,858 available to offset future federal and state taxable income, respectively. At December 31, 2020, the Mutual has federal and state net operating loss carryforwards of \$193,927 and \$6,572,647 available to offset future federal and state taxable income, respectively. The federal and state carryforward amounts expire in varying amounts between 2022 and 2040.

Income tax expense was computed by applying the U.S. federal income tax rate of 21% for both December 31, 2021 and 2020, respectively.

THIRD LAGUNA HILLS MUTUAL

Notes to Financial Statements

December 31, 2021 and 2020

(5) Related Parties

As discussed in note 1, the Mutual is a corporate member of GRF and a member of VMS, all related entities. The accompanying financial statements include assessments to GRF for operating expenses and restricted funds as well as a receivable due from GRF for assessments collected by GRF not yet remitted to the Mutual. The accompanying financial statements also include amounts paid and owed to VMS as managing agent for compensation and related costs.

(6) Pension Plans

Village Management Services, Inc. makes contributions to two union-sponsored, multiemployer, defined-benefit pension plans (covering most union employees) in accordance with a negotiated labor contract between VMS and the labor union. In the event these plans are either terminated or VMS withdraws from the plans, VMS may be required to contribute additional amounts under the provisions of the Employee Retirement Income Security Act of 1974. Such amounts would be reimbursed by GRF and the Mutuals. However, no such termination of or withdrawal from the plans is currently contemplated.

During 2021 and 2020, VMS sponsored a 401(k) plan covering all eligible employees. Employee contributions to the plan are at the participants' discretion. In 2016, VMS made contributions into the plan for eligible nonunion employee participants. The Mutuals and GRF are not responsible for the management or ultimate funding of the 401(k) plan beyond the agreed-upon annual contributions.

Amounts contributed by VMS to these plans in 2021 and 2020, and reimbursed by the Mutual, totaled \$427,907 and \$383,714, respectively, for the defined-benefit pension plans and \$66,057 and \$62,389, respectively, for the 401(k) plan.

(7) Contingencies

The Mutual is involved in various legal matters arising in the normal course of business. In the opinion of management, the liability, if any, will not have a material effect on the Mutual's financial position.

(8) Malware Attack

The Mutual, along with Golden Rain Foundation and United Laguna Woods Mutual, were victims of a malware attack in October 2020. The criminal(s) responsible for the attack encrypted data denying users access. While the financial systems remained functional, numerous internal systems were rendered inoperable. The FBI and local law enforcement were notified and a team of professionals were contracted with to resolve the incident. At December 31, 2021 the corporations had access to the recovered data and safeguard measures had been enacted to limit the risk of future losses.

(9) Insurance

Total insurance expense of \$6,491,514 and \$2,829,407 for the years ended December 31, 2021 and 2020, respectively, include property insurance of \$5,579,708 and \$2,163,139 for the same respective periods. During the 2020 calendar year, the Mutual's insurance company directed the Mutual to complete a property valuation prior to the renewal period beginning October 2020. The completed valuation resulted in an increase in fair market value of the Mutual's property resulting in an increase in insurance premiums.

THIRD LAGUNA HILLS MUTUAL

Notes to Financial Statements

December 31, 2021 and 2020

(10) Subsequent Events

Subsequent events have been evaluated through April 20, 2022, which is the date the financial statements were available to be issued.

SUPPLEMENTARY INFORMATION

THIRD LAGUNA HILLS MUTUAL

Future Major Repairs and Replacements

December 31, 2021

(Unaudited)

The Mutual contracted a study in 2021 to estimate the remaining useful lives and current replacement costs of major components of common property, except for certain land improvements, buildings, and building improvements for which major repair and replacement funds are not provided, as these items are expected to last the life of the community or to be maintained from general operating and/or preventive maintenance funds. The estimates were determined from past experience and from information obtained from certain contractors.

The following table is based on the Mutual study of common property:

Major components	Estimated useful lives (in years)	Estimated remaining useful lives (in years)	Estimated current replacement costs	Estimated funding requirement as of December 31, 2021
Paved surfaces	1 to 25	0 to 24	\$ 9,176,000	5,005,390
Roofing & gutters	1 to 40	0 to 32	57,835,400	29,479,165
Building structures	1 to 10	0 to 18	8,206,200	3,169,810
Decking projects	1	0 to 6	1,310,700	436,500
Prior to painting & painting projects	1	0 to 13	4,795,200	2,329,000
Elevators	1 to 40	0 to 29	5,784,900	3,223,133
Garden villas	1 to 10	0 to 29	879,600	191,880
Lighting replacement projects	1	0 to 1	75,000	25,000
Walls, fencing & railings	1	0 to 1	268,200	123,200
Laundry facilities	1 to 25	0 to 19	315,300	182,987
Sewer lines, water lines, & electricity	1	0 to 24	1,540,300	1,230,000
Grounds & miscellaneous	1	0	9,200	9,200
Landscape projects	1	0 to 2	1,846,500	1,596,500
			\$ 92,042,500	47,001,765

Replacement fund balance as of December 31, 2021 (note 3) \$ 19,358,210

The Board voted to contribute \$11,130,048 to the replacement funds in 2021. The contribution is included in the 2021 member assessments at \$152 per manor per month. Actual replacement costs when expended may vary and the variations may be material.

Because the reserve study is a projection, the estimated lives and costs of components will likely change over time depending on a variety of factors such as (i) future inflation rates, (ii) levels of maintenance applied by future boards, unknown defects in materials that may lead to premature failures, remaining useful lives, etc. As a result, some components may experience longer lives while others will experience premature failures. Some components may cost less at the time of replacement while others may cost more. To adequately plan for future expenditures, the Board has adopted via resolution a 30-Year Funding Plan that projects contributions to and disbursements from the reserves over the next thirty years, without falling below a minimum threshold in the reserve balance.

Reserves receive monies through assessments and net interest earned on invested fund balances.

See accompanying independent auditors' report.