



THIRD LAGUNA HILLS MUTUAL

Financial Statements and Supplementary Information

December 31, 2022 and 2021

(With Independent Auditors' Report Thereon)

THIRD LAGUNA HILLS MUTUAL

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Independent Auditors' Report

The Board of Directors
Third Laguna Hills Mutual:

Opinion

We have audited the financial statements of Third Laguna Hills Mutual (the Mutual), which comprise the balance sheets as of December 31, 2022 and 2021, and the related statements of operations, changes in members' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Mutual as of December 31, 2022 and 2021, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Mutual and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Mutual's ability to continue as a going concern for one year after the date that the financial statements are available to be issued.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.



- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Mutual's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Mutual's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Required Supplementary Information

U.S. generally accepted accounting principles require that the information included in schedule 1 on future major repairs and replacements on page 17 be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by 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 GAAS, 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.

KPMG LLP

Irvine, California
April 7, 2023

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Balance Sheets

December 31, 2022 and 2021

Assets	2022	2021
Cash and cash equivalents (note 3)	\$ 135,623	198,457
Accounts receivable and interest receivable, net of allowance for doubtful accounts of \$643,110 in 2022 and \$463,566 in 2021, respectively	84,306	218,076
Receivable from Golden Rain Foundation of Laguna Woods (note 5)	1,292,193	479,350
Income tax receivable (note 4)	31,029	31,029
Prepaid expenses	3,332,534	2,818,713
Total current assets	4,875,685	3,745,625
Investments and restricted cash (note 3)	31,086,860	28,949,011
Beneficial interest in Golden Rain Foundation of Laguna Hills Trust (note 2(g))	4,950,211	5,055,140
Equity Interest in Golden Rain Foundation of Laguna Woods (note 2(g))	42,272,100	41,073,262
Total assets	\$ 83,184,856	78,823,038
Liabilities and Members' Equity		
Liabilities:		
Accounts payable and accrued expenses	\$ 2,846,226	3,429,091
Amounts payable for accrued compensation (note 5)	598,365	596,103
Assessments and charges paid in advance	637,145	684,426
Total current liabilities	4,081,736	4,709,620
Total liabilities	4,081,736	4,709,620
Members' equity	79,103,120	74,113,418
Total liabilities and members' equity	\$ 83,184,856	78,823,038

See accompanying notes to financial statements.

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Statements of Operations

Years ended December 31, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Revenue:		
Member assessments:		
Operating	\$ 42,917,426	34,631,177
Golden Rain Foundation of Laguna Woods restricted funds (note 5)	1,610,928	1,391,256
Restricted funds	<u>12,811,362</u>	<u>13,632,138</u>
Total member assessments	<u>57,339,716</u>	<u>49,654,571</u>
Other revenue:		
Chargeable services revenue	1,087,996	738,934
Laundry	213,498	214,443
Investment income	16,709	88,640
Amortization of investment discount	187,965	—
Lease and resale processing fees	452,924	460,398
Income tax benefit (note 4)	4,240	5,024
Miscellaneous	<u>298,580</u>	<u>279,977</u>
Total other revenue	<u>2,261,912</u>	<u>1,787,416</u>
Total revenue	<u>59,601,628</u>	<u>51,441,987</u>
Expenses:		
Amounts paid to VMS for compensation	13,237,185	12,915,986
Operating materials and supplies	1,408,555	1,420,625
Utilities and telephone	5,887,317	5,821,810
Professional fees	130,160	67,881
Legal fees	268,778	382,074
Repairs and maintenance	8,660,179	9,078,503
Insurance	8,311,811	6,491,514
Golden Rain Foundation of Laguna Woods operating expenses	15,831,070	15,039,359
Payments to Golden Rain Foundation of Laguna Woods restricted funds (note 5)	1,610,928	1,391,256
Other	<u>356,153</u>	<u>266,911</u>
Total expenses	<u>55,702,136</u>	<u>52,875,919</u>
Net income (loss) before other changes	3,899,492	(1,433,932)
Other changes:		
Realized loss on available-for-sale investments (note 3)	(3,699)	(15,377)
Unrealized loss on available-for-sale investments	—	(450,949)
Unrealized gain from voting interest in Golden Rain Foundation of Laguna Woods	1,198,838	1,479,140
Loss from beneficial interest in Golden Rain Foundation of Laguna Hills Trust	<u>(104,929)</u>	<u>(134,497)</u>
Net income (loss)	<u>\$ 4,989,702</u>	<u>(555,615)</u>

See accompanying notes to financial statements.

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Statements of Changes in Members' Equity

Years ended December 31, 2022 and 2021

	Memberships		Changes	Total members' equity
	Number	Amount		
Members' equity, December 31, 2020	6,102	\$ 610,200	74,058,833	74,669,033
Net loss	—	—	(555,615)	(555,615)
Members' equity, December 31, 2021	6,102	610,200	73,503,218	74,113,418
Net income	—	—	4,989,702	4,989,702
Members' equity, December 31, 2022	6,102	\$ 610,200	78,492,920	79,103,120

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended December 31, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Cash flows from operating activities:		
Net income (loss)	\$ 4,989,702	(555,615)
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Loss from beneficial interest in Golden Rain Foundation of Laguna Hills Trust	104,929	134,497
Realized loss on available-for-sale investments	3,699	—
Unrealized loss on available-for-sale investments	—	450,949
Amortization of investment discount	(187,965)	—
Unrealized gain from voting interest in Golden Rain Foundation of Laguna Woods	(1,198,838)	(1,479,140)
Changes in operating assets and liabilities:		
Accounts and interest receivable	133,770	(45,806)
Prepaid expenses	(513,821)	471,683
Receivable from Golden Rain Foundation of Laguna Woods	(812,843)	(125,172)
Payable for accrued compensation	2,262	47,811
Accounts payable and accrued expenses	(582,865)	(212,738)
Member assessments paid in advance	(47,281)	(75,329)
Income taxes receivable	—	(5,024)
Net cash provided by (used in) operating activities	<u>1,890,749</u>	<u>(1,393,884)</u>
Cash flows from investing activities:		
Purchases of held-to-maturity investments	(42,161,519)	(4,499,871)
Maturities of held-to-maturity investments	11,989,028	8,499,765
Proceeds from sales of available-for-sale investments	4,996,342	100,187,839
Purchases of available-for-sale investments	—	(80,431,853)
Net cash (used in) provided by investing activities	<u>(25,176,149)</u>	<u>23,755,880</u>
Net (decrease) increase in cash and cash equivalents and restricted cash	(23,285,400)	22,361,996
Cash and cash equivalents and restricted cash, beginning of year	<u>24,147,427</u>	<u>1,785,431</u>
Cash and cash equivalents and restricted cash, end of year (note 2b)	<u>\$ 862,027</u>	<u>24,147,427</u>

See accompanying notes to financial statements.

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Notes to Financial Statements

December 31, 2022 and 2021

(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(f). For 2022 and 2021, the members were assessed Mutual basic monthly assessments of \$777.12 and \$672.22, 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 \$57,339,716 and \$49,654,571, respectively, in 2022 and 2021.

(2) Significant Accounting Policies

(a) Basis of Presentation

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

(b) Cash and Cash Equivalents

For purposes of reporting cash flows, the Company considers all highly liquid investments with an original maturity of three months or less to be cash and cash equivalents. The total balance of cash and cash equivalents at December 31, 2022 and 2021 is \$135,623 and \$198,457, respectively.

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Notes to Financial Statements

December 31, 2022 and 2021

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:

	<u>2022</u>	<u>2021</u>
Cash and cash equivalents	\$ 135,623	198,457
Restricted cash	<u>726,404</u>	<u>23,948,970</u>
Total cash and cash equivalents and restricted cash	<u>\$ 862,027</u>	<u>24,147,427</u>

(c) *Investments*

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 years ended December 31, 2022 and 2021.

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.

(d) *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).

(e) *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

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Notes to Financial Statements

December 31, 2022 and 2021

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.

(f) Future Major Repairs and Replacements

A study was conducted by the Mutual in 2022 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 reserve funds. Under the assumption that certain buildings would not be completely replaced within the next 30 years, replacement funds also provide for major repair of the common property. 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.

(g) 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 \$42,272,100 or 47.91% of \$88,229,674 and \$41,073,262, or 47.91% of \$85,727,477, at December 31, 2022 and 2021.

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 adjusted for earnings (loss), and totals \$4,950,211 and \$5,055,140, respectively, at December 31, 2022 and 2021.

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Notes to Financial Statements

December 31, 2022 and 2021

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

	<u>2022</u>	<u>2021</u>
Cash and cash equivalents	\$ 4,440,915	2,581,444
Receivables from Laguna Woods Mutuals	765,496	571,084
Receivables	1,237,202	1,285,950
Income tax receivable	10,000	10,000
Other current assets	3,117,448	2,837,515
Investments and restricted cash	33,013,304	29,406,430
Property and equipment, net	56,174,610	57,359,627
Community facilities, net	10,257,887	10,517,803
Intangible assets, net	85,573	143,580
Total assets	<u>\$ 109,102,435</u>	<u>104,713,433</u>
Accounts payable and accrued liabilities	\$ 8,472,924	7,204,521
Payables to Laguna Woods Mutual	1,345,602	533,196
Deferred income	622,209	556,287
Income tax payable	—	10
Total liabilities	<u>10,440,735</u>	<u>8,294,014</u>
Members' equity in Golden Rain Foundation of Laguna Woods	88,229,674	85,727,477
Noncontrolling interest in consolidated trust	10,432,026	10,691,942
Total equity	<u>98,661,700</u>	<u>96,419,419</u>
Total liabilities and equity	<u>\$ 109,102,435</u>	<u>104,713,433</u>

(h) 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, 2022 and 2021.

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Notes to Financial Statements

December 31, 2022 and 2021

(i) Concentration of Credit Risk

The Mutual had cash balances of \$135,623 and \$198,457, and restricted cash balances of \$726,404 and \$3,768,611 at December 31, 2022 and 2021, respectively, maintained in a commercial bank and that consist of cash on deposit. At December 31, 2022 and 2021, all noninterest-bearing deposit transaction accounts were Federal Deposit Insurance Corporation (FDIC) insured up to a maximum of \$250,000, per depositor, per insured bank, for each account ownership category.

The Mutual also maintained restricted money market fund balances of \$0 and \$20,180,359 at December 31, 2022 and 2021, respectively. At December 31, 2021, the money market funds were Securities Investor Protection Corporation insured up to a maximum of \$500,000 per institution.

(j) 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.

THIRD LAGUNA HILLS MUTUAL

Notes to Financial Statements

December 31, 2022 and 2021

(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, 2022 and 2021:

	<u>2022</u>	<u>2021</u>
Restricted cash and cash equivalent:		
Restricted cash	\$ 726,404	3,768,611
Restricted money market	<u>—</u>	<u>20,180,359</u>
Total restricted cash	<u>726,404</u>	<u>23,948,970</u>
Restricted investments:		
Available-for-sale (at fair value):		
Certificate of Deposit Account Registry Service	<u>—</u>	<u>5,000,041</u>
Total restricted investments at fair value	<u>—</u>	<u>5,000,041</u>
Held-to-maturity (at amortized cost):		
U.S. Treasury notes	<u>30,360,456</u>	<u>—</u>
Total restricted investment at amortized cost	<u>30,360,456</u>	<u>—</u>
Total restricted cash and investments	<u>\$ 31,086,860</u>	<u>28,949,011</u>

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.

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Notes to Financial Statements

December 31, 2022 and 2021

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, 2022 and 2021 are as follows:

		2022		
		Level 1	Level 2	Total
Cash and cash equivalents	\$	135,623	—	135,623
Investments and restricted cash:				
Restricted cash		726,404	—	726,404
Total cash and cash equivalents and restricted cash	\$	<u>862,027</u>	<u>—</u>	<u>862,027</u>
		2021		
		Level 1	Level 2	Total
Cash and cash equivalents	\$	198,457	—	198,457
Investments and restricted cash:				
Restricted cash		23,948,970	—	23,948,970
Available-for-sale:				
Certificate of Deposit Account Registry Service (CDARS)		5,000,041	—	5,000,041
Total cash and cash equivalents, available-for-sale investments and restricted cash	\$	<u>29,147,468</u>	<u>—</u>	<u>29,147,468</u>

Investments held-to-maturity comprised of U.S. Treasury notes maturing one year from date of purchase, totaling \$30,360,456, were carried at amortized cost at December 31, 2022. Fair value of held-to-maturity investments totaled \$30,244,778 at December 31, 2022. Investments available-for-sale were comprised of CDARS of \$5,000,041 at December 31, 2021. Fair value of available-for-sale investments were \$5,000,041 at December 31, 2021 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, 2022:				
Held to Maturity	\$ 30,360,456	61	(115,739)	30,244,778

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Notes to Financial Statements

December 31, 2022 and 2021

	<u>Purchase/ amortized cost</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized loss</u>	<u>Estimated fair value</u>
At December 31, 2021:				
Available-for-sale	\$ 5,000,041	—	—	5,000,041

The Mutual determines realized gains and losses based on the specific-identification method. In 2022 realized gains and realized losses were as follows in 2022 and 2021:

<u>Available-for-sale</u>	<u>2022</u>	<u>2021</u>
Realized gain	\$ —	255,681
Realized loss	(3,699)	(271,058)
Realized loss on available-for-sale investments, net	<u>\$ (3,699)</u>	<u>(15,377)</u>

(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, 2022 and 2021 consists of the following:

	<u>2022</u>	<u>2021</u>
State taxes – current	\$ —	10
Federal taxes – current	(4,240)	(5,034)
Total tax (benefit) expense	<u>\$ (4,240)</u>	<u>(5,024)</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2022 and 2021 are presented below:

	<u>2022</u>	<u>2021</u>
Deferred tax assets:		
IRC Section 277 loss carryforwards	\$ 388,894	388,894
Net operating loss carryforwards	684,186	655,200
Capital loss carryforwards	73,639	72,604
Total gross deferred tax assets	1,146,719	1,116,698
Less valuation allowance	(1,146,719)	(1,116,698)
Total deferred tax assets	<u>\$ —</u>	<u>—</u>

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Notes to Financial Statements

December 31, 2022 and 2021

The valuation allowance for deferred tax assets as of December 31, 2022 and 2021 was \$1,146,719 and \$1,116,698, respectively. The net change in the total valuation allowance for the years ended December 31, 2022 and 2021 was an increase of \$30,021 and \$37,755, respectively. Based upon the level of historical taxable income and projections for future taxable income over periods, 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, 2022 and 2021.

At December 31, 2022, the Mutual has federal and state net operating loss carryforwards of \$193,927 and \$7,278,976 available to offset future federal and state taxable income, respectively. At December 31, 2021, the Mutual has federal and state net operating loss carryforwards of \$193,927 and \$6,950,858 available to offset future federal and state taxable income, respectively. The federal and state carryforward amounts expire in varying amounts between 2022 and 2040.

At December 31, 2022 and 2021 estimated federal income tax receivable was \$31,039 and estimated state income tax payable was \$10.

Income tax expense was computed by applying the U.S. federal income tax rate of 21% for both December 31, 2022 and 2021, 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. At December 31, 2022 and 2021, respectively, the Mutual had related party receivable balances of \$1,292,193 and \$479,350. The accompanying balance sheets also include amounts owed to VMS for accrued compensation of \$598,365 and \$596,103 at December 31, 2022 and 2021, respectively.

THIRD LAGUNA HILLS MUTUAL

Notes to Financial Statements

December 31, 2022 and 2021

(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 2022 and 2021, VMS sponsored a 401(k) plan covering all eligible employees and makes annual contributions to the plan. Employee contributions to the plan are at the participants' discretion. 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 2022 and 2021, and reimbursed by the Mutual, totaled \$466,623 and \$427,907, respectively, for the defined-benefit pension plans and \$74,794 and \$66,057, 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 7, 2023, which is the date the financial statements were available to be issued.

SUPPLEMENTARY INFORMATION

THIRD LAGUNA HILLS MUTUAL

Future Major Repairs and Replacements

December 31, 2022

(Unaudited)

The Mutual contracted a study in 2022 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, 2022
Paved surfaces	1 to 25	0 to 24	\$ 11,725,675	6,158,225
Roofing and gutters	1 to 40	0 to 29	57,640,495	30,549,255
Building structures	1 to 20	0 to 19	8,431,740	2,980,345
Decking projects	1	0 to 3	600,698	423,698
Prior to painting and painting projects	1	0 to 1	4,389,793	2,404,793
Elevators	1 to 40	0 to 29	6,217,000	3,464,518
Garden villas	1 to 10	0 to 28	906,176	245,736
Lighting replacement projects	1	0 to 1	65,500	12,500
Walls, fencing and railings	1	0 to 1	193,415	141,915
Laundry facilities	1 to 10	0 to 18	366,945	208,345
Sewer lines, water lines, and electricity	1	0 to 23	2,288,000	1,730,000
Grounds and miscellaneous	1 to 10	0 to 9	35,180	26,180
Landscape projects	1 to 5	0 to 2	1,891,429	1,695,789
			<u>\$ 94,752,046</u>	<u>50,041,299</u>

Replacement fund balance as of December 31, 2022 \$ 21,200,436

The Board voted to contribute \$10,690,704 to the replacement funds in 2022. The contribution is included in the 2022 member assessments at \$146.00 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.