THIRD LAGUNA HILLS MUTUAL

Financial Statements and Supplementary Information

December 31, 2019 and 2018

(With Independent Auditors' Report Thereon)

THIRD LAGUNA HILLS MUTUAL

Table of Contents

KPMG LLP
Suite 700
20 Pacifica
Irvine, CA 92618-3391

Independent Auditors' Report

The Board of Directors
Third Laguna Hills Mutual:

Report on the Financial Statements

We have audited the accompanying financial statements of Third Laguna Hills Mutual (the Mutual), which comprise the balance sheets as of December 31, 2019 and 2018, and the related statements of operations, comprehensive income, changes in members' equity, and cash flows for the years 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 U.S. generally accepted accounting principles; 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 auditors' 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 Third Laguna Hills Mutual as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matter

Required Supplementary Information

U.S. generally accepted accounting principles require that the information included in schedule 1 on future major repairs and replacements be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Financial Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audits of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

Irvine, California
April 5, 2020

THIRD LAGUNA HILLS MUTUAL

Balance Sheets

December 31, 2019 and 2018

Assets		**2019**	**2018**
Cash and cash equivalents (note 3)	$	834,438	1,894,801
Accounts receivable and interest receivable, net of allowance for doubtful accounts of $782,725 in 2019 and $551,915 in 2018, respectively		406,748	442,470
Receivable from Golden Rain Foundation of Laguna Woods (note 5)		688,618	1,527,661
Prepaid expenses		807,109	195,117
Total current assets		2,736,913	4,060,049
Investments and restricted cash (note 3)		30,533,117	29,260,565
Beneficial interest in Golden Rain Foundation of Laguna Hills Trust (note 2(h))		5,324,513	5,460,742
Equity Interest in Golden Rain Foundation of Laguna Woods (note 2(h))		37,749,056	36,986,050
Total assets	$	76,343,599	75,767,406
Liabilities and Members' Equity			
Liabilities:			
Accounts payable and accrued expenses	$	2,429,597	2,604,255
Amounts payable for accrued compensation		629,534	646,315
Assessments and charges paid in advance		659,936	756,376
Income taxes payable (note 4)		80,710	—
Total current liabilities		3,799,777	4,006,946
Total liabilities		3,799,777	4,006,946
Members' equity		72,543,822	71,760,460
Total liabilities and members' equity	$	76,343,599	75,767,406

See accompanying notes to financial statements.

THIRD LAGUNA HILLS MUTUAL

Statements of Operations

Years ended December 31, 2019 and 2018

		2019	2018
Revenue:			
Member assessments:			
Operating	$	32,227,670	31,954,846
Golden Rain Foundation of Laguna Woods restricted funds (note 5)		1,391,256	1,464,480
Restricted funds (note 3)		13,459,997	13,154,417
Total member assessments		47,078,923	46,573,743
Other revenue:			
Chargeable services revenue		1,087,533	977,603
Laundry		210,085	132,633
Investment income		665,119	486,123
Lease and resale processing fees		432,062	410,125
Miscellaneous		563,128	426,785
Total other revenue		2,957,927	2,433,269
Total revenue		50,036,850	49,007,012
Expenses:			
Reimbursement to managing agent for compensation and related costs		12,590,828	13,052,566
Operating materials and supplies		1,375,711	1,342,619
Utilities and telephone		5,208,741	5,530,064
Professional fees		149,906	123,280
Legal fees		726,416	427,069
Repairs and maintenance		11,833,401	10,090,033
Insurance		1,512,536	1,267,140
Income taxes (note 4)		80,710	—
Golden Rain Foundation of Laguna Woods operating expenses		14,739,014	14,293,450
Payments to Golden Rain Foundation of Laguna Woods restricted funds (note 5)		1,391,256	1,464,480
Other		567,089	350,403
Total expenses		50,175,608	47,941,104
Net income before other changes		(138,758)	1,065,908
Other changes:			
Realized loss on available for sale investments (note 3)		(271,923)	—
Unrealized gain from voting interest in Golden Rain Foundation of Laguna Woods		763,005	328,201
Loss from beneficial interest in Golden Rain Foundation of Laguna Hills Trust		(136,229)	(143,050)
Net income	$	216,095	1,251,059

See accompanying notes to financial statements.

THIRD LAGUNA HILLS MUTUAL

Statements of Comprehensive Income

Years ended December 31, 2019 and 2018

		2019	2018
Net income	$	216,095	1,251,059
Other comprehensive loss:			
Unrealized gain (loss) on available-for-sale investments arising during the year, net:			
Unrealized holding gain (loss) arising during the period		567,267	(166,633)
Comprehensive income	$	783,362	1,084,426

See accompanying notes to financial statements.

THIRD LAGUNA HILLS MUTUAL

Statements of Changes in Members' Equity

Years ended December 31, 2019 and 2018

	Memberships				Total
	Number		Amount	Changes	members' equity
Members' equity, December 31, 2017	6,102	$	610,200	70,065,834	70,676,034
Net income	—		—	1,251,059	1,251,059
Unrealized loss on available-for-sale investments, net	—		—	(166,633)	(166,633)
Members' equity, December 31, 2018	6,102		610,200	71,150,260	71,760,460
Net income	—		—	216,095	216,095
Unrealized gain on available-for-sale investments, net	—		—	567,267	567,267
Members' equity, December 31, 2019	6,102	$	610,200	71,933,622	72,543,822

See accompanying notes to financial statements.

THIRD LAGUNA HILLS MUTUAL

Statements of Cash Flows

Years ended December 31, 2019 and 2018

		2019	2018
Cash flows from operating activities:			
Net income	$	216,095	1,251,059
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Loss from beneficial interest in Golden Rain Foundation of Laguna Hills Trust		136,229	143,050
Amortization of investment premium and discount, net		(386,543)	(2,586)
Unrealized gain from voting interest in Golden Rain Foundation of Laguna Woods		(763,005)	(328,201)
Effect of changes in operating assets and liabilities:			
Accounts and accrued interest receivable		35,722	(81,398)
Prepaid expenses		(611,993)	65,671
Receivable from Golden Rain Foundation of Laguna Woods		839,043	207,532
Payable for accrued compensation		(16,781)	(227,514)
Accounts payable and accrued expenses		(174,658)	466,683
Member assessments paid in advance		(96,440)	74,894
Income taxes payable		80,710	—
Net cash (used in) provided by operating activities		(741,621)	1,569,190
Cash flows from investing activities:			
Purchases of held-to-maturity investments		(21,800,527)	(17,780,931)
Maturities of held-to-maturity investments		19,779,105	18,869,770
Proceeds from payments and maturities of available-for-sale investments		21,739,276	3,191,222
Purchases of available-for-sale investments		(21,530,913)	(3,593,081)
Net cash provided by (used in) investing activities		(1,813,059)	686,980
Net (decrease) increase in cash and cash equivalents and restricted cash		(2,554,680)	2,256,170
Cash and cash equivalents and restricted cash, beginning of year		3,389,118	1,132,948
Cash and cash equivalents and restricted cash, end of year (note 2 (c))	$	834,438	3,389,118

See accompanying notes to financial statements.

(1) Organization

(a) General

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

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

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

(b) Assessments

The Mutual receives, on a monthly basis, assessments from its members (member assessments) to conduct its operations and to fund certain reserve accounts as discussed in note 2(g). For 2019 and 2018, the members were assessed Mutual basic monthly assessments of $637.22 and $628.42, respectively, per manor per month, for direct and Mutual shared operating costs, Mutual reserve contributions, and GRF shared operating expenses and restricted funds. The Mutual basic monthly assessment does not include surcharges for those manors with common laundry facilities, elevators, and/or Garden Villa recreation rooms.

The total assessed to the members of the Mutual for Mutual basic costs and surcharges and GRF costs was $47,078,923 and $46,573,743, respectively, in 2019 and 2018.

(2) Significant Accounting Policies

(a) Basis of Presentation

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

(b) Comprehensive Income

Accounting Standards Codification (ASC) Topic 220, *Comprehensive Income*, establishes standards for the reporting and display of comprehensive income. Comprehensive income is defined as all changes in an entity’s equity, except changes resulting from transactions with owners. It differs from net income, in which certain items currently recorded to equity would be part of comprehensive income. Changes in accumulated other comprehensive income was as follows for 2019 and 2018:

		Unrealized loss on securities, net
Ending balance, December 31, 2017	$	(387,092)
Net current period other comprehensive loss		(166,633)
Ending balance, December 31, 2018		(553,725)
Net current period other comprehensive loss		567,267
Ending balance, December 31, 2019	$	13,542

(c) Cash and Cash Equivalents

For purposes of reporting cash flows, the Mutual considers all highly liquid investments with an original maturity of three months or less to be cash and cash equivalents.

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

		2019	2018
Cash and cash equivalents	$	834,438	1,894,801
Restricted cash		—	1,494,317
	$	834,438	3,389,118

(d) Investments and Restricted Cash

The Mutual accounts for investments and restricted funds under the provisions of ASC Topic 320, *Investments – Debt and Equity Securities*. This statement requires the Mutual to classify and account for investments in equity securities that have readily determinable fair values, and for all debt securities, into three categories: (1) debt securities that the Mutual has the positive intent and the ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost; (2) debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings; and (3) debt securities not classified as held-to-maturity securities or trading securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses excluded from earnings and reported as other comprehensive income. Equity securities including mutual funds not classified as held-to-maturity securities or trading securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses included in earnings during the year ended December 31, 2019.

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

(e) Fair Value Measurements

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

(f) Property

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

(g) Future Major Repairs and Replacements

A study was conducted by the Mutual in 2019 to estimate the remaining useful lives and current replacement costs of certain major components of common property. This study also considered future replacement costs of these certain major components based on the estimated useful lives, assuming a 3.0% inflation factor. The board of directors has a policy to plan additional fund contributions over the estimated useful lives of the components (on a current-cost basis) based on an annual analysis of the adequacy of the funds. Under the assumption that certain buildings would not be completely replaced within the next 30 years, replacement funds are not provided for those community facilities. Actual replacement costs when expended may vary from the estimated future expenditures considered in the fund analysis, and the variations may be material. If additional monies are needed, the Mutual has the right to adjust the monthly assessment, impose special assessments, or delay expenditures as appropriate.

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

The Mutual reports its 47.91% interest in GRF based on the non-Trust net assets of GRF to reflect the significant influence the Mutual exercises over GRF through its voting interest in accordance with ASC Topic 323, *Investments – Equity Method and Joint Ventures*. Such interest totaled $37,749,056 and $36,986,050 at December 31, 2019 and 2018.

The Mutual also has a beneficial interest in Golden Rain Foundation of Laguna Hills Trust (the Trust), which holds certain community facilities in trust for the Village Mutuals. The Mutual's beneficial interest is calculated based on the Mutual's "trusteed sums," defined as the original contribution amounts as stated in the trust agreement, and totals $5,324,513 and $5,460,742, respectively, at December 31, 2019 and 2018.

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

		2019	2018
Cash and cash equivalents	$	2,731,180	4,110,259
Receivables		1,445,309	1,543,311
Income tax receivable		46,377	45,407
Other current assets		2,483,748	1,870,881
Restricted funds and investments		21,895,591	23,869,568
Property and equipment, net		58,814,798	55,538,601
Community facilities, net		11,185,066	11,522,516
Intangible assets, net		235,982	282,184
Total assets	$	98,838,051	98,782,727
Accounts payable and accrued liabilities	$	6,019,484	5,971,734
Payables to Laguna Woods Mutuals		2,056,698	3,380,132
Deferred income		613,419	537,493
Total liabilities		8,689,601	9,889,359
Members' equity in Golden Rain Foundation of Laguna Woods		78,789,245	77,196,713
Noncontrolling interest in consolidated trust		11,359,205	11,696,655
Total equity		90,148,450	88,893,368
Total liabilities and equity	$	98,838,051	98,782,727
Third Laguna Hills Mutual's 47.91% interest in Golden Rain Foundation of Laguna Woods	$	37,749,056	36,986,050

(i) Income Taxes

The Mutual provides for income taxes in accordance with ASC Topic 740, *Income Taxes*. ASC 740 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a threshold of more likely than not for recognition of tax benefits of uncertain tax positions taken or expected to be taken in a tax return. ASC 740 also provides related guidance on measurement, derecognition, classification, interest and penalties, and disclosure. Management believes that no uncertain tax positions requiring accrual or disclosure existed at December 31, 2019 and 2018. The open years for federal and state tax assessments are 2016–2019 for federal and 2015–2019 for California.

(Continued)

(j) Concentration of Credit Risk

The Mutual had cash balances of $692,297 and $1,827,227, respectively, and restricted cash balances of $0 and $1,494,317, respectively, at December 31, 2019 and 2018, maintained in a commercial bank and that consist of cash on deposit. At December 31, 2019 and 2018, all noninterest-bearing deposit transaction accounts are Federal Deposit Insurance Corporation insured up to a maximum of $250,000, per depositor, per insured bank, for each account ownership category.

The Mutual also maintained a money market fund of $142,141 and $67,574, respectively, at December 31, 2019 and 2018, which was Securities Investor Protection Corporation insured up to the maximum of $500,000 per institution.

(k) Recent Accounting Pronouncements

On January 1, 2019, the Mutual adopted ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, during the year ended December 31, 2019. This guidance requires an entity to recognize revenue to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Mutual's revenue is derived primarily from assessments billed to residents. Assessments are recognized as revenue over the course of the year in the month for which they are earned. The adoption of ASU 2014-09 did not result in a material change to the timing of when revenue is recognized.

On January 1, 2019, the Mutual adopted ASU 2016-01, Financial Instruments-Overall: *Recognition and Measurement of Financial Assets and Financial Liabilities*. This guidance addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments including presentation of unrealized gains and losses associated with available-for-sale equity securities within the statement of operations instead of other comprehensive income. The adoption of ASU 2016-01 did not have a material impact on the Mutual's financial statements and disclosures.

On January 1, 2019, the Mutual adopted ASU 2016-18, *Statement of Cash Flows – Restricted Cash*, which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and restricted cash or restricted cash equivalents. The Mutual applied a retrospective transition method to each period presented.

(l) Use of Estimates

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

(m) Reclassifications

Certain reclassifications have been made to the 2018 financial statements to conform to the 2019 financial statement presentation.

(3) Cash and Cash Equivalents, and Investments and Restricted Cash

The Mutual's investments and restricted cash are presented as follows on the accompanying balance sheets at December 31, 2019 and 2018:

		2019	2018
Restricted cash	$	—	1,494,317
Restricted investments:			
Available for sale (at fair value):			
Index funds		16,569,280	—
U.S. Treasury notes		—	7,744,278
Governmental National Mortgage Association securities (GNMAs)		—	3,489,276
Corporate bonds		—	4,657,046
Total restricted investments at fair value		16,569,280	15,890,600
Held to maturity (at amortized cost):			
U.S. Treasury notes		12,277,370	11,875,648
Total restricted investment at amortized cost		12,277,370	11,875,648
Total restricted cash and restricted investments at fair value		28,846,650	29,260,565
Unrestricted Investments:			
Held to maturity (at amortized cost):			
U.S. Treasury notes		1,686,467	—
Total restricted cash, restricted and unrestricted investments	$	30,533,117	29,260,565

(Continued)

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

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

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

The Mutual's cash and cash equivalents and investments that are measured at fair value on a recurring basis as reflected on the accompanying balance sheets at December 31, 2019 and 2018 are as follows:

		2019		
		Level 1	**Level 2**	**Total**
Cash and cash equivalents	$	834,438	—	834,438
Investments and restricted cash:				
Restricted cash		—	—	—
Available for sale:				
Index funds		16,569,280	—	16,569,280
Total investments and restricted cash		16,569,280	—	16,569,280
Total cash and cash equivalents, and investments and restricted cash	$	17,403,718	—	17,403,718

		2018		
		Level 1	**Level 2**	**Total**
Cash and cash equivalents	$	1,894,801	—	1,894,801
Investments and restricted cash:				
Available for sale:				
Restricted cash		1,494,317	—	1,494,317
U.S. Treasury notes		7,744,278	—	7,744,278
GNMAs		—	3,489,276	3,489,276
Corporate bonds		—	4,657,046	4,657,046
Total investments and restricted cash		9,238,595	8,146,322	17,384,917
Total cash and cash equivalents, and investments and restricted cash	$	11,133,396	8,146,322	19,279,718

In November 2019 the Board of Directors approved a revised Investment Policy allowing bond holdings at investment grade ratings and directing the Mutual's Investment Manager to convert individual holdings of U.S. Treasury notes, GNMAs, and corporate bonds to a portfolio of index funds. In December 2019 the sale of previously owned holdings was executed and all proceeds were used for the immediate purchase of index funds. The valuation of the index fund portfolio used quoted prices in active markets for identical investments and are classified as Level 1 in the fair value hierarchy. Fair value of such investments totaled $16,569,280 at December 31, 2019.

Investments held to maturity comprised U.S Treasury notes, totaling $13,963,837 and $11,875,648 were carried at cost at December 31, 2019 and 2018, respectively. Fair value of such investments totaled $13,978,194 and $11,873,702 at December 31, 2019 and 2018, respectively, and were considered Level 1 in the fair value hierarchy.

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

		Purchase / Amortized cost	**Gross unrealized gains**	**Gross unrealized loss**	**Estimated fair value**
At December 31, 2019:					
Available for sale	$	16,555,738	13,542	—	16,569,280
Held to maturity		13,963,837	14,357	—	13,978,194

		Amortized cost	Gross unrealized gains	Gross unrealized loss	Estimated fair value
At December 31, 2018:					
Available for sale	$	16,444,326	30,582	(584,308)	15,890,600
Held to maturity		11,875,648	—	(1,946)	11,873,702

Due to the December 2019 conversion of individual holdings of U.S. Treasury notes, GNMAs, and corporate bonds to a portfolio of index funds, the 2019 unrealized gain on available-for sale investment balance of $281,802 was offset by the 2018 unrealized loss on available-for-sale investment of $553,725. The result of the conversion was a net realized loss on available-for-sale investments of $271,923 in 2019.

The Mutual determines realized gains and losses based on the specific-identification method. In 2019 realized gains and realized losses were as follows in 2019 and 2018:

Available for sale		2019	2018
Realized gain	$	128,640	—
Realized (loss)		(400,563)	—
Realized loss on available for sale, net	$	(271,923)	—

Restricted cash and investments consist of the following reserve funds:

		Replacement funds	Garden villa recreation room fund	Disaster fund	Unappropriated expenditures fund	Total
Balances, December 31, 2017	$	16,538,935	63,639	8,728,229	2,762,888	28,093,691
Member assessments		10,334,256	59,616	2,028,305	732,240	13,154,417
Net investment income and other contributions		259,345	1,518	138,269	45,267	444,399
Expenditures		(10,363,054)	(63,474)	(1,677,999)	(327,415)	(12,431,942)
Balances, December 31, 2018		16,769,482	61,299	9,216,804	3,212,980	29,260,565
Member assessments		10,763,928	81,972	2,028,305	585,792	13,459,997
Net investment income and other contributions		208,992	718	111,599	37,996	359,305
Expenditures		(11,663,965)	(71,036)	(2,287,219)	(210,997)	(14,233,217)
Balances, December 31, 2019	$	16,078,437	72,953	9,069,489	3,625,771	28,846,650

(a) Replacement Reserve Funds

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

(b) Garden Villa Recreation Room Fund

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

(c) Disaster Fund

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

(d) Unappropriated Expenditures Fund

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

(4) Income Taxes

The Mutual is considered a homeowners' association for federal and state income tax purposes and is liable for tax on nonexempt function net income. The provision for income taxes for the years ended December 31, 2019 and 2018 consists of the following:

		2019	2018
State taxes – current	$	—	—
Federal taxes – current		80,710	—
Total taxes	$	80,710	—

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2019 and 2018 are presented below:

		2019	2,018
Deferred tax assets:			
IRC Section 277 loss carryforwards	$	388,894	388,894
Net operating loss carryforwards		623,281	626,174
Capital loss carryforwards		79,864	—
Total gross deferred tax assets		1,092,039	1,015,068
Less valuation allowance		(1,092,039)	(1,015,068)
Total deferred tax assets	$	—	—

The valuation allowance for deferred tax assets as of December 31, 2019 and 2018 was $1,092,039 and $1,015,068, respectively. The net change in the total valuation allowance for the years ended December 31, 2019 and 2018 was an increase of $76,971 and $39,999, respectively. Based upon the level of historical taxable income and projections for future taxable income over periods, which the deferred tax assets are deductible, management believes it is more likely than not that the Mutual will not realize the benefits of the deductible differences. As such, the Mutual recorded a full valuation allowance against the deferred tax assets at December 31, 2019 and 2018.

At December 31, 2019, the Mutual has federal and state net operating loss carryforwards of $193,927 and $6,590,007 available to offset future federal and state taxable income, respectively. At December 31, 2018, the Mutual has federal and state net operating loss carryforwards of $193,927 and $6,337,548 available to offset future federal and state taxable income, respectively. The federal and state carryforward amounts expire in varying amounts between 2019 and 2037.

Income tax expense was computed by applying the U.S. federal income tax rate of 21% for both December 31, 2019 and 2018, respectively.

(5) Related Parties

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

(6) Pension Plans

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

During 2019 and 2018, VMS sponsored a 401(k) plan covering all eligible employees. Employee contributions to the plan are at the participants' discretion. In 2016, VMS made contributions into the plan for eligible nonunion employee participants. The Mutuals and GRF are not responsible for the management or ultimate funding of the 401(k) plan beyond the agreed-upon annual contributions.

Amounts contributed by VMS to these plans in 2019 and 2018, and reimbursed by the Mutual, totaled $364,577 and $331,261, respectively, for the defined-benefit pension plan and $52,322 and $52,766, respectively, for the 401(k) plan.

(7) Contingencies

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

(8) Subsequent Events

Subsequent events have been evaluated through April 5, 2020, which is the date the financial statements were available to be issued.

SUPPLEMENTARY INFORMATION

Schedule 1

THIRD LAGUNA HILLS MUTUAL

Future Major Repairs and Replacements

December 31, 2019

(Unaudited)

The Mutual contracted a study in 2019 to estimate the remaining useful lives and current replacement costs of major components of common property, except for certain land improvements, buildings, and building improvements for which major repair and replacement funds are not provided, as these items are expected to last the life of the community or to be maintained from general operating and/or preventive maintenance funds. The estimates were determined from past experience and from information obtained from certain contractors.

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

Major components	Estimated useful lives (in years)	Estimated remaining useful lives (in years)	Estimated current replacement costs	Estimated funding requirement as of December 31, 2019
Paved Surfaces	1 to 25	0 to 24	$ 8,739,557	5,483,679
Roofing & Gutters	0 to 40	0 to 35	18,750,000	6,833,603
Building Structures	0 to 20	0 to 20	14,295,300	5,608,317
Decking Projects	1	0 to 6	727,000	537,000
Prior to Painting & Painting Projects	1 to 20	0 to 10	27,537,800	15,572,925
Elevators	1 to 30	0 to 29	9,664,800	5,578,468
Garden Villas	0 to 20	0 to 21	1,597,050	456,163
Lighting Replacement Projects	0 to 1	0	97,750	97,750
Walls, Fencing & Railings	1	0	81,800	81,800
Laundry Facilities	1 to 20	0 to 21	370,502	200,789
Sewer Lines, Water Lines, & Electricity	0 to 1	0 to 14	2,881,700	1,564,500
Grounds & Miscellaneous	1	0	29,500	29,500
Landscape Projects	1	0 to 11	1,997,000	1,922,000
			$ 86,769,759	43,966,494

Replacement fund balance as of December 31, 2019 (note 3) $ 16,078,437

The Board voted to contribute $10,763,928 to the replacement funds in 2019. The contribution is included in the 2019 member assessments at $147 per manor per month. Actual replacement costs when expended may vary and the variations may be material.

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

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

See accompanying independent auditors’ report.