For: Riverwalk Diamond Building Association Members
From: Board of Directors, Riverwalk Diamond Building Association
Subject: Report on Follow-Up Actions from DBA Annual Meeting of 13 Jan 2015

Background. At the Annual Meeting of the Riverwalk Diamond Building Association, held on 13 January 2015, the Board presented the revised Reserve Fund study and led discussion about the condition of the building and short vs. long-term tradeoffs in assessments of Members and anticipated funding liabilities to maintain the building. Based on the general consensus, the Board agreed:

- To continue the annual 5% increase in the Reserve Fund budget line.
- To create a menu of options for growing the Reserve Fund, combining increased investment returns and varying levels of Special Assessments, for hedging anticipated major building infrastructure expenses over the next 20 years while, at the same time, fairly and consistently balancing assessments of owners.
- To report the Board's conclusions for actions in 2015.
- To refine preliminary analysis for making discretionary investments (common area lighting, building security, partial exterior re-painting) to improve the building.

Purpose. To report and explain the Board's follow-up conclusions on these matters.

Headlines.

- Assessment allocations for Commercial and Residential owners are clarified and confirmed as follows.

% allocation – ***See specifics in Appendix 1***	Commercial Owners	Residential Owners
General Assessments to fund the routine annual operating budget.	70%	30%
Special Assessments to fund one-off major capital repairs and strategic investments in the building infrastructure common elements.	56%	44%

- We aim to grow the Reserve Fund (RF) to best balance (a) funding of long-term anticipated major infrastructure repair, maintenance, and replacement expenses and (b) a fair and consistent burden of assessments on owners. How? [1] There will be no Special Assessment now (in the foreseeable future). [2] The Reserve Fund will be invested in a liquid asset portfolio, managed by a professional investment advisor on a non-discretionary basis on behalf of the DBA Board, targeted to achieve returns consistent with a moderate risk/reward profile. ***See Appendix 2 for back-up details.***
- Discretionary investments:
  - In the elevator will touch-up the appearance of the walls in 2015 (in addition to the completed floor tile replacement).
  - In common area LED lighting are halted because of low-value returns (ROI).
  - In building security are pending review of revised bid quotes with execution targeted for 2015.
  - In exterior partial re-painting are being considered for execution in 2016.

We value your feedback. Please call/email us with your comments before 15 March when actions begin.

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Appendix 1: DBA Assessment Allocations

General Assessments for the annual operating budget are allocated 70% to commercial owners and 30% to residential owners. Within these two assessment pools, each respective unit owner pays a monthly assessment prorated to his/her %-share (by square footage) of the total square footage of the respective owner pool.

Special Assessments to fund major capital repairs and strategic investments in the building infrastructure common elements are levied by the DBAB on a one-off basis when necessary. As approved by 96% voting by owners and the Board, effective 15 April 2008, assessments are allocated 56% to commercial owners and 44% to residential owners. Rationale:

- Commercial properties "use" the building more, generate higher "wear and tear" on the building, and benefit from the Association services on a more intense and consistent basis than do residential properties; therefore, commercial properties should pay a higher share of normal maintenance and operating expenses.
- All owners bear responsibility for the integrity of our building infrastructure independently of how differentially they "use" the building and generate normal operating "wear and tear". Therefore, owners should pay for one-off major capital expenses for building repair purely on the basis of ownership interest (pure square footage).
- Impact: different assessment burdens for owners for different purposes.

The last Special Assessments were $15k in 2008 to jump-start the Reserve Fund and $100k in 2010 to fund the major repairs associated with the construction defects of our building. These were assessed at the owner interest rates of 56/44 for commercial/residential owners.

See the specific figures to the right for a range of Special Assessment options analyzed here.

RIVERWALK DIAMOND BUILDING ASSOCIATION

2015 Special Assessment Options

Allocations @ 56/44 for Commercial/Residential Owners

	SQ FT	SQ FT %	For a DBA SpA of:		
			$50,000	**$100,000**	**$150,000**
C-101	2,395	6.02%	$3,008	$6,015	$9,023
C-102	1,187	2.98%	$1,491	$2,981	$4,472
C-103 W	697	1.75%	$875	$1,751	$2,626
C-103 E	969	2.43%	$1,217	$2,434	$3,651
C-104	1,735	4.36%	$2,179	$4,358	$6,536
C-105	753	1.89%	$946	$1,891	$2,837
C-106 W	1,007	2.53%	$1,265	$2,529	$3,794
C-106 E	1,198	3.01%	$1,504	$3,009	$4,513
C-107 W	626	1.57%	$786	$1,572	$2,358
C-107 E	1,219	3.06%	$1,531	$3,062	$4,592
G-001	2,679	6.73%	$3,364	$6,729	$10,093
G-002	1,278	3.21%	$1,605	$3,210	$4,815
G-003 W	617	1.55%	$775	$1,550	$2,325
G-003 E	572	1.44%	$718	$1,437	$2,155
G-004	1,147	2.88%	$1,440	$2,881	$4,321
O-201	1,221	3.07%	$1,533	$3,067	$4,600
O-202	1,155	2.90%	$1,450	$2,901	$4,351
O-203	1,276	3.20%	$1,602	$3,205	$4,807
O-204	745	1.87%	$936	$1,871	$2,807
COMMERCIAL	**22,476**	**56.45%**	**$28,226**	**$56,451**	**$84,677**
$/sq ft			$1.26	$2.51	$3.77
R-201	4,672	11.73%	$5,867	$11,734	$17,601
R-202	2,986	7.50%	$3,750	$7,500	$11,250
R-203	2,976	7.47%	$3,737	$7,475	$11,212
R-204	3,025	7.60%	$3,799	$7,598	$11,396
R-205	3,680	9.24%	$4,621	$9,243	$13,864
RESIDENTIAL	**17,339**	**43.55%**	**$21,774**	**$43,549**	**$65,323**
$/sq ft			$1.26	$2.51	$3.77
Total Sq Ft	39,815	100.00%	$50,000	$100,000	$150,000
$/sq ft			$1.26	$2.51	$3.77

Appendix 2: Rationale for prudent, reasonable, balanced growth of the DBA Reserve Fund

Our Reserve Fund Plan includes a [a] Physical Plan pegged to the installation/refresh date and lifespan of DB infrastructure components, and a [b] Financial Plan to fund these expenses/investments based on estimated costs and inflation. Updated in Dec 2014, here is our DBA Reserve Plan summary. See the next 2 pages for how these expenses phase out over time and how they are funded by the Reserve Fund.

PHYSICAL PLAN: Inventory of major DB infrastructure components

Timing & cost of capital spending to maintain DB Common Elements infrastructure

As of 8 Dec 2014

		Useful life & aging Clock						
		Start Year	Useful Life	[RMR/paint] in:	Replcmnt Cost at (re)Start	Next Replcmnt Cost	Remarks	
Exterior	**CD-based RMRs**							$-basis
	EIFS	2010/11	20	2030	$1,445,049	$2,609,919	includes CD RMR + exterior paint = 2010 CD + 2011 (CD + roofing)	actual CD RMR from 2007/2011
	Siding & Trim	2010/11	25	2035				
	Synthetic brick & stone	2010/11	20	2030				
	Roofing	2010/11	20	2030				
	Roofing: asphalt shingles	2010/11	20	2030				
	Metal railings	2012	7	2019	$1,410	$1,734		
	Lighting	1998	5	2015	$4,000	$4,637	1 set on front balcony	SS swag
Interior	Walls & ceilings	2013	10	2023	$15,082	$20,269		2013+inflation
	Flooring tiles	1998	20	2018	$15,000	$15,000		SS swag
	Flooring carpets	2011	10	2023	$13,454	$18,081		2013+inflation
	Interior stairways	2013	5	2018	$1,610	$1,866	Only 1, paint ea 5 yrs	2013+inflation
	Restrooms	1998	15	2015	$6,600	$10,283		Garnet Bldg RFS
	Mailboxes	1998	30	2028	$1,200	$2,913		SS
	Fire alarm system	1998	30	2028	$24,000	$58,254		SS
	Skylights	????	15	2015	$11,000	$17,138	2 ea @ $5500	
Mechanical	Heat exchanger	1998	10	2015	$2,500	$3,360		SS swag
	Boilers & Expansion tanks	2010, 2014	20	2030, 2034	$37,621	$67,948	2 ea	$ each > 20 yrs
	Hot water storage tanks	1998	15	2020	$15,000	$23,370	2 ea	SS swag
	Circulation pumps	1998	6	2016	$18,000	$21,493	6@$1k + 6@$2k	SS swag
	Elevator	2015	15	2030	$5,000	$7,790	replace starter + floor tiles	2014+inflation

See below for time-phased capital expenses, draw-downs from the Reserve Fund to pay for these expenses, inputs into the Reserve Fund from annual 5% budget increases in RF funding and investment returns, and end-of-year net RF balances for the period 2008/2018 – the second decade of the Diamond Building.

FINANCIAL PLAN: Projection of RF income for 2008 through 2035 to [a] fund anticipated required RMR investments, and [b] mainta

As of 4 Dec 2014

DB age (since 1998)	10	11	12	13	14	15	16	17	18	19	20
	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
FUND BALANCE											
Fund balance carryover	41,647	58,452	74,862	150,906	42,203	62,289	69,097	76,776	73,231	82,032	110,195
START-YEAR BALANCE	**41,647**	**58,452**	**74,862**	**150,906**	**42,203**	**62,289**	**69,097**	**76,776**	**73,231**	**82,032**	**110,195**
INCOME											
+ annual assessment	15,491	15,750	16,538	20,672	21,700	22,791	23,930	25,127	26,383	27,702	29,087
+ special assessment	15,000	0	110,000	0	0	0	0	0	0	0	0
+ CD recovery		0	1,330,619	0	0	0	0	0	0	0	0
subtotal to invest	72,138	74,202	1,532,019	171,578	63,903	85,080	93,027	101,903	99,614	109,734	139,282
investment return	976	660	4,860	259	51	99	391	428	418	461	585
TOTAL INCOME	**31,467**	**16,410**	**1,462,017**	**20,931**	**21,751**	**22,890**	**24,321**	**25,554**	**26,801**	**28,163**	**29,672**
EXPENDITURES											
Loan to operating	(10,000)					(1,000)					
Legal fees	(4,662)		(13,880)								
CD-based RMRs			(1,364,723)	(116,180)							
EIFS											
Siding & Trim											
Synthetic brick & stone											
Roofing											
Roofing: asphalt shingles											
Metal railings					(1,410)						
Directories					(255)						
Lighting								(4,000)			
Walls & ceilings						(15,082)					
Flooring tiles											(15,000)
Flooring carpets				(13,454)							
Interior stairways											(1,866)
Restrooms								(6,600)			
Mailboxes											
Fire alarm system											
Skylights								(11,000)			
Heat exchanger								(2,500)			
Boilers & Expansion Tanks			(7,370)				(15,541)				
Hot water storage tanks											
Circulation pumps									(18,000)		
Expansion tanks											
Elevator							(1,100)	(5,000)			
Taxes											
TOTAL EXPENDITURES	**(14,662)**	**0**	**(1,385,973)**	**(129,634)**	**(1,665)**	**(16,082)**	**(16,641)**	**(29,100)**	**(18,000)**	**0**	**(16,866)**
FUND YEAR-END BALANCE	58,452	74,862	150,906	42,203	62,289	69,097	76,776	73,231	82,032	110,195	123,000

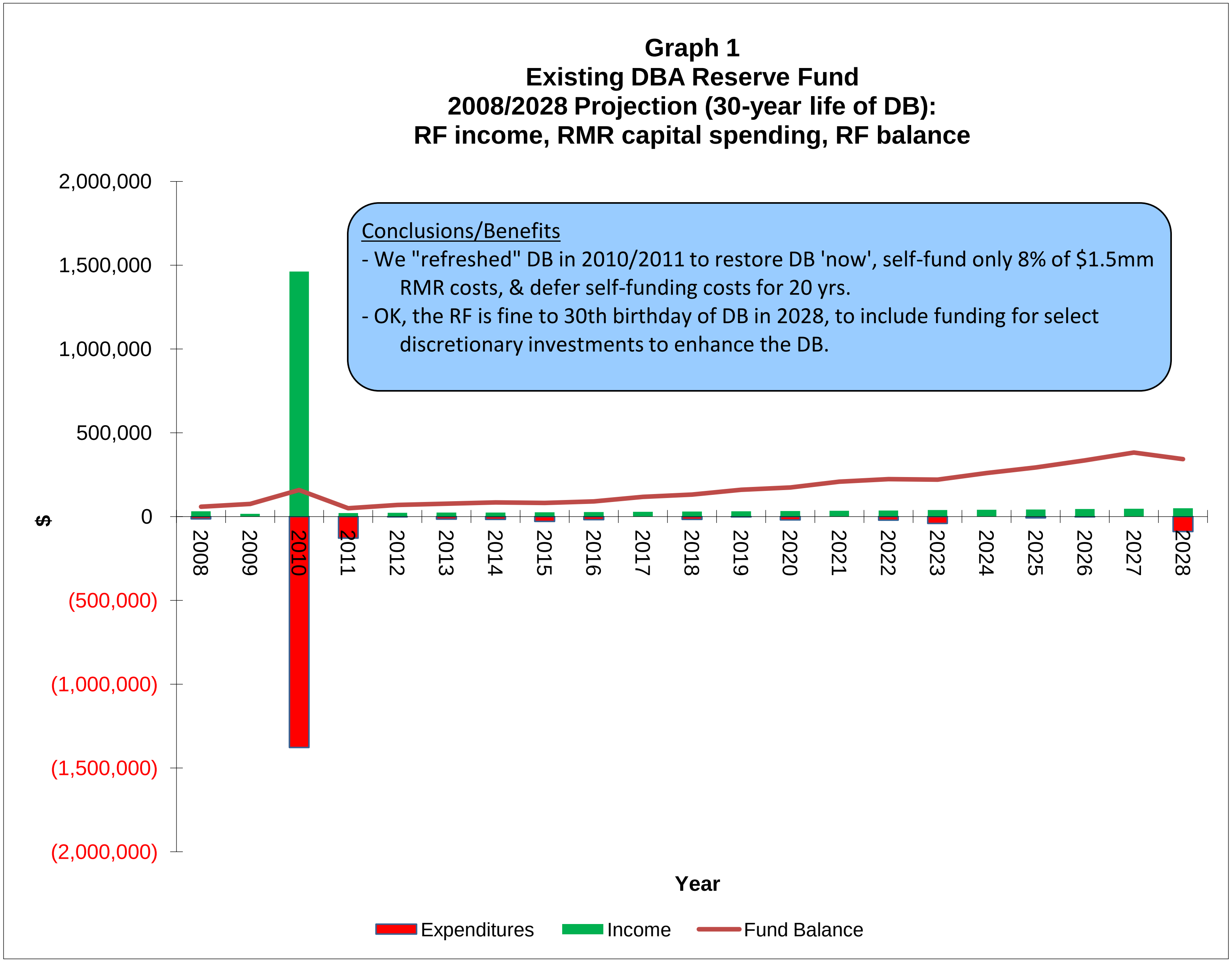
See below for time-phased capital expenses, draw-downs from the Reserve Fund to pay for these expenses, inputs into the Reserve Fund from annual 5% budget increases in RF funding and investment returns, and end-of-year net RF balances for the period 2018/203128 – past the 30th anniversary of the Diamond Building in 2028.

See the effects of varying capital expenses on the growth of the RF. See the 20-year spike of RMR expenses (pegged to the 20-year lifespan of the major repairs in 2010/11) that blows up the RF and creates, in the worst case, a $2.3m shortfall that must be funded via a commercial loan with debt service obligations for owners for the loan service period. See next 2 pages for visual display.

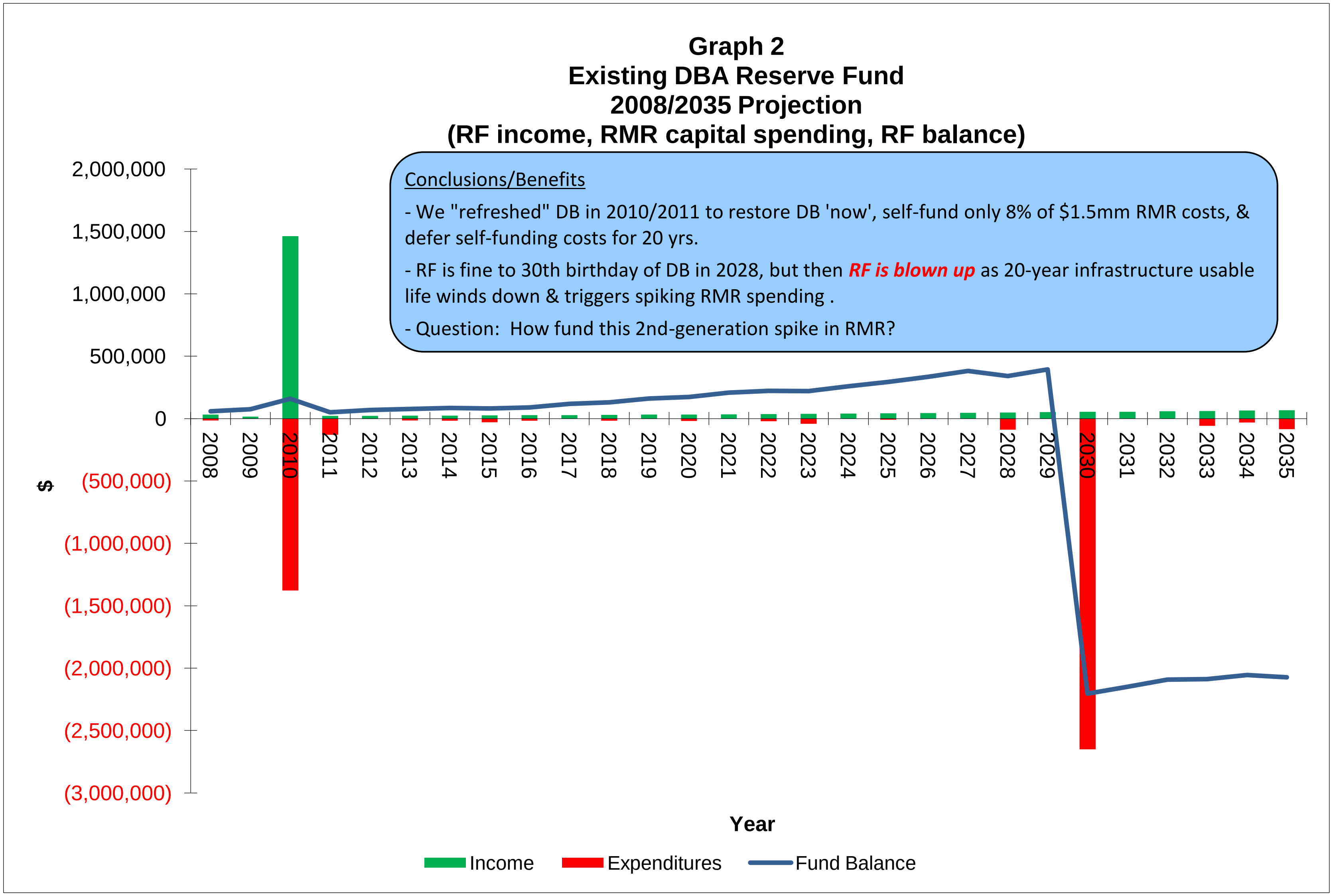
FINANCIAL PLAN: Projection of RF income for 2008 through 2035 to [a] fund anticipated required RMR investments, and [b] maintain a cash reserve to

DB age (since 1998)	21	22	23	24	25	26	27	28	29	30	31	32	33
	2019	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**	**2031**
				0.42%									
FUND BALANCE													
Fund balance carryover	123,000	152,453	165,659	200,168	215,020	211,769	251,802	285,224	327,445	374,133	333,944	385,305	(2,279,930)
START-YEAR BALANCE	**123,000**	**152,453**	**165,659**	**200,168**	**215,020**	**211,769**	**251,802**	**285,224**	**327,445**	**374,133**	**333,944**	**385,305**	**(2,279,930)**
INCOME													
+ annual assessment	30,541	32,068	33,672	35,356	37,123	38,979	40,928	42,975	45,124	47,380	49,749	52,236	54,848
+ special assessment	0	0	0	0	0	0	0	0	0	0	0	0	0
+ CD recovery	0	0	0	0	0	0	0	0	0	0	0	0	0
subtotal to invest	153,542	184,521	199,331	235,524	252,143	250,749	292,730	328,199	372,569	421,513	383,693	437,541	54,848
investment return	645	775	837	989	1,059	1,053	1,229	1,378	1,565	1,770	1,612	1,838	230
TOTAL INCOME	**31,186**	**32,843**	**34,509**	**36,345**	**38,182**	**40,033**	**42,158**	**44,353**	**46,688**	**49,150**	**51,360**	**54,074**	**55,078**
EXPENDITURES													
Loan to operating													
Legal fees													
CD-based RMRs												(2,609,919)	
EIFS													
Siding & Trim													
Synthetic brick & stone													
Roofing													
Roofing: asphalt shingles													
Metal railings	(1,734)							(2,133)					
Directories													
Lighting		(4,637)					(5,376)					(6,232)	
Walls & ceilings					(20,269)								
Flooring tiles													
Flooring carpets					(19,000)								
Interior stairways					(2,164)					(2,508)			
Restrooms												(10,283)	
Mailboxes										(2,913)			
Fire alarm system										(58,254)			
Skylights												(17,138)	
Heat exchanger							(3,360)						
Boilers & Expansion Tanks												(67,948)	
Hot water storage tanks		(15,000)											
Circulation pumps				(21,493)						(25,664)			
Expansion tanks													
Elevator												(7,790)	
Taxes													
TOTAL EXPENDITURES	**(1,734)**	**(19,637)**	**0**	**(21,493)**	**(41,433)**	**0**	**(8,735)**	**(2,133)**	**0**	**(89,339)**	**0**	**(2,719,309)**	**0**
FUND YEAR-END BALANCE	152,453	165,659	200,168	215,020	211,769	251,802	285,224	327,445	374,133	333,944	385,305	(2,279,930)	(2,224,852)

See the effects of these RF inflows and outflows on our RF balance. Fine out to our 30th birthday in 2028.



See the effects of these RF inflows and outflows on our RF balance. We're fine out to our 30th birthday in 2028, but the worst-case \$2m+ spike in RMR expenses in 2030 blows up the RF and requires us to resort to commercial loan financing to cover our RF shortfall – with debt service obligations on owners for the life of the loan (say, 10 years). ***How should we hedge <u>some</u> of this future liability?***



How should we hedge some portion of this future liability?

A. Pay (Big) Later. Do nothing more now. Stay our course (5% annual increase in RF budget line), and deal with actual problems/costs as they arise? But mortgage our future. ***OR***

B. Pay Small now and not-Big Later. Hedge our future by paying a bit more during 2015/2030? But I don't like the hit to my wallet.

➢ In any case, shift risk/reward profile of RF to gain higher investment returns to grow RF more.

What should we do? ------ "WE ALL KNOW THE ARGUMENTS"

• Do nothing more	• Do more
• We're OK for next 15 years (major capital spending & discretionary upgrades • "I don't want to set aside my $$ for hypothetical expenses way out in the future. A waste. I may not be here."	• The DB is a treasured, long-duration asset. Must be maintained in sound operating order with solid and growing asset value. • Assessments must be adequate to physical plan reqts, financially efficient, & avoid undue burdens on owners. • We can't ignore the 2nd generation spike of necessary capital spending that will confront us – whether a spike or a stream. • It's prudent to plan for the worse case, and aim to manage to a better case; i.e., less costly RMR spending with lower shortfall and lower assessments to owners. • We all will sell our unit one day. No one wants to pay more, but we all want the DB to be in great shape with rising asset value. Prospective buyers will be scared off if they see a large liability hanging over the future and the prospect of large assessments. • NO "free riders". Owners share interests in the DB. Must invest in the DB for near-term operability and long-term value enhancement. • Assessments over time ➔ lower, more consistent cash flow & gain leverage thru long-term compounding investing.

At our 13 Jan 2015 DBA Annual meeting, we agreed:

- To continue current annual 5% increase in RF budget line (do not increase it more because it generates little leverage).
- To increase RF investment returns from current .42% pa to 5%+ pa (in liquid assets, with moderate risk/reward profile).
- To consider a Special Assessment levy in 2016 of $___ to front-load fund ramped-up investment returns over 2015/2030.

What is a reasonable menu of options that combine higher RF returns + injections of additional cash to invest -- either in a front-loaded (Special Assessment) lump-sum or in a stream (annual budget)?

Which combination grows the RF to optimally balance hedging of future funding and owner assessment burdens in the short and long term?

First, how can we prudently increase RF investment returns?

How increase Investment Return on our RF?

Menu?

CDs = ☒
√ FDIC, but
X $ locked up
X Lousy rtn

	Tranche	Conservative	Moderate	Aggressive	
		Risk/Reward Profile			
A	25%	VGIT	VGIT	VGIT	
B	25%	CIU	CIU	CIU	Fixed Income
C	25%	LAG	MGK	PRF	Equities
D	25%	SCHP	SPY	PRFZ	
Portfolio Return pa	1 year	4.63%	8.95%	6.38%	Pre-tax return pa
	5 year	4.39%	10.21%	10.64%	
	10 year		6.77%		

- Each alternative portfolio varies in asset allocation to achieve a different risk/reward profile (low to higher risk/reward)
- All profiles include ≥ 50% of AUM in low-risk fixed income assets to preserve capital
- All assets are ETFs that target a defined market segment, are cheap (low expense ratio fees< .40% pa), & are liquid

➢ These profiles all have acceptable risk.
➢ But we can compare how these different levels of risk/reward hedge DBA future liabilities.
➢ Which is comfortable and best-suited for the DBA?

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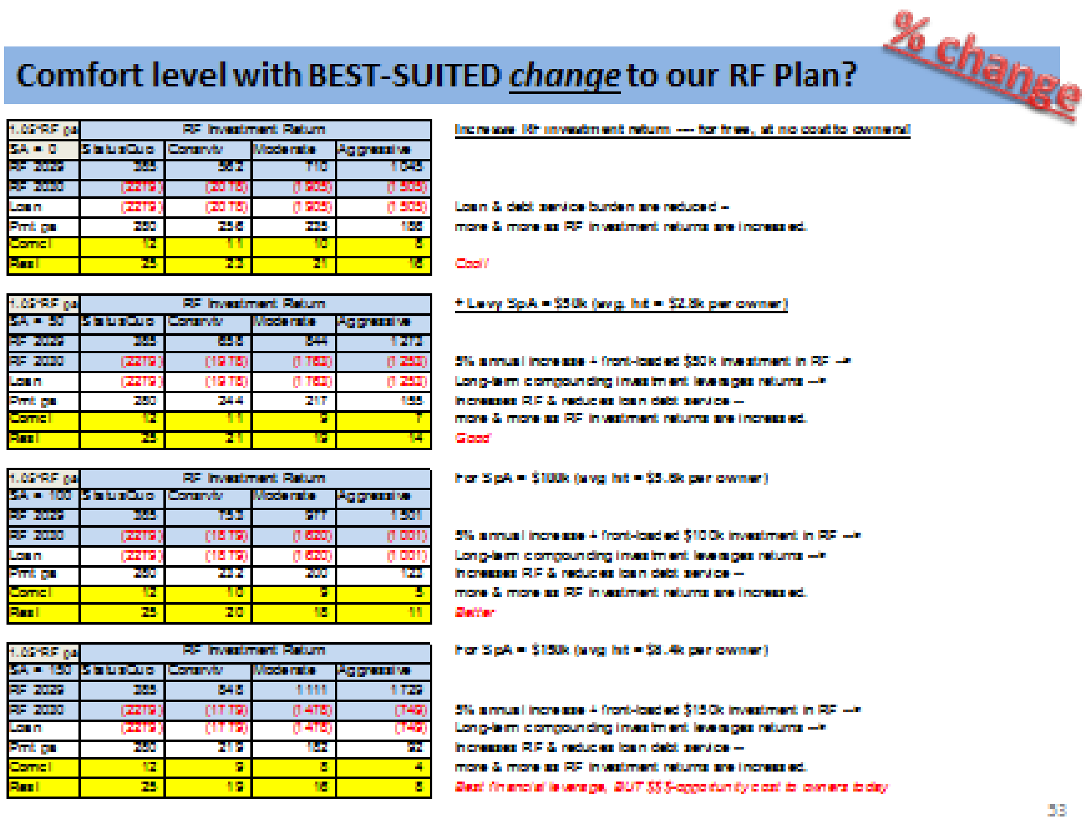
The sense of owners attending the 13 Jan DBA Annual meeting:

10% return is too risky & too volatile. Reject.

5 to 7% return is comfortable because 15-year timeframe allows boosted returns to absorb volatile market downturns in 1-off random years. OK.

<5% return leaves opportunity on the table. Too conservative. Reject.

Second, how can we get best hedge value (reduced loan debt service burden from a combination of higher RF investment return + a Special Assessment to front-load the RF portfolio to grow with the leverage of long-term compounding returns)? Which combination of risk/return + up-front cash injection is best?



% change

Comfort level with BEST-SUITED *change* to our RF Plan?

1.05*RF pa	RF Investment Return			
SA = 0	StatusQuo	Conserv	Moderate	Aggressive
RF 2029	385	582	710	1045
RF 2030	(2279)	(2078)	(1 909)	(1 505)
Loan	(2279)	(2078)	(1 909)	(1 505)
Pmt pa	280	256	235	188
Comcl	12	11	10	8
Resl	25	23	21	16

Increase RF investment return --- for free, at no cost to owners!

Loan & debt service burden are reduced –
more & more as RF investment returns are increased.

Cool!

1.05*RF pa	RF Investment Return			
SA = 50	StatusQuo	Conserv	Moderate	Aggressive
RF 2029	385	658	844	1 272
RF 2030	(2279)	(1978)	(1 763)	(1 250)
Loan	(2279)	(1978)	(1 763)	(1 250)
Pmt pa	280	244	217	155
Comcl	12	11	9	7
Resl	25	21	19	14

+ Levy SpA = $50k (avg. hit = $2.8k per owner)

5% annual increase + front-loaded $50k investment in RF →
Long-term compounding investment leverages returns →
Increases RF & reduces loan debt service –
more & more as RF investment returns are increased.

Good

1.05*RF pa	RF Investment Return			
SA = 100	StatusQuo	Conserv	Moderate	Aggressive
RF 2029	385	753	977	1 501
RF 2030	(2279)	(1879)	(1 620)	(1 001)
Loan	(2279)	(1879)	(1 620)	(1 001)
Pmt pa	280	232	200	123
Comcl	12	10	9	5
Resl	25	20	18	11

For SpA = $100k (avg hit = $5.6k per owner)

5% annual increase + front-loaded $100k investment in RF →
Long-term compounding investment leverages returns →
Increases RF & reduces loan debt service –
more & more as RF investment returns are increased.

Better

1.05*RF pa	RF Investment Return			
SA = 150	StatusQuo	Conserv	Moderate	Aggressive
RF 2029	385	848	1 111	1 729
RF 2030	(2279)	(1779)	(1 418)	(749)
Loan	(2279)	(1779)	(1 418)	(749)
Pmt pa	280	219	182	92
Comcl	12	9	8	4
Resl	25	19	16	8

For SpA = $150k (avg hit = $8.4k per owner)

5% annual increase + front-loaded $150k investment in RF →
Long-term compounding investment leverages returns →
Increases RF & reduces loan debt service –
more & more as RF investment returns are increased.

Best financial leverage, BUT $$$-opportunity cost to owners today

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Status Quo = 5% pa increase in RF budget line & current .42% RF return pa & with no SpA = current Base Case. Compare it with "pay now to save later" value of other options. Higher risk/return ➔ larger 2029 RF ➔ smaller 2030 funding shortfall and required loan ➔ lower debt service payment ➔ reduced debt service burden for owners = hedge value (ROI).

Hedge value increases with higher RF risk/return and with larger 2016 SpA to front-load RF balance to invest for 15 years and gain leverage of compounding investment returns.

Higher RF risk/return grows RF more, but DBA takes on higher risk.

Higher SpA grows RF more, but weighs owners with higher cash opportunity cost (in 2016 when paid, and in future if sell unit and don't get value of reduced funding costs in 2030+).

Another option is to levy a small SpA in 2016 and each year thereafter to 2030. See the value derived below.

Another approach

Comfort level with BEST-SUITED *change* to our RF Plan?

SpA = $10k in 2016 + $10k ea yr out to 2030	avg SpA pa C = $400 R = $880	RF 2030 $296K + $710k
	(@56/44)	$1006k

So, WDYT ? →
➢ SpA 2016?

Run this thru RF Model to forecast actual $$$ RF 2029 RF2030

$947k ($1642k) *Funding gap*

$1.624m loan (10 yrs @ 5%) = PMT = $203k pa = debt svc pa for 10 years =

on average	Com cl =	$8.7k pa	$12k pa	-$3.3k pa
	Resl =	$17.9k pa	$25k pa	-$7.1k pa

\>>>>>>> *15 yr pmt stream of $555 pa (weighted avg/owner)*

(NPV = $5.8k) to save $35k NPV total = 20% rtn pa

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Good, this approach grows the RF with moderate risk and annual small SpAs to generate significant debt service savings in the long-term.

The SpA is small, but recurs each year → to add up to real $$$.

Annual small injections into the RF generate weaker compounding leverage than a single larger up-front cash injection.

But worth considering.

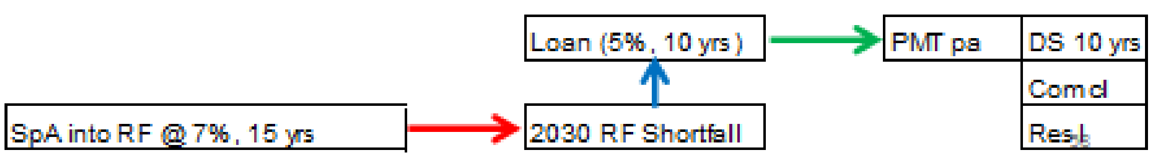
Which combination of boosted RF risk/return and SpAs to inject cash into the RF suits us best? ***At the margin, which combination achieves highest debt service savings at least SpA cost to owners?***

Menu of choices

Comfort level with BEST-SUITED *change* to our RF Plan?

	Pay-In option (Rtn/SpA)	2016 SpA (NPV)	2030 shortfall = Loan	Loan PMT pa (10y, 5%)	Debt Svc pa		Avg Savings		Eff. Return pa
	$1000s				Comcl	Resl	pa	10 yrs NPV	
Base	.42%/zero	0	($2,280)	$280	$12	$25	-	-	-
A	7%/zero	0	($1,905)	$235	$10	$21	-$3	-$20	free
B	5%/$150k	-$8.0	($1,779)	$219	$9	$19	-$4	-$31	15%
C	7%/$100k	-$6.0	($1,620)	$200	$9	$18	-$5	-$35	19%
D	7%/$50k	-$2.8	($1,763)	$217	$9	$19	-$4	-$28	25%
E= A	7%/zero	0	($1,905)	$235	$10	$21	-$3	-$20	free
F	10%/zero	0	($1,505)	$186	$8	$16	-$5	-$41	free
G	7%/$10 pa...	-$5.8	($1,642)	$203	$9	$18	-$4	-$35	20%

NPV uses 5% to discount cash flows back to present value



A saves $3k pa & $20k overall for free. Great. A = OK.

B saves more ($4k pa), but so do D & G at less cost. Reject B.

C is better than B: costs less &saves more because it takes higher risk/return. C = OK, but expensive?

D saves $4k pa, for a 10-yr rtn = 25%! Wow, best deal yet. D = OK.

F saves the most, but it takes too much risk. Reject F.

G saves $4k & $35k overall, but costs more than D. Lower value. Reject G.

Therefore

- Reject F (too risky) and B, C, G (too expensive) ➔ lower value ROI.
- Best = D (spend $2.8k to save $28k for 25% ROI value).
- But A/E saves $20k with same risk/reward profile <u>and at no cost</u>. Better → best value!

RF =MODERATE RISK/REWARD PROFILE + NO SpA.

How do we implement, manage, and control the Reserve Fund?

The DBA Board mandates and manages the Reserve Fund and all associated activities, to include implementing these actions to the RF, selecting a local professional investment advisor to execute transactions and provide advisory/admin services on behalf of the DBA, holding sole discretionary authority over buy-and-sell decisions on the RF, and engaging vendors to execute RMR activities on the DB. Checks and balances accountability for the RF are maintained through an Investment Policy Statement (see draft 1 below), multiple interdependent roles (DBAB, IA, Custodian of RF, DBA tax advisor, and Slifer Mgt Co), and the fact that the DBAB holds sole discretion and authority with respect to the RF and exercises this authority consistent with its fiduciary responsibilities to the DBA.

************************************Draft 1************************************

INVESTMENT POLICY STATEMENT

RIVERWALK DIAMOND BUILDING ASSOCIATION

Introduction

The purpose of this investment policy statement is to:

1. Articulate key terms with respect to the Diamond Building Association (DBA) and its Reserve Fund (RF), to include investment goals, risk appetite, liquidity/funding constraints, suitable assets and asset allocation guidance, discretion for execution, and prudent procedures for monitoring/evaluating investments and for adjusting the investment portfolio as well as this plan for the long term. Three hypothetical portfolios are included as benchmarks to start detailed discussion about what the DBA wants to achieve in the short and long run.
2. In order for the investment advisor engaged by the DBA to understand the context and specific terms of the desired advisory/client relationship.
3. In order to set terms/parameters for agreement and documentation for the DBA Reserve Fund investment portfolio and the associated advisory/client relationship.

The goal is mutual understanding and agreement of how to undertake an advisor-client relationship, subject to normal market practices, DBA Decs, advisor practices, and relevant laws and guidelines. It is not a contract. Both parties understand that there is no guarantee that the goals and results laid out here will be achieved. However, by signing this statement, both parties agree to abide by the enclosed terms in good faith, consistent with the fiduciary responsibilities of the advisor, for the optimal benefit of the DBA.

Parties

Client Investor
Diamond Building Association
137 Main Street
Edwards CO 81632

Investment Advisor
ABC Advisors
Address
Address

Client Summary

The DBA aims to engage an IA to advise on and execute, on a non-discretionary basis, investments in assets to grow its Reserve Fund consistently, within reasonable moderate risk, in order to fund its variable stream of major capital expenditures for the repair, maintenance, and replacement of DB infrastructure components. Growth, risk, and liquidity must be balanced year-on-year and with an eye to long-term projections out to 25 years on a rolling basis. Given the tax status of the DBA, managing the tax efficiency of the portfolio and funding liquidations is crucial.

DBA Goals for the RF investment portfolio.

- Achieve a consistent annual pre-tax return on assets in the range of 5% to 7% pa with acceptable levels of risk less than that of the annualized S&P 500 index.
- Invest in a portfolio of only liquid assets consistent with the asset allocation as agreed now, and as adjusted from time to time and confirmed in writing.
- Achieve optimal tax efficiency.

Financial Parameters

- Value of assets included in plan: $80,000 cash initially, plus annual insertions of additional cash.
- ETFs (with low expense ratios) are preferred over single stocks, mutual funds, and bonds.

- Index or sector funds are preferred over single stocks to underwrite diversification. The portfolio will always include at least one equity asset that is based on a "fundamentals" index (such as the RAFI index funds) to capture fundamental dynamics rather just market price shifts.
- Eligible assets to include: cash, US Large-Cap Value & Growth Stocks, US Mid/Small-Cap Stocks, US Investment Grade Bonds (USTs and agency bonds, corporate bonds, & select asset-backed bonds).
    - In-eligible assets that are excluded: US High Yield Bonds, Non-US Stocks and Bonds, Commodities, Alternatives, Derivatives (Futures, Options, CDS, CLOs, Swaps).
- Asset allocation:
    - 50% = US investment grade fixed income (to include some inflation-protected assets such as TIPs).
    - __% = US equities.
    - __% = Residual cash.
    - Periodic funding demands will require liquidations from RF assets each year. IA will advise DBAB as to which assets to cash-out to optimize tax efficiency and facilitate portfolio re-balancing to optimize long-term gains and growth.
- Three hypothetical portfolios are included as benchmarks to start detailed discussion with the IA about what risk/reward assets/portfolio best targets DBA short and long run goals.

Risk Constraints

- Risk tolerance level: Moderate.
- Portfolio is diversified consistent with the asset allocation as agreed at the time.
- IA will aim to generate returns on the basis of the quality and diversification of portfolio assets, and will NOT trade actively to try to "time" the markets.
- IA will advise DBA on performance and recommended adjustments based on market calls and anticipated DBA liquidity needs. IA will execute trades on a non-discretionary basis; i.e., buy or sell only on the trigger-pull of the designated DBAB trigger person(s).
- Method for determining risk tolerance: Client self-assessment

Portfolio Monitoring

Terms set out here are suited to circumstances today. But changes will constantly challenge DBA RF fitness/suitability over the long-term in the face of performance spikes/dips, market volatility and trends, changes in funding requirements for the DBA RF, and changes in the DBAB. Accordingly, a systematic monitoring and adjustment approach is necessary to allow for flexibility while providing circuit-breakers on over-reaction to normal short-term market events.

Asset Allocation

IA and DBAB should review asset allocation when one of the following occurs:

- When DBA objectives, liquidity requirements, or circumstances change.
- When significant assets are added/removed from the plan.

Portfolio Implementation

IA and DBAB should look to adjust asset holdings when one of the following occurs:

- Quarterly re-balancing to "sell high/buy low" consistent with the asset allocation and to optimize the efficient growth of the RF.
- When a security over/under-performs its primary benchmark (for more than a quarter).
- When a security's Morningstar star rating is lowered.
- When a security's style or category is changed.

Reporting

IA will provide secured reports and information about the portfolio to the DBAB, DBA Manager, and others as indicated by the DBAB.

- 24/7 password-secured online access to the portfolio on the custodian's website.
- Quarterly reports, to include performance results and portfolio risk relative to the S&P500 benchmark, and recommendations for adjustments.
- Annual reviews and recommendations for adjustments.

Confirmation

I have read this **Investment Policy Statement.** I affirm that [a] it reflects the needs and constraints of the DBA and [b] it structures a reasonable and suitable investment approach to support these DBA needs and constraints. I am comfortable to work within these investment policy terms, subject to mutual agreement of both parties to make changes as needed based on written notice of no less than one full week.

Steve Lincks, President DBA Signature/Date

Todd Williams, Commercial Rep. Signature/Date

Asa Clark, Residential Rep. Signature/Date

Fname Lname, ABC Co.

*************************************Draft 1*************************************