

FREQUENTLY ASKED QUESTIONS REGARDING THE FINANCIAL SYSTEM

NOVEMBER 2024

Over the years some questions are repeatedly asked. Brief answers are provided below.

TAX EXEMPTION

What type of federal tax exemption does LOHO have?

An IRS letter dated Feb 12, 2008 states that LOHO is "classified as a public charity" under the IRS code section 501 (c) (3) based on information submitted to the IRS regarding the operations of LOHO. According to the files, the submitted information included housing for seniors, affordable housing, and related subjects. The general rights and responsibilities of a public charity are detailed in [IRS Publication 557, Tax Exempt Status for Your Organization](#).

Being classified as a 501(c)(3) nonprofit public charity provides LOHO an exemption from paying federal income taxes and also provides donors a federal income tax exemption on their donations to LOHO (there are some nonprofit classifications which are not eligible for donor exemption).

Why is there no property tax exemption on the Cottages and why is there a small amount of property taxes paid on the Hamlet House?

Under state law the Cottages cannot obtain an exemption unless at least 75% of the Cottages (11 Cottages) are rented to "Very Low Income" residents. (RCW 84.52.560 (1)). This substantial decrease in the rent from 11 Cottages (all 7 1BR Moderate Rate plus 4 2BR Market Rate Cottages) exceeds the benefit of the tax exemption.

Hamlet House is fully exempt except for an apartment that is not considered eligible for tax exemption, thus a small amount of property tax is levied upon only that area. The Administrator/RM must renew the exemption annually before March 31st with both DOR and the SJCO Assessor's office, which can be done online. She/he must submit a form REV 64 0043 for each resident every year to continue this exemption.

RENTAL RATES FOR COTTAGES

Can we raise the Market Rate ("MR") Cottages rental rate to whatever we want?

LOHO established two types of rental rates: new MR residents and existing MR residents.

New Residents:

The annual new resident rental rate (or "rent") is set to provide greater coverage of the costs but is somewhat constrained by the market for comparable housing. In the early years, we discovered that there were a number of comparable apartments and condos that were less expensive than the rate offered on the Market Rate Cottages. Given LOHO cannot serve food and does not provide transportation, as do many senior facilities, the case had to be made for other amenities that justified a higher rental rate. Also, the Market Rate Cottages had been mostly empty for several years, so new prospects were concerned. Over the last decade, LOHO has shown that it can offer a community experience unlike apartments and a history of full and lengthy occupancy to attract new residents.

Existing Residents:

As long as the rate of increase does not exceed 5% annually (set by the current Residential Lease Agreement), then LOHO may set the rental rate increase at the Board's discretion. The Board could change this restriction in new leases, but then must negotiate with all the existing residents to change their leases. Given the residents are seniors, mostly with fixed incomes, increasing the rental rate can be financially difficult if the increase is too large. Past Boards generally looked at the Consumer Price Index and annually approved rate increases that reasonably matched the increase in expenses.

The current Residential Lease Agreement also restricts how often the increase may occur to annually or as otherwise agreed to in writing. The total increase for the year, however, is still restricted to 5%.

The Board has approved two policies which also affect the monthly rent:

- **Existing Rate Not to Exceed New Rate:** No existing resident monthly rent may exceed the monthly rent for new residents.
- **Equal Rent Increase Policy:** The Market Rate Cottages have differing monthly rent amounts according to when the resident began their lease. This meant that if increases were applied to each Cottage on a percentage basis, the dollar amount of the increases was larger for the more recent residents, even though the services provided were not different. The Board approved a policy in March 2018 providing that the

Board will set the overall annual percentage rate of increase which is then applied to the Market Rate Cottages' total annual rent to compute a total annual dollar increase. That total dollar increase is then divided by the number of affected Cottages (those rented at the time of calculation) and then this average dollar amount is added to the annual rent for each Market Rate Cottage.

For example, let's say the Board decides the overall percentage rate of increase is going to be 2 percent:

- That is applied to each Market Rate Cottages' annual rent to determine the dollar increase.
- Then all those dollar increases are added together to come up with the total dollar increase, let's say \$700 increase in total annual rent.
- This total dollar increase is then divided by the number of Cottages that are rented (7 MR Cottages would be an annual rent increase of \$100).
- Then that amount, \$100, is added to the annual rent for each Cottage.

Why can't we increase the Moderate Rate Cottages rental rate to whatever we want?

The Hamlet's building permit requires 7 "units" (the Moderate Cottages) must be operated in accordance with the "affordable housing" rules of HUD and County code. The rental rate must conform to the "Moderate" level determined according to the HUD rules. There are other rules which also apply, including that utilities (as defined by HUD) must be covered by the rent.

Why don't the Moderate Cottages receive an operating subsidy as many affordable housing projects receive?

LOHO financed construction with a commercial bank loan. The primary source of operating subsidies for affordable housing, HUD, provides the subsidy to those projects whose construction was financed with HUD or similar governmental loans. The State of Washington has some funds available (or did back in 2012) but those went only to facilities that provide rental rates at the "Very Low" or "Low" level, not "Moderate."

How is the Moderate rental rate calculated each year?

The rules are somewhat complicated, but we have worksheets and reports to help. The following summarizes the basic process.

Income Limits: Each year, usually in early April, HUD publishes income limits:

<https://www.huduser.gov/portal/datasets/il.html> (Select the year, then click the icon for the **Individual** Income Limits Documentation, then select WA and San Juan County, then View County Calculations). This will provide a table with the SJC Median Family Income (for a family of 4) and then various medians by income type and family size. The Very Low income type can be used to calculate the median income for a family of 1 or 2 (most typical for LOHO). Since Very Low is 50% of the median, doubling the number shown will provide the median needed for that family size. Note that there is a different median needed for each family size.

Eligibility: LOHO is assigned the "Moderate Income Range," which is 80% to 95% of the median for each family size. The "**Maximum Moderate Income**" (95% of the median for the family size) is used to determine eligibility. A resident's (or family's) gross income must be checked annually to determine eligibility. As long as their income is less than the Maximum Moderate Income figure, they are eligible.

Rental rate: The rental rate is 30% of the resident's gross income. If the resident's gross income is less than the "**Minimum Moderate Income**" (80% of the median for the family size), then the Minimum Moderate Income is used as the gross income to calculate the rental rate. A resident whose gross income falls between the Maximum and Minimum will need their rental rate calculated on their gross income and it may differ from the other Moderate resident rates. Most LOHO Moderate residents have income below the Minimum Moderate Income so the minimum rental rate applies.

The rental rate must also cover "Utilities," which include "water, sewage disposal, electricity and/or gas for lighting, heating and cooking." Since LOHO residents pay for their own electricity, they are reimbursed by lowering the rental rate for an average electricity cost (the other Utilities are normally included in LOHO rental rates). Then certain permitted adjustments are made increasing the rate *slightly* to cover services such as housekeeping, maintenance, grounds.

Are there any other restrictions on the Moderate Rate Cottages?

Of course. The best source for the rules is the Findings of Fact and Conditions from the SJC Hearing Examiner from February 2006 and SJC Code 18.60.260. Basically they include:

- Condition 7: LOHO must have 7 affordable units. The County clarified in December 2011 that the permit applies to LOHO as a whole and therefore the apartment in the Hamlet House may be treated as one of the 7 units if the above requirements for affordable housing are met.
- Condition 7: Rent only to the eligible individuals or families, as calculated above for Moderate Income.
- Condition 10: The resident **cannot own a home and shall sign an affidavit** to County Community Development and Planning saying the Cottage will be their primary residence and that they own no other home. LOHO keeps these affidavits on file but does not send them to the County, unless requested. In past years there were problems with this requirement if the home is for sale or the resident is not actively trying to sell it. LOHO developed a “grace period” procedure in 2014, but that too presented problems with non-compliance. The son of a resident contacted the County objecting to the prohibition, but the County insisted on conformance.
- Condition 21: Prohibits “the erection of accessory structures...or making additions to the units.” The resident “has no right to make **exterior or interior improvements.**” The County representative clarified in 2012 that she thought improvements could be made with the approval of the Board.
- Condition 21: Prohibits **subletting**.

Is there any time limit on how long the Moderate Cottages are subject to the HUD rules?

YES. Finding 17 states that the rental units must be subject to a contract...that assures “affordability for a minimum of 20 years.” This implies that in 2028 (assuming the 20 year period begins when Cottages were first rented, 2008) LOHO may be able to reduce the number of affordable units, if it so wishes. Care must be taken, however, given the language is not only in the building permit but also in the IRS tax exemption communications.

ACCOUNTS

Why is there a separate account for Long Term Maintenance expenditures?

In 2011 the Board decided to save towards Long Term Maintenance needs and set up two bank accounts with \$500 per month contributions from each facility. In 2016, financial difficulties at the Hamlet House required use of the Hamlet House Long Term Maintenance account money for operations, leaving only the Cottages Long Term Maintenance account.

In 2016 LOHO began a 5-year grant that could be applied to either facility but could only be spent on Long Term Maintenance expenses. The first year grant proceeds were deposited into the Cottages Long Term Maintenance account but in 2017 the Board decided that a separate account provided the best way to provide funding to either facility. This account tracks expenditures, assuring only Long Term Maintenance costs use the grant funds. This account also provides LOHO a record of Long Term Maintenance costs and timing.

In 2024 the accounting for this account was changed to a “Restricted Account” to track the expenditures from a large matching grant and the associated donations restricted by the donor to Long Term Maintenance uses only.

BUDGETS

What is the “gap”?

At the bottom of the Total Projected column on the monthly budget reports there is a “Gap”. This is the amount all of the current year revenues fell short or covered the current year expenses. This has often been referred to as the “Gap” and this gap is used in determining the fundraising needs.

What is the difference between Long Term Maintenance and the Budget item “Maintenance – Buildings”?

Generally, the budget item is for ongoing annual maintenance, repair and replacement. Long Term Maintenance reflects more major renovation, replacement of appliances and items with longer useful lives and major maintenance such as exterior painting. In accounting terms, the replacement of fixed assets that are “capitalized” (reflected on the balance sheet, but not treated as expense items) is usually treated as Long Term Maintenance while items that are “expensed” are usually treated as annual maintenance.

In 2023 the maintenance consultant created a Long Term Maintenance Plan for likely expenditures. This plan is used as a guide for creating the Long Term Maintenance budget.

REPORTS

Why are there two separate financial reports for the two facilities, rather than combined, since LOHO is a single nonprofit entity?

The USDA loan documents require that the revenues generated at the Hamlet House be spent only on Hamlet House operations and USDA debt, nothing else. Thus, the Hamlet House revenues and expenses had to be accounted for separately. This provides an added benefit in showing the revenues of that facility available to cover the costs for that facility, thus determining the “gap.” Some LOHO services (accounting, financial, payroll, legal, grounds, marketing) are mostly paid by the LOHO budget, since the Executive Director provides, or manages the contracts for, these services. This then requires reimbursement transfers from the Hamlet House for the costs of those services. The reimbursement amount is an estimate of the total cost to the LOHO budget.

The QuickBooks reports are for LOHO as an entity. The balance sheet (Financial Condition) covers all accounts and reserves of LOHO and the P&L report includes the three main accounts (Hamlet House, LOHO, Long Term Maintenance Account). The P&L report also contains several small restricted accounts and reserves.

Why do the monthly reports differ from the QuickBooks reports?

There are two QuickBooks reports, Profit & Loss and Financial Condition. These comprise the **accounting reports** for LOHO.

For management purposes, especially when checking balances were low, staff and the Board needed **cashflow reports** that showed how much revenue was actually available to pay bills and how much money was being expended on all costs. P&L statements do not show the payment of the principal portion due on loans, which were substantial and needed to be seen. P&L statements also do not show most transfers, so the LOHO P&L did not show the monthly transfer from the Hamlet House, which was needed to pay bills, and the Hamlet House P&L did not show this reimbursement cost. Therefore, the monthly reports were developed as cashflow reports which only show revenue coming in during the fiscal year which can be used to pay bills and the full amount of expenses that must be paid in the fiscal year (LOHO fiscal year is the calendar year). The cashflow reports help the Managers and Board see any shortfall in annual rental revenue to pay the annual costs (“the gap”) and thus if fundraising is needed for that year.

Why reduce forecast rental revenue, when the facilities are full, by occupancy percentages less than 100%?

The Hamlet House has only 8 beds that must generate enough revenue to pay the costs of 24/7 caregiving (that continues even when beds are not filled), so a bed empty for only a month has a significant revenue impact. Even if all beds are rented throughout the year, if there is a turnover, it must be empty a month or so to clean, repair and prepare the room for the next resident. Also, given the advanced ages of the residents, vacancies can be expected, but the timing is difficult to project. Sometimes the waiting list doesn't have a person who can move in immediately with short notice.

The Cottages have 14 units and at 100% occupancy they may come close to covering the costs (rising rents over the years have brought this closer). The 7 Moderate Cottages have rates which do not cover the costs, thus only the remaining 7 Market Rate Cottages can generate sufficient revenue. However, given the residents' advanced ages, it is unlikely that there would be no turnover and thus there needs to be time to clean, repair and prepare the Cottage for the new resident and in some cases, the Cottage may not be rented immediately, even with the waiting list.

Thus, to project the most likely case for rental revenue collection, the Board annually selects a percentage of occupancy that it feels best reflects the current experience and expectations and uses that to budget and forecast revenue. The total rent for the coming months is calculated assuming 100% occupancy, and then that total is reduced by the occupancy percentage (currently, 95% Cottages and 92% Hamlet House). This projected rental revenue amount is then added to the actual collected amount to date to provide the forecast total for the year.

DEBT***Why does LOHO have debt and what types?***

LOHO constructed the two facilities and owns them. The construction was funded from loans, donations and “individual debt” (refundable deposits or short-term loans from Lopez individuals that eventually were mostly forgiven).

LOHO debt for Hamlet House: LOHO obtained a 40-year construction loan from USDA. It must follow certain rules in the loan documents, including applying all revenues to Hamlet House operations and debt only.

LOHO debt for Cottages/GP: LOHO originally obtained a short-term construction loan from Islanders Bank. Upon completion of construction, it retired the short-term note with a long term variable rate Business Loan from Banner Bank (formerly Islanders Bank).

While eligible for a state fixed rate tax-exempt loan, the founders were concerned about the up-front cost of that loan and decided to pursue a commercial bank borrowing. LOHO may still be eligible for a fixed rate state loan to refinance the bank loan, but LOHO must locate a willing lender (the state program for this type of loan works through banks).

What does variable rate mean?

The current bank loan resets its interest rate every 5 years based on an “Index” which is now “the Bullet Rate for the 5-year FHLB (Federal Home Loan Bank) Fixed Rate Advances.” The loan rate is currently 4.45%.

The next rate reset is late spring of 2027 and cannot drop below 4.375%. The setting of the rate is detailed in the most recent Change of Terms Agreement dated April 27, 2022. In basic terms, the rate is set by adding a “Margin” of 2.5% to whatever the Index may be on the date of the reset (generally determined by the bank).