HAMILTON COVE HOMEOWNERS ASSOCIATION

Audited Financial Statements

For The Year Ended December 31, 2018

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Hamilton Cove Homeowners Association

We have audited the accompanying financial statements of Hamilton Cove Homeowners Association, which comprise the balance sheet as of December 31, 2018, and the related statements of revenue and expenses and association funds, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hamilton Cove Homeowners Association as of December 31, 2018, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of- Matter Regarding Supplemental Information

Per California Civil Code requirements, the Association has conducted a study to estimate the remaining lives and replacement costs of the common property within the past three years. The schedule that the American Institute of Certified Public Accountants has determined is required to supplement, although not required to be a part of, the basic financial statements has used the most current study, dated October 4, 2017. The projections of this study have not been updated and may no longer be valid.

Owens, Moskowitz and Associates, Inc.

Owens, Moskowitz and Associates, Inc.

March 26, 2019

HAMILTON COVE HOMEOWNERS ASSOCIATION
BALANCE SHEET
DECEMBER 31, 2018

	OPERATING FUND	REPLACEMENT FUND	LAND PURCHASE FUND	TOTAL
ASSETS				
Cash	$ 175,892	$ 1,404,760	$ -	$ 1,580,652
Assessments receivable	54,809	-	1,011	55,820
Less: allowance for doubtful accounts	(14,292)	-	-	(14,292)
Prepaid insurance	85,097	-	-	85,097
Land	-	-	536,690	536,690
Fixed assets	228,930	-	-	228,930
Accumulated depreciation	(227,742)	-	-	(227,742)
Total Assets	**$ 302,694**	**$ 1,404,760**	**$ 537,701**	**$ 2,245,155**
LIABILITIES AND ASSOCIATION FUNDS				
Liabilities				
Note payable	$ -	$ -	$ 536,690	$ 536,690
Accounts payable	55,608	-	-	55,608
Prepaid assessments	50,390	-	-	50,390
Accrued interest payable	-	-	1,011	1,011
Master land liability	18,724	-	-	18,724
Income taxes payable	7,681	-	-	7,681
Total Liabilities	**132,403**	**-**	**537,701**	**670,104**
Commitments	-	-	-	-
Association funds	**170,291**	**1,404,760**	**-**	**1,575,051**
Total Liabilities & Association Funds	**$ 302,694**	**$ 1,404,760**	**$ 537,701**	**$ 2,245,155**

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

HAMILTON COVE HOMEOWNERS ASSOCIATION
STATEMENT OF REVENUE EXPENSES AND ASSOCIATION FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2018

	OPERATING FUND	REPLACEMENT FUND	LAND PURCHASE FUND	TOTAL
REVENUE				
Assessments	$ 1,961,400	$ 350,000	$ -	$ 2,311,400
Recovery of Unit 1/62 dues	-	151,555	-	151,555
Sublease rent	-	-	40,934	40,934
Preferred mooring fees	27,400	-	-	27,400
Interest income	52	1,498	-	1,550
Unit 1/62 sale proceeds	-	475,000	-	475,000
Unit 1/62 basis	-	(242,880)	-	(242,880)
Rental income	4,723	-	-	4,723
Cell tower income	18,634	-	-	18,634
Other income	36,476	-	-	36,476
Total Revenue	**2,048,685**	**735,173**	**40,934**	**2,824,792**
EXPENSES				
Accounting	8,400	-	-	8,400
Property taxes	7,787	-	-	7,787
Administrative	32,626	9,007	-	41,633
Legal and audit	14,649	174,396	-	189,045
Insurance	661,723	-	-	661,723
Commissions	-	23,750	-	23,750
Pool	14,963	436	-	15,399
Rubbish collection	20,393	-	-	20,393
Pest control	5,900	-	-	5,900
Landscape maintenance	12,134	-	-	12,134
Painting	35,804	-	-	35,804
General maintenance	45,724	-	-	45,724
Interest expense	-	-	40,934	40,934
Depreciation	476	-	-	476
Electricity	76,852	-	-	76,852
Water	69,038	-	-	69,038
Telephone	52,362	-	-	52,362
Pier and dock	29,204	-	-	29,204
Custodial	17,472	-	-	17,472
Automotive	13,226	-	-	13,226
Plumbing	9,865		-	9,865
Uniforms	3,810	-	-	3,810
Salaries and related expenses	849,631	-	-	849,631
Fire system	35,943	43,339	-	79,282
Mooring fees	64,158	-	-	64,158
Elevator	4,819	28,216	-	33,035
Mooring maintenance	20,391	-	-	20,391
Salt water motor	-	38,992	-	38,992
Recreation equipment	-	13,562	-	13,562
Infrastructure	-	8,785	-	8,785
Income tax	10,393	-	-	10,393
Total Expenses	**2,117,743**	**340,483**	**40,934**	**2,499,160**
Excess (deficiency) of revenue over expenses	**(69,058)**	**394,690**	**-**	**325,632**
Association funds balance beginning of year	**272,131**	**977,288**	**-**	**1,249,419**
Interfund transfers	(32,782)	32,782	-	-
Association funds balance end of year	**$ 170,291**	**$ 1,404,760**	**$ -**	**$ 1,575,051**

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

HAMILTON COVE HOMEOWNERS ASSOCIATION
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2018

	OPERATING FUND	REPLACEMENT FUND	LAND PURCHASE FUND	TOTAL
Cash flows from operating activities:				
Cash received from members	$ 2,053,240	$ 305,038	$ 41,232	$ 2,399,510
Unit 1/62 sale proceeds	-	428,637	-	428,637
Cash paid to suppliers of goods and services	(2,104,017)	(340,483)	-	(2,444,500)
Interest received	52	1,498	-	1,550
Interest paid	-	-	(41,232)	(41,232)
Income taxes paid	(2,925)	-	-	(2,925)
Net cash provided by (used in) operating activities	**(53,650)**	**394,690**	**-**	**341,040**
Cash flows from investing activities:				
Sale of land interest	-	65,000	158,517	223,517
Cash flows from financing activities:				
Interfund transfers	(32,782)	32,782	-	-
Principal payments on debt	-	-	(158,517)	(158,517)
Net cash provided by (used in) financing activities	(32,782)	32,782	(158,517)	(158,517)
Net increase (decrease) in cash and cash equivalents	**(86,432)**	**492,472**	**-**	**406,040**
Cash and cash equivalents at beginning of year	**262,324**	**912,288**	**-**	**1,174,612**
Cash and cash equivalents at end of year	**$ 175,892**	**$ 1,404,760**	**$ -**	**$ 1,580,652**

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

HAMILTON COVE HOMEOWNERS ASSOCIATION
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2018

RECONCILIATION OF EXCESS OF REVENUE OVER EXPENSES
TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	OPERATING FUND	REPLACEMENT FUND	LAND PURCHASE FUND	TOTAL
Excess (deficiency) of revenue over expenses	**$ (69,058)**	**$ 394,690**	**$ -**	**$ 325,632**
Adjustments to reconcile excess (deficiency) of revenue over expenses to net cash provided by operating activities:				
Depreciation	476	-	-	476
Change in assessments receivable	(12,301)	-	298	(12,003)
Change in prepaid insurance	(847)	-	-	(847)
Change in prepaid expenses	3,500	-	-	3,500
Change in accounts payable	2,757	-	-	2,757
Change in accrued interest	-	-	(298)	(298)
Change in master land liability	(2,553)	-	-	(2,553)
Change in prepaid assessments	19,908	-	-	19,908
Change in security deposit	(3,000)	-	-	(3,000)
Change in income tax payable	7,468	-	-	7,468
Net cash provided by (used in) operating activities	**$ (53,650)**	**$ 394,690**	**$ -**	**$ 341,040**

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

NOTE 1 NATURE OF ORGANIZATION

Hamilton Cove Homeowners Association was incorporated on March 9, 1982, in the state of California. It is responsible for the operation and maintenance of the common property within the development, which is located Catalina Island, California. The development consists of 185 residential units. Three single family residences located on adjacent land have been annexed into the Association. The Association does not have any responsibility for the structures.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting

The books of Hamilton Cove Homeowners Association are maintained on the modified cash basis of accounting with entries made to convert them to the accrual basis for audit and tax purposes.

Fund Accounting

The Association's governing documents provide certain guidelines for governing its financial activities. To ensure observance of limitations and restrictions on the use of financial resources, the Association maintains its accounts using fund accounting. Financial resources are classified for accounting and reporting purposes in the following funds established according to their nature and purpose:

Operating fund -	This fund is used to account for financial resources available for the general operations of the Association.
Replacement fund -	This fund is used to accumulate financial resources designated for future major repairs and replacements.
Land purchase fund -	This fund is used to account for the purchase of land upon which the Association is located. (Note 10)

Property and Equipment

Real property and common areas acquired by the original homeowners from the developer are owned by the individual owners in common and are not capitalized on the Association's financial statements. Replacements and improvements to the real property and common areas also belong to the owners and are not capitalized on the Association's financial statements.

Fixed assets purchased by the Association are capitalized at cost and depreciated over useful lives of five to seven years using the straight-line method and declining balance methods of depreciation.

Cash Equivalents and Short-term Investments

Cash equivalents consist primarily of certificates of deposit and other securities with original maturities of 90 days or less. Certificates of deposit and other securities with original maturities over 90 days are classified as short-term investments. Cash equivalents and short-term investments are stated at cost, which approximates market value.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

The Association uses estimates and assumptions in preparing these financial statements in accordance with generally accepted accounting principles. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606).* This guidance outlines a single, comprehensive model for accounting for revenue from contracts with customers. We adopted the standard on January 1, 2018. Our revenue is generated substantially all from assessments from member homeowners charged monthly, for services rendered monthly.

We have analyzed the provisions of the FASB's ASC Topic 606, *Revenue from Contracts with Customers,* and have concluded that no changes are necessary to conform to the new standard. Our revenue contains a single delivery element and revenue is recognized at a single point in time when ownership, risks and rewards transfer.

Credit Losses

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326).* This guidance represents a significant change in the accounting model for credit losses by requiring immediate recognition of management's estimates of "current expected credit losses". Under the prior model, losses were recognized only as they were incurred, which FASB has noted delayed recognition of expected losses that might not yet have met the threshold of being probable. The new model is applicable to all financial instruments that are not accounted for at fair value through net income, thereby bringing consistency in accounting treatment across different types of financial instruments and requiring consideration of a broader range of variables when forming loss estimates. Although this change affects any entity holding financial instruments (ie: trade receivables or investments in debt securities) the financial services industry by its nature bears the most exposure. The effect of adoption of this standard will be to accelerate the recognition of credit losses. The effective date of this standard is for years beginning after December 15, 2021, with early adoption allowed. We do not plan an early adoption of this standard.

NOTE 3 REPLACEMENT FUND

The Association is funding contributions to capital for the future replacement of selected Association common areas. The funds are held in separate savings accounts to be used for the replacement of common areas only and not in the course of normal operations.

California Civil Code Section 5550 requires that associations identify the estimated remaining life of assets the association is obligated to maintain and the methods of funding used to defray future repair and replacement costs.

Industry practice is to engage outside consultants with experience in construction and maintenance to study and report on the estimated remaining life of assets that the Association is obligated to maintain and the costs of their repair and replacement. These reports address the adequacy of reserves and their funding.

NOTE 3 REPLACEMENT FUND (Continued)

A study of the Association's funding program for the replacement of Association common areas, conducted as of December 31, 2017, indicated the Association's ideal cash replacement fund balance was $ 2,053,530 at that date. The study indicated the replacement fund was approximately 44% ideally funded.

An independent study to determine the adequacy of the funding program for the replacement of Association common areas has not been conducted for the current year. The preparation of such a study involves significant estimates by the persons preparing the study, and these estimates are subject to annual revision for changing prices, circumstances and assumptions. Accordingly, the current program and cash savings may not be sufficient to meet all future replacement costs. Therefore, when replacement funds are needed, the Association has the right to increase the monthly assessments, pass special assessments, or delay replacement until funds are available.

NOTE 4 INCOME TAXES

The Association is a corporation that is potentially taxable on all of its net income, including unspent member assessments. However, under state and federal filing elections, the Association may choose to be taxed only on its net non-membership income, which includes interest income.

The State of California allows qualifying homeowner associations to file an election to be taxed under special rules. Under this election, income from members (such as assessments) is exempt from taxation.

Federal law offers a similar election, which must be made annually. However, net non-membership income under this election is taxed at a flat rate of 30%. If the Association chooses to file as a regular corporation, it may still exclude from taxation its net membership income by making certain elections. Tax at the regular corporate tax rate is generally lower. Some of these elections, however, have come under IRS attack and certain issues are yet to be clarified.

In 2018, the Association filed as a regular corporation for federal taxes, since it had an excess of maintenance expenses over membership source income. That excess may be carried over to future periods to offset future membership source income when the Association files as a regular corporation. This election is not related to the issues involved in the recent IRS audits.

Regardless of how the Association files its taxes, non-membership income (interest) may not be offset with membership expenses (such as common area maintenance costs). That is why the Association's taxable income can be greater than its net income as recorded in the financial statements.

The Association recognizes tax benefits only to the extent that it believes it is more likely than not that its tax positions will be sustained upon examination by taxing authorities. The Association believes that all of its tax positions will be sustained if examined by taxing authorities, therefore no additional tax liabilities or related penalties and interest due to uncertain tax positions have been recorded. The Association's tax returns are subject to examination by the Internal Revenue Service for three years after they are filed, and by the California Franchise Tax Board for four years after they are filed.

Federal and California income taxes have been accrued based on the taxable portion of the income reported in the accompanying financial statements.

NOTE 4 INCOME TAXES (Continued)

Income taxes for the current year were:

2018 INCOME TAXES	FEDERAL	STATE TAX	STATE FEE	TOTAL
Income Taxes	$ 6,878	$ 3,505	$ 10	$ 10,393
Less: Credit from prior year return	(809)	(638)	-	(1,447)
Less: Estimated payments	(647)	(618)	-	(1,265)
Income tax payable	**$ 5,422**	**$ 2,249**	**$ 10**	**$ 7,681**

NOTE 5 CASH

The Association's cash account balances as of December 31, 2018, were as follows:

INSTITUTION	INTEREST RATE	AMOUNT	MATURITY DATE
Petty Cash	-	$ 300	-
U.S. Bank	-	129,932	-
Mutual of Omaha Bank	0.05%	46,682	-
U.S. Bank	-	908,162	-
Mutual of Omaha Bank	0.50%	495,854	-
Total		**$ 1,580,930**	

As of December 31, 2018, the Association's accounts at both U.S. Bank and Mutual of Omaha Bank exceeded the FDIC insurance limit of $ 250,000 per depositor per institution.

NOTE 6 ASSESSMENTS RECEIVABLE

Association members are subject to annual assessments (paid in monthly installments) to fund the Association's operating expenses, future capital acquisitions and major repairs and replacements. Assessments receivable at the balance sheet date represent assessments and other fees due from unit owners. Most owners live within Southern California and their ability to pay would be influenced by the local economy. The Association's CC & R's provide for various collection remedies for delinquent assessments including filing of liens on the owner's unit, foreclosing on the unit owner, and obtaining judgment on other assets of the unit owner.

Generally accepted accounting principles require uncollectible receivables to be accounted for using the allowance method, which requires an annual provision for doubtful accounts. As such, the allowance for doubtful accounts represents an estimate of the amount of accounts receivable that may eventually be uncollectible. The allowance was computed by adding all receivables with balances older than 180 days.

Receivable balances are written off once all collection alternatives have been exhausted and the Board of Directors has deemed them uncollectible.

NOTE 7 ASSESSMENTS

During 2018, assessments were billed at a rate of $ 990.00 per unit per month. Effective January 1, 2019, the rate decreased to $ 840.00 per unit per month.

NOTE 8 LAND PURCHASE

In January 2010, the Association acquired the land on which the existing buildings are located, including the beach area, and all of the improvements including all of the buildings, subject to 185 individual subleases, for $8,325,000 plus costs and fees of $256,569. Subsequently, the Association immediately transferred undivided fractional fee interests in the land and the improvements and fee title to their condominiums to 119 owners who exercised the option to purchase in full. In the process, the subleases of those 119 owners were cancelled. Sixty-six owners remained sub-lessees of the Association.

The Association obtained a loan, in the amount of $3,215,000, to finance the purchase. The remaining sub-lessee owners participate in the Master Land Loan (MLL), which has the following terms: 15 year note; monthly payments consisting of principal and interest; annual interest rate of 6.25%, adjustable every five years; final payment of all unpaid principal and interest will become due on January 20, 2025; collateral on the loan is the title to the land and improvements. Sub-lessee owners pay $419.67 per month in lieu of the rent called for by their subleases. Upon payment in full of his/her pro-rata share, the Association transfers an undivided fractional fee interest in the land and improvements and fee title to their condominiums. As of December 31, 2018, there were still 23 owners under the MLL; monthly principal and interest payments on the MLL were $9,652.41.

NOTE 9 RENTAL UNIT

During 2010, the Association terminated the sublease of Unit 1/62 for non-payment of assessments and the pro-rata share of the MLL Note. Bank of America held a Deed of Trust secured by the sublease. On February 25, 2015, the Association filed a Quiet Title action to Unit 1/62 alleging that the termination of the sublease extinguished the Deed of Trust. Nationstar Mortgage filed an Answer in Action generally denying the Association's allegations and claimed successor ownership of the Loan and the Deed of Trust. In October 2017, a settlement agreement was reached. The Association paid Nationstar $65,000 in exchange for a termination of the Deed of Trust. A judgment quieting title was entered on April 6, 2018.

The Association was renting the Unit and paying the Unit's pro rata share of the MLL (Note 10) on the unit. During 2018, the Association collected $4,723 in rental income on the unit. Unit 1/62 was sold in November 2018 (Note 10).

NOTE 10 RELATED PARTY TRANSACTIONS

The Association has entered into a legal services agreement with a law firm of which the Board President is the managing partner. Commencing in 2010, the Association retained the law firm to collect unpaid assessments and other amounts due from the Owner of Unit 1/62 on a contingent fee basis. The actions required for Unit 1/62 are detailed in Note 9. In November 2018, after the litigation was successfully completed and the Association had obtained clear title, Unit 1/62 was sold at a $475,000 purchase price. The Association used these proceeds to repay $151,555 in foregone assessments and master land loan payments. The law firm was paid fees totaling $169,523. During 2018, the law firm was paid $7,517 in costs and fees for work in connection with unit transfers, refinancing, and other general legal services.

The Association utilized Hamilton Cove Real Estate owned by the Board Executive Vice President in connection with the sale of the unit described above and paid a 2.5% broker's fee totaling $11,875.

NOTE 11 SUBSEQUENT EVENTS

The date to which events occurring after December 31, 2018, the date of the most recent balance sheet, have been evaluated for possible adjustment to the financial statements or disclosure is March 26, 2019, which is the date on which the financial statements were issued.

SUPPLEMENTAL INFORMATION

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INDEPENDENT AUDITORS' REPORT ON SUPPLEMENTAL INFORMATION

Board of Directors
Hamilton Cove Homeowners Association

Our report on our audit of the basic financial statements of Hamilton Cove Homeowners Association for the year ended December 31, 2018 appears on page 3. That audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. Accounting principles generally accepted in the United States of America require that the information on future major repairs and replacements on page 17 be presented to supplement the basic financial statements. Such information, 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.

Owens, Moskowitz and Associates, Inc.

Owens, Moskowitz and Associates, Inc.

March 26, 2019

HAMILTON COVE HOMEOWNERS ASSOCIATION
SUPPLEMENTAL INFORMATION ON FUTURE MAJOR REPAIRS AND REPLACEMENTS
DECEMBER 31, 2018
(UNAUDITED)

Please Note: A current year study has not been conducted.

The board of directors contracted an independent consultant who conducted a October 4, 2017 study, projected to December 31, 2017, to estimate the remaining useful lives and replacement costs of the components of common property. Funding requirements include an inflation factor of 2% and an interest rate of 1%.

The following table is based on the study and presents information about the components of common property.

Components	**Estimated Remaining Useful Lives**	**Estimated Current Replacement Cost**	**2018 Funding Requirement**	**Recommended Fund Balances**
Streets	0 to 4 years	$ 374,532	$ 56,746	$ 331,002
Roofs	0 years	29,887	1,275	39,887
Painting	2 years	62,000	18,550	31,000
Fencing	3 to 7 years	126,923	19,048	110,660
Beach Area	0 to 23 years	449,823	36,413	203,513
Clubhouse	0 to 23 years	261,071	26,544	187,102
Pool/Spa	1 to 5 years	101,374	9,394	80,091
Tennis Courts	17 years	9,770	999	-
Building 10	7 to 19 years	28,380	1,585	15,336
Decks	0 years	60,000	17,952	60,000
Equipment	0 to 19 years	396,750	90,992	300,841
Irrigation/Motors	0 to 12 years	225,000	25,626	180,200
Grounds	0 to 1 year	52,900	5,860	52,079
Termite Control	0 to 8 years	449,280	24,949	364,032
Contingency	n/a	-	16,986	97,787
		$ 2,627,690	**$ 352,919**	**$ 2,053,530**

As shown above, the study recommended a replacement fund balance of $2,053,530 as of December 31, 2018 and contributions to reserves of $352,919 during 2018. The Association's replacement fund balance at December 31, 2017 was $912,288 or 44.43% of the recommended fund balance.