

# INTRODUCTION TO THE LOHO FINANCIAL SYSTEM – Revised November 2024

*The last draft of this report was prepared in late 2022.*

## LOPEZ HOUSING OPTIONS (“LOHO”) BACKGROUND

Lopez Housing Options is a 501c3 (“public charity”) tax exempt nonprofit corporation. “The Hamlet” is the name the Board chose to use for marketing and for community communications, but The Hamlet is not the legal name for use in official documents.

According to the Articles of Incorporation filed May 22, 2003, the purpose of LOHO is:

*“To develop, promote and manage alternative housing options on Lopez Island, Washington, with the specific purpose of addressing the needs for senior housing, assisted living facilities and affordable, low cost and moderate cost housing.”*

The LOHO Board held its first meeting April 27, 2004 and adopted the Bylaws December 15, 2004. The County Building Permit was approved February 2006 and construction loans were obtained September 2006 (USDA) and June 2007 (bank). Cottages and Hamlet House beds began renting in mid 2008.

In 2008, LOHO’s mission statement was:

*“The Mission of LOHO is to create and manage residential communities, with supporting services, that enable seniors to age in place on Lopez Island.”*

The mission statement was changed several times. In 2014, the LOHO Board approved the following mission statement:

*“The mission of The Hamlet / LOHO is to provide safe, convenient housing on Lopez Island for people 55 and over: an adult family home for six individuals needing 24-hour care and 14 garden cottages for rent to independent seniors. We offer almost half of our cottages and at least one room in our adult family home at reduced rent for those living on limited incomes.”*

One area of frequent confusion is that the Cottages or Hamlet House are not actual legal entities and cannot borrow or take actions as a separate legal entity; they are facilities operated by LOHO. LOHO is the nonprofit corporation and only LOHO can borrow or enter into contracts, etc. The LOHO Board can delegate certain responsibilities to its managers, such as contracting with staff or vendors, but the obligation is LOHO’s, even if the contract may limit the obligation to a facility’s revenues. For instance, the loans for each facility have certain provisions limiting the revenues of that facility to its loan and each loan has claims upon the property of the facility but not the revenues or property of the other facility. Yet both loan contracts are with LOHO, not with the facility. If one facility decided to close its doors or change its operations significantly, this might affect the entire Hamlet given the County Building permit, the IRS tax exemption and so forth are all with LOHO, the legal entity.

## LOHO OPERATIONS

LOHO owns only The Hamlet and operates The Hamlet’s two facilities:

**Hamlet House:** An 8 bed “adult family home.” As an adult family home, Hamlet House can only have 8 beds. Originally limited to 6 beds, the State recently agreed to allow up to 8 beds.

The option to change to an “assisted living facility” was explored several times, but the costs of the state requirements outweighed the benefits each time.

Staffing includes a salaried Administrator and/or a Resident Manager (“RM”), multiple caregivers and cook/cleaners who are paid on an hourly basis. The Administrator/RM manages all staff and operations at the Hamlet House. She/he reports to the Board Chair.

Apartment Hamlet House contains a separate apartment on the second floor, which is accessed only by the staircase indoors. This was originally intended to house the Administrator/RM at a reduced rental rate; however, several Administrators did not wish to live there. Therefore, it has been rented to others, including some not related to Hamlet House. The USDA representative approved rental of the apartment to non-residents or staff as long as the rental income remains with the Hamlet House. Currently the apartment is not rented. Any major modifications or renovations must be approved by USDA.

**Cottages:** An “independent senior living” facility with 7 duplex cottages: 7 units “Market Rate” and 7 units “Moderate Rate,” the latter being subject to county and federal “affordable housing” rules. As a condition of the County building permit, 7 “units” at The Hamlet must remain affordable housing in

the "Moderate" income category. At one point the Hamlet House apartment was rented to a low income senior whose lease conformed to the affordable housing rules, therefore allowing it to be counted as one of the 7 required affordable units. The County approved the apartment as one of the 7 "units" thus allowing 8 market rate and 6 affordable rate Cottages.

Staffing includes a salaried Executive Director, and usually a Cottages Manager. Through professional services contracts, a Personal Assistant, accountants and as-needed professional assistance, including maintenance, are hired on an hourly basis. The Executive Director manages all staff, maintenance and operations at the Cottages and GP as well as Hamlet grounds. She/he also manages all financial reporting for LOHO generally, Cottages and Hamlet House. LOHO hires accountants to perform monthly accounting and to prepare the IRS 990 tax return for LOHO. The Executive Director reports to the Board Chair.

Gathering Place ("GP"): The GP is an area which houses the LOHO office, the LIHHS office and serves as the residents' space for gathering as a common "living room." All Cottages financial reports and budgets include the GP as it was partially financed by the same bank loan.

The GP may not be rented out for any purpose not acceptable to the Cottages residents and must conform to any rules applicable to a 501c3 tax exempt nonprofit.

There is a kitchen in the GP which, according to the San Juan County "Conditional Permit Agreement," dated January 9, 2008, can only be used as a "Warming Kitchen." According to the permit agreement, the kitchen

*"is only to be used for the warming, assembly, serving and clean-up for foods previously cooked, baked, or otherwise prepared at other facilities."*

Therefore, LOHO may not use the kitchen to prepare meals for the residents on a regular basis (as do many other independent housing facilities). Use of the kitchen is limited to the Cottages residents, shall not be used for any commercial purposes and shall not be made available or open to the general public.

LIHHS Office: In 2006 Lopez Island Home and Hospice Support ("LIHHS") contributed a non-refundable \$10,000 to the construction of the GP in return for a long-term lease (25 years). In 2008 the lease was negotiated, finalized and signed. The lease was renegotiated July 26, 2021 and allows annual increases on the base rent of \$500 for property taxes and utility expenses allocated to the leased premises.

## LOHO ACCOUNTS

LOHO has several accounts which manage funds for specific purposes.

- Hamlet House:** The checking account holds the revenue from Hamlet House operations, mostly resident rent, and pays the costs of operation, annual maintenance and debt (by transfers to the USDA Debt Service Account). This account reimburses the LOHO checking account for certain services provided by LOHO staff including bookkeeping, accounting and financial reporting, legal services, grounds maintenance, marketing, etc. A portion of the account balance is invested in a Vanguard mutual fund.
- LOHO:** The checking account holds the revenue from Cottages operations, mostly resident rent, and pays the costs of operation, annual maintenance and debt. Any general costs of LOHO are paid from this account. It also collects any unrestricted donations and grants (formerly deposited to the Unrestricted Donations Account). A substantial portion of the account balance is invested in the LPL investment account.
- Long Term Maintenance Reserve:** This reserve was established by the Board in 2017 to hold funds set aside to pay the costs of long term maintenance on the two facilities. A substantial matching grant was received and fully matched in 2024. Additional donations were also received. Most of the account balance is invested in Vanguard mutual funds.
- Unearned Revenue Reserve:** This reserve was established by the Board in October 2020 to hold the residents' refundable security and last month rent deposits ("unearned income") for the Cottages (including LIHHS) and Hamlet House until a resident terminates their lease. If repairs are required and are payable from the **security deposit**, such repairs may be paid directly from this account, and the remainder is refunded to the resident. If needed to cover the final rent, the **last month rent** amount is transferred to the facility checking account upon lease termination, otherwise, it is refunded to the resident. Currently a portion of the account balance is invested in the LPL investment account.
- Hamlet House Money Market:** This bank account manages two subaccounts which are used solely for paying the USDA debt.
- USDA Debt Service Account:** This account holds the monthly \$4,520 Hamlet House transfers to fund the USDA loan payment in May, when the USDA automatically draws the annual payment from this account. It may not be used for any other purpose. If the payment is insufficient, the USDA will draw upon the Debt Reserve.
- USDA Reserve Account:** This "Debt Reserve" account holds the USDA required reserve to secure the loan. The reserve is fully funded at \$54,242 so no further deposits are required. If the account is drawn upon (by USDA) because the Debt Service Account lacks sufficient funds to make the annual payment, then the requirement for monthly deposits is resumed. The funds may only be used for the loan (not operations) and must be held until the loan is repaid in 2048. Currently this account is invested in the LPL investment account.
- In 2016, during financial difficulties, Hamlet House discussed the situation with the USDA representative and thereafter suspended making the monthly deposits to the two debt accounts. Thus, some of the reserve money was drawn to make the May 2016 payment. A "Gala" fundraising event raised a net \$34,300 which was deposited into the debt accounts. Monthly payments to both accounts resumed June 1, 2017.
- Cottages Loan Reserve** The Banner Bank loan documents require that a \$20,200 reserve be held until the loan is retired (currently June 5, 2044) or the Cottages have a "positive cash flow from operations" as determined by the bank. Currently this entire account is invested in the LPL investment account.
- Endowment Account** This account was established by the Board in December 2017 to hold assets donated to the Corporation "in perpetuity". The assets of the Endowment Fund shall not be invaded except on dissolution of LOHO. Income that accrues to the account may be used at the discretion of the Board. The concurrence of at least two-thirds of the members of the Board is necessary to approve any expenditures of income. Currently this entire account is invested in the LPL investment account.

## LOHO ACCOUNTING AND REPORTING

LOHO uses QuickBooks software to account for all financial transactions. The Executive Director enters the transactions. At the end of each month an accountant makes certain entries, reconciles with monthly bank statements and generates two financial statements:

- Profit & Loss and
- Financial Condition.

These statements are then processed by the finance volunteer who prepares, with the assistance of the Executive Director and Administrator/RM, Monthly Financial Reports (account cashflows) from the QuickBooks statements. In addition to the actual cashflow information, these reports provide comparative information regarding budgets as well as monthly forecasts for the remainder of the year.

During the year, transactions are recorded on a “cash basis” (when revenues received, when expenditures made). However, during the spring following year end, an accountant changes the basis to an “accrual basis” (when revenue or expenditure obligations are committed to), making adjustments as needed.

## LOHO TAX RETURN

An accountant prepares the federal tax return, the Form 990. The Board is required by law to review this tax return before it is submitted to the IRS.

## LOHO DEBT

LOHO has two loans outstanding. Both loans are secured by not only a foreclosable lien on all the property, but also by a pledge of all rent and certain other revenue of the facility. Thus, these are not conventional mortgage loans, but rather, a “Bank Business Loan” (Cottages) or a “Debt Issue” (USDA).

**USDA Loan:** The original principal amount of the 2006 loan was \$998,000. This was reduced by \$27,000 in 2008, which will shorten the term of the loan slightly from its original 40 years, if all payments are made on time and in full. The annual payment amount is \$54,242, paid in May, at a fixed interest rate of 4.5%.

This loan is secured by all “real and personal property” on the Hamlet House parcel and also by a pledge of “all rents and other revenue or income therefrom.” Thus, the Hamlet House revenue may not be used for any purpose other than Hamlet House operations or debt. This restriction is what necessitated separate facility accounts. Since the LOHO account pays for some Hamlet House accounting, legal, marketing and other similar professional services, the USDA accepted a monthly transfer to reimburse the LOHO account for the Hamlet House share of these costs.

The loan documents (primarily, the Loan Resolution Security Agreement) contain a few other restrictions (other than the debt service account and reserve discussed earlier):

<u>Investment of funds:</u>	Any Hamlet House money can only be invested in institutions insured by the State or Federal Government or invested in readily marketable securities backed by the full faith and credit of the United States.
<u>Construction or renovations:</u>	The primary concern is any construction or renovation for purposes not considered consistent with the adult family home purpose, especially to the apartment. USDA must review any plans prior to construction.
<u>Compliance Review:</u>	A “Compliance Review and Security Inspection” is required every 3 years. This includes the preparation of an “Affirmative Fair Housing Marketing Plan.”
<u>Bylaws changes:</u>	Copies must be sent to USDA.

**Bank Loan:** After funding construction with an interim loan, LOHO and Islanders Bank (now Banner Bank) negotiated a Business Loan Agreement, dated June 18, 2007, for funding up to a maximum of \$1,500,000. The master agreement (“Business Loan Agreement” of 2007) lays out most of the details of this loan.

The Promissory Note details the main provisions of the loan and this Note has been modified multiple times. The most recent Promissory Note is dated June 4, 2019 for a principal amount of \$1,372,000 and a maturity date of June 5, 2044. This Note was modified by a Change in Terms Agreement dated 4/27/2022. The principal amount became \$1,287,232.25 and the interest rate was reset as well as the reset period and the terms of the reset.

The interest rate is a variable rate which now changes every 5 years (prior to 2022 the rate changed every 3 years). The current rate is 4.45% and should reset in 2027. Details on how this rate is calculated can be found in the Change in Terms Agreement. Based on the current rate, the monthly debt payments are \$7,646.14. On June 5, 2027, the rate would increase to 5.65% and the payment to \$8,359.63 if the "Index Rate" remains the same as it was on April 27, 2022; however, that is unlikely and the rate will adjust to the Index Rate occurring in spring 2027.

This loan is secured by two pledges:

1. The Deed of Trust gives the bank a "security interest" in all real property on the Cottages parcel and the parcel itself.
2. The Assignment of Rents Agreement also pledges the "Rents" which it defines as:
 

*"...all present and future leases, including...all rents, revenue, income, issues, royalties, bonuses, accounts receivable, cash or security deposits, advance rentals, profits and proceeds from the Property..."*

## LOHO FIXED ASSETS

LOHO has **fixed assets** relating to the two facilities and these are listed on the Financial Condition report. The amounts shown are the original construction or purchase price, not fair market value.

The amounts for **accumulated depreciation** are also shown on the Financial Condition report in the same location. These accumulated depreciation amounts are also shown on the monthly Net Worth Statements. The **annual depreciation** amounts for each facility are provided by an accountant at or after the end of the fiscal year on the QuickBooks P&L report. These depreciation amounts are not shown on the monthly cashflow reports, since no revenue is expended on depreciation.

## LOHO INSURANCE

LOHO retains Fortiphi Insurance in Blaine, Washington, as its insurance agent; however, prior to 2022 the insurance agency was Rice Insurance of Bellingham, Washington. Rice advised joining the Non Profit Insurance Program (NPIP) to obtain the various types of coverage required for LOHO's facilities and operations.

The coverage includes (contact Fortiphi for the most recent coverage levels):

- Property (Including Limited Quake)
- Equipment Breakdown
- General Liability/Professional Liability
- Non-Owned Auto Liability
- Wrongful Acts (Directors, Officers and Employees Liability)
- Crime

NPIP (from its website):

NPIP is an insurance cooperative created and managed by its members. After being confronted with unpredictable insurance premiums, constantly shifting coverages, and extremely limited risk reduction tools, a small group of nonprofit leaders created an alliance to take control of their insurance needs. In 2004, these original nonprofit organizations formed the Non Profit Insurance Program (NPIP).

Today NPIP provides insurance coverage and risk management services to hundreds of organizations across various nonprofit sectors.

To protect the program against any catastrophic claim, NPIP purchases an excess insurance policy to cover losses that exceed the self-insurance layer. In addition, NPIP's assets are protected against an abnormally high frequency of claims that may occur during a given year through its aggregate stop loss policy. This helps ensure the amount paid towards claims is capped in any one year and will likely never exceed a predetermined amount.