

Investing Association Reserve Funds

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In making investment decisions the Board should use its best business judgment to protect the association's reserve funds. Always check your association's governing documents first for any specific investment limitations that have been imposed on the Board. Absent such document specific limitations, the Board should be primarily concerned with the security of the funds and ensure that any investment has very little risk. Investments in government securities or long term certificates of deposit are usually low risk. **Losses from investments in riskier or speculative securities could be personally charged to the individual Board members who authorized those investments.**

Accordingly, ordinary risk taking which may be recommended by an investment counselor not familiar with trusts or association reserve funds may not be appropriate in the context of community association investment options. An investment strategy in the community association context will be considered "risky" if has any significant risk of fluctuation over the life of the investment. You need to ensure that your funds are invested in accounts which are both safe and available. Put another way, let the following investment principles guide you in this order: First, preservation of principal. Second, liquidity. Third, return.

1. Preservation of principal. How safe is the investment? Is this a federally backed or otherwise insured investment? Some associations' governing documents expressly require association funds to be deposited into FDIC insured accounts or, at a minimum, into accounts which are otherwise sufficiently insured, so as to prevent the loss of any capital. Even if a particular association's CC&Rs and Bylaws reflect no such restriction, the reasoning behind this requirement that is found in so many other associations' governing documents nevertheless applies to all nonprofit mutual benefit corporations. The funds of the association are controlled by the Board of Directors for the benefit of all members. The Board in effect holds these funds in trust for the members of the association, and the Board should be guided by principles of fiduciary responsibilities applicable to trust investments. **Thus, safety of deposit and preservation of principle is the first and highest priority.**

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While cases in California relating to appropriate trust investments turn on the express terms of the trust instrument itself, and in the community association context there is generally no formal trust instrument to guide the Board, Civil Code Section 1365.5 provides important guidance. Civil Code Section 1365.5(c)(1) provides in pertinent part:

(c)(1) The board of directors shall not expend funds designated as reserve funds for any purpose other than the repair, restoration, replacement, or maintenance of, or litigation involving the repair, restoration, replacement or maintenance of major components that the association is obligated to repair, restore, replace, or maintain and for which the reserve fund was established.

The reserve funds must always be available to the association in order to fulfill the purposes expressly enumerated in this section. They may not be used for any other purpose other than the repair, restoration, replacement, or maintenance of, or litigation involving these purposes of the association.

The question is whether investment of the reserve funds, particularly in the more speculative options of riskier investments, is an "expenditure" of the funds for a purpose other than that which is expressly allowed under Civil Code Section 1365.5. No case clearly explains what is considered an "expenditure" in this sense.

Speculative investments should be avoided completely, lest a future challenge to such an investment strategy lead to a judicial interpretation that such speculation with the association's funds was an improper "expenditure" for money making purposes rather than ensuring the availability of these funds for the operation of the association and for the express purposes enumerated under the statute when needed.

2. Liquidity. After preserving principal, maintaining liquidity is the next most important factor when investing association funds. How readily available are the funds at any given time? Most professionals advising community associations would probably recommend SAFE investments (FDIC insured accounts) with maturity dates of between 2-3 years. In addition, such investments could be staggered at 90 or 180 day intervals each. This allows new cash money to be more readily available every 90-180 days each time an investment matures, with the option to roll over the money each time into something with the best interest available.

Consult your accountant about how best to liquidate these funds and get into a safer and more secure investment. We recommend obtaining at least 2-3 other opinions from investment counselors more familiar with association reserve account deposits. You can contact the local office of the Community Association's Institute to obtain a listing of all local representatives of investment firms with programs tailored to community associations.

3. Return. The last and least important principle governing investment of association funds should be return. How much can you gain in terms of interest rate or capital gain on your investment over time? If you can obtain in an investment that is readily available to the association and safely protect principal (which generally eliminates riskier investments from consideration), then the association should ***lastly*** consider the rate of return. Of course, all other things being equal concerning protection of principal and liquidity, the association should seek to get the highest rate of return on the deposited funds.

It is this firm's opinion that all investments should be in federally-insured Certificates of Deposit or Treasury Bills backed by the United States Government. We would urge the Board of Directors not to become involved in any type of risky or high-yield money market type accounts. Please keep in mind that the association is a non-profit organization which is required to preserve and protect the property of the community. We strongly discourage the investment in any uninsured accounts or poorly rated banks or savings institutions. Also, you should make sure that the amount invested in any given institution, including interest over the duration of the investment, stays lower than the maximum limit that federally-guaranteed insurance will cover. The Board of Directors should use reputable financial advisors to assist them in making the appropriate decisions regarding the investment of funds. Through the years we have found that the safest (but not necessarily the highest yield) investment is in Certificates of Deposit.