Carlsbad Inn
BEACH RESORT

VACATION CONDOMINIUM OWNERS ASSOCIATION

3075 Carlsbad Blvd., Carlsbad, CA 92008

Financial Statements

December 31, 2016

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Independent Auditor's Report

To the Board of Directors and Owners
Carlsbad Inn Vacation Condominium Owners Association
Carlsbad, California

Report on the Financial Statements

We have audited the accompanying financial statements of Carlsbad Inn Vacation Condominium Owners Association (the Association), which comprise the statement of assets, liabilities and fund balance as of December 31, 2016, the related statements of revenues, expenses and changes in fund balance, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Association'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 Association'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 Carlsbad Inn Vacation Condominium Owners Association as of December 31, 2016 and the changes in its fund balance and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Accounting principles generally accepted in the United States of America require that the supplementary information on future major repairs and replacements on page 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Financial Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

RSM US LLP

San Francisco, California
May 30, 2017

Carlsbad Inn
BEACH RESORT
VACATION CONDOMINIUM OWNERS ASSOCIATION

Statement of Assets, Liabilities and Fund Balance

December 31, 2016

	Operating Fund	Replacement Fund	Total
Assets			
Cash	$ 1,827,523	$ 2,322,104	$ 4,149,627
Accounts receivable, net	26,914	–	26,914
Prepaid expenses	43,642	–	43,642
Due from related parties (Note 2)	371,772	–	371,772
Due from operating fund	–	330,802	330,802
Total assets	**$2,269,851**	**$2,652,906**	**$4,922,757**
Liabilities and Fund Balance			
Accounts payable and accrued liabilities	$ 79,226	$ 5,027	$ 84,253
Due to replacement fund	330,802	–	330,802
Assessments and deposits collected in advance	1,745,039	719,247	2,464,286
Total liabilities	**2,155,067**	**724,274**	**2,879,341**
Commitments and contingencies (Notes 2 and 4)			
Fund balance	114,784	1,928,632	2,043,416
Total liabilities and fund balance	**$2,269,851**	**$2,652,906**	**$4,922,757**

See notes to the financial statements

Carlsbad Inn
BEACH RESORT
VACATION CONDOMINIUM OWNERS ASSOCIATION

Statement of Revenues, Expenses and Changes in Fund Balance

Year Ended December 31, 2016

	Operating Fund	Replacement Fund	Total
Revenues:			
Assessments	$4,002,831	$1,682,015	$5,684,846
Interest	1,827	3,667	5,494
Room revenue and other income (Note 2)	697,244		697,244
Total revenues	4,701,902	1,685,682	6,387,584
Expenses:			
Front office	508,171	–	508,171
Housekeeping	1,219,988	–	1,219,988
Owner relations and guest activities	395,287	–	395,287
Administration and sales	731,553	17,287	748,840
Repairs, replacements and maintenance	630,187	425,784	1,055,971
Telephone and utilities	343,906	–	343,906
Fixed expenses	531,301	–	531,301
Insurance and property taxes	159,108	–	159,108
Safety and security	112,852	–	112,852
Uncollectible assessments, net	79,063	31,798	110,861
Provision for income taxes	800	–	800
Total expenses	4,712,216	474,869	5,187,085
Excess (deficiency) of revenues over expenses	(10,314)	1,210,813	1,200,499
Fund balance, beginning of year	125,098	717,819	842,917
Fund balance, end of year	$ 114,784	$1,928,632	$2,043,416

See notes to the financial statements

Carlsbad Inn
BEACH RESORT
VACATION CONDOMINIUM OWNERS ASSOCIATION

Statement of Cash Flows

Year Ended December 31, 2016

	Operating Fund	Replacement Fund	Total
Cash flows from operating activities:			
Excess (deficiency) of revenues over expenses	$ (10,314)	$1,210,813	$1,200,499
Adjustments to reconcile excess (deficiency) of revenues over expenses to net cash (used in) provided by operating activities:			
(Increase) decrease in operating assets:			
Accounts receivable, net	(4,753)	–	(4,753)
Prepaid expenses	58,650	–	58,650
Due from replacement fund	(371,772)	–	(371,772)
Due from operating fund	–	(20,659)	(20,659)
Increase (decrease) in operating liabilities:			
Accounts payable and accrued liabilities	29,241	(155,872)	(126,631)
Due to related parties, net	(68,155)	–	(68,155)
Due to replacement fund	20,659	–	20,659
Assessments and deposits collected in advance	55,089	16,195	71,284
Net cash (used in) provided by operating activities	**(291,355)**	**1,050,477**	**759,122**
Net (decrease) increase in cash	**(291,355)**	**1,050,477**	**759,122**
Cash, beginning of year	2,118,878	1,271,627	3,390,505
Cash, end of year	$1,827,523	$2,322,104	$4,149,627
Supplemental disclosure of cash flow information:			
Cash paid during the year for income taxes			$ 800

See notes to the financial statements

Notes to the Financial Statements

Note 1. Nature of Association and Summary of Significant Accounting Policies

Nature of association: Carlsbad Inn Vacation Condominium Owners Association (the Association) was incorporated on June 9, 1985, as a California nonprofit mutual benefit corporation with the specific and primary purpose of promoting the interests and welfare of the owners of vacation intervals situated in the project known as Carlsbad Inn Beach and Tennis Resort in Carlsbad, California. The Association comprises 6,732 Class A memberships, each of which is entitled to one vote.

In accordance with the Association's bylaws, each vacation interval owner is subject to basic, special and personal charge assessments by the Association.

A summary of significant accounting policies is as follows:

Basis of accounting: The financial statements of the Association have been prepared on the accrual basis of accounting. Accordingly, all significant receivables, revenues and gains are recognized when earned and expenses, liabilities and losses are recognized when incurred.

Fund accounting: The Association uses fund accounting, which requires that funds, such as the operating fund and replacement fund, be classified separately for accounting and reporting purposes. Disbursements from the operating and replacement funds are generally at the discretion of the Board of Directors (the Board) and Association management. Disbursements from the replacement fund generally may be made only for designated purposes.

Concentration of credit risk: The Association maintains its cash in bank accounts and money market accounts that exceed the federally insured limit of $250,000. The Association has not experienced any losses in such accounts.

Assessments collected in advance: For the year ended December 31, 2016, each vacation membership owner was assessed $874 for a one-bedroom unit and $999 for a two-bedroom unit, inclusive of the replacement fund assessment.

For the year ending December 31, 2017, each vacation membership owner was assessed $906 for a one-bedroom unit and $1,036 for a two-bedroom unit, inclusive of the replacement fund assessment.

The Association's policy is to bill the annual assessments in advance and recognize them as revenue on a pro rata basis over the period covered by the billing. As of December 31, 2016, the Association has billed in advance $5,820,317 of the 2017 assessment and collected $2,463,438, which is included in deferred assessments until earned.

Allowance for doubtful accounts: All assessments are due and payable on January 1 after the interval owner is billed or in quarterly installments if elected by the interval owner. Interest is charged on delinquent assessments at rates determined by the Board. The Association may suspend rights and privileges of interval owners with delinquent assessments as defined in the bylaws. The Association's policy is to write off all unpaid assessment receivables not collected by December 31 of the year in which the assessment pertains. Subsequent collection is recognized as a recovery in the year received, which is netted with the uncollectible assessments on the statement of revenues, expenses and changes in fund balance. For the year ended December 31, 2016, total bad debt recovery included in uncollected assessments was $31,534.The allowance for doubtful accounts on accounts receivable was $48,734 at December 31, 2016.

Common property: Property and equipment consist of vacation condominium units, common area (land and real property), common furnishings and Association personal property as defined in the Declaration of Covenants, Conditions and Restrictions. The Association does not capitalize land, real property and common furnishings directly associated with the vacation condominium units since the interval owners directly or indirectly own these assets. Should the Association directly acquire any personal property, it will be capitalized and depreciated by the straight-line method over its estimated useful life. Expenses incurred for the repair and replacement of commonly owned assets are reported as expenses in the replacement fund on the statement of revenues, expenses and changes in fund balance.

Replacement fund assessments: The Association has designated certain amounts as replacement funds to provide for the payment of future repair and rehabilitation expenditures, as specifically approved by the Association's Board. The Association's replacement fund program is subject to a reserve analysis study. The most recent study conducted on March 25, 2016, was prepared by Association Reserves San

Diego, LLC, who specializes in the preparation of reserve studies. The preparation of the reserve analysis is based upon certain assumptions in regard to existing reserve fund balances, inflation and investment rate factors, the estimated life span and the current cost of the reserve items. Furthermore, there will usually be differences between the projected and actual results because events and circumstances frequently do not occur as expected, and those differences may be material.

Based on the study and the estimates contained in the underlying report, the Association's management believes that the existing replacement fund program, together with the future business plan, is adequate to meet future repair and rehabilitation expenditures. Accordingly, the Association has budgeted approximately $1,709,458 of replacement fund assessments for the year ending December 31, 2017. Should such funds not be adequate, or if additional funds are needed, the Association has the right, subject to certain limitations, to increase the annual assessments, pass special assessments or delay the expenditures until funds are available.

Presentation of certain taxes: The Association collects various taxes, generally occupancy taxes, and remits these amounts to applicable taxing authorities. The Association's accounting policy is to exclude these taxes from revenues and expenses.

Accounting estimates: The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported as assets, liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues, expenses and related disclosures during the reporting period. Actual results could differ from these estimates.

Subsequent events: Management has assessed subsequent events through May 30, 2017, the date on which the financial statements were available to be issued.

Note 2. Related Parties

Management agreement: The Association is operated under an amended management agreement dated June 16, 1996, with a professional property management company, Grand Pacific Resorts Services, L.P. (GPRS), an affiliate of the developer. The Association's management budget is within the guidelines established by the California Bureau of Real Estate, which regulates common interest developments. Management fees under this agreement were $458,631 for the year ended December 31, 2016, of which $421,195 is allocated as fixed expenses under the operating fund and $37,436 is allocated as repairs, replacements and maintenance under the replacement fund on the statement of revenues, expenses and changes in fund balance.

Other: In addition, the Association shall compensate GPRS and Advanced Financial Corporation (AFC), an affiliate of the developer, for other services provided, including but not limited to assessments billing and collection; accounting and computer services; file and reservation system maintenance; owner relations service; and Board and members meetings coordination. The Association also reimburses GPRS for any out-of-pocket expenses paid. At December 31, 2016, the Association was owed from GPRS and AFC and other related parties $10,222 for services provided. The Association incurred $283,043 in expense for these services, which has been allocated to administration and sales, fixed expenses, and owner relations and guest activities in the operating fund on the statement of revenues, expenses and changes in fund balance.

Cost-sharing agreement: The Association has entered into a cost-sharing agreement with Carlsbad Inn Hotel (the Hotel), an affiliate of the developer, to share common operating costs. These expenses shall be shared between the Association and the Hotel based on the burden each places on the property, as measured by such factors as the number of rooms, square footage of rooms, occupancy rates and occupants per unit. At December 31, 2016, the allocation percentages for the Association and the Hotel were generally 80 percent and 20 percent, respectively. Under the cost-sharing agreement, the Association was owed from the Hotel $361,550 at December 31, 2016.

Unit week inventory: The Association, developer and Advanced Commercial Corporation (ACC), a company affiliated with the developer, entered into various agreements regarding unpurchased vacation intervals. The developer and ACC will bear the cost of foreclosing, deeding back, marketing and reselling the unpurchased vacation intervals. The developer will not be responsible for assessments on unpurchased vacation intervals. The Association will be responsible for property taxes on unpurchased vacation intervals.

Inventory management agreement: The Association entered into an inventory management agreement with GPRS. Under this agreement, GPRS will use its centralized management of resort interval inventory to maximize owner use of the property and ensure quality outbound exchanges for owners who wish to vacation elsewhere. The Association agrees to permit GPRS to manage, allocate and control resort room inventory and to use all room inventory that is not occupied. In exchange, GPRS guarantees the Association will receive the transient room revenue it has budgeted. The Association recognized $260,435 in guaranteed room revenue for the year ended December 31, 2016.

Note 3. Income Taxes

For federal tax purposes, the Association is taxed under Internal Revenue Code Section 528 as an exempt organization. The Association is taxed on its non-exempt income less expenses directly connected with the production of the non-exempt income. Exempt function income is not subject to tax. Income tax is calculated at 32 percent of taxable income.

For state tax purposes, the Association is organized as a non-exempt membership organization and is taxed on its excess nonmember income (principally interest and usage by nonmembers) at the normal corporate tax rates.

Federal and state income taxes totaled $0 and $800, respectively, for 2016.

Uncertain tax positions: The Association identifies and evaluates all uncertain tax positions and believes that positions taken are more likely than not to be sustained upon examination for all open tax years. The Association's tax returns are subject to examination by federal taxing authorities for a period of three years from the date they are filed and a period of four years for California taxing authorities.

Note 4. Operating Lease

Effective August 31, 1996, the Association has leased telecommunication equipment from GPRS. The Association has also granted GPRS the exclusive right to provide local and long-distance services and operator-assisted services. The term of the lease was 10 years and was subsequently renewed for an additional five years. The lease is currently being continued on a month-to-month basis. The Association pays approximately $4,602 per month (subject to a maximum 10 percent annual increase) for the leased equipment and remits user charges in accordance with the agreement. Telephone expense of $56,797 for the year ended December 31, 2016, included operating lease payments and charges incurred with long-distance carriers.

Supplementary Information on Future Major Repairs and Replacements (Unaudited)

Association Reserves San Diego, LLC conducted an updated no-site visit reserve study on March 25, 2016, to estimate the remaining useful lives and the replacement costs of the components of common property subject to future repairs and replacements. Estimated current replacement costs have been based on the average best and worst case estimates using the Association's cost history, database industry history, vendor history and national industry cost estimation guides. The estimated current replacement costs have not been revised since that date and do not take into account the effects of inflation between the date of the study and the date the components will require repair or replacement, or the costs incurred since the date of the study. During 2016 the Association conducted repairs and replacements totaling $338,348.

The following table is based on the no-site visit study conducted on March 25, 2016, and presents a condensed summary of information about the items of property. Recommended funding requirements are based on the assumptions that the inflation rate and interest rate are 3 percent and 1 percent, respectively.

Components	Estimated Remaining Life (in Years)	Estimated Current Replacement Costs
Building exterior	1-27	$ 1,384,710
Elm unit interiors	1-26	4,543,550
Oak unit interiors	0-28	5,440,900
Mechanical	0-21	1,181,400
Shared	0-19	1,778,800
Total		**$14,329,360**