

Investing Association Funds

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Traditionally, advisors to community associations have recommended to their clients that association funds must be invested in “risk free” investments, with no potential for loss of capital. This results in association funds being invested in Certificates of Deposit or Money Market accounts which carry no potential for significant growth through strategic investments. Typically, higher risk investments, like stocks, have a higher expected investment return. They can also have a greater potential for loss. Lately, many community associations have been expressing an interest in moving at least some of their funds out of the traditional “no risk” investment model and into higher risk/higher return investments. What, if any, high risk investments is an association allowed to make?

We believe associations may put funds in higher risk investments if: (1) the association seeks advice from a qualified advisor; and (2) the association has complied with state statutes governing trusts discussed below. In addition, we recommend associations adopt a policy covering the investment of association funds. The purpose of such a policy is to clearly outline the association’s general tolerance for higher risk investments (i.e., the percentage of reserve funds which may be invested, or the type of investments which are acceptable) and to designate one or more board members with authority to make investment decisions within the policy.

There are no specific requirements in the Washington Condominium Act for how condominiums must manage their funds from an investment or savings perspective, beyond the general requirement that associations budget for reserves and maintain a separate segregated account for reserve funds.¹ The Washington Nonprofit Corporation Act (under which most associations are incorporated) also contains only general provisions.²

Since the Condominium Act and the Nonprofit Corporation Act provide little direction for a condominium board,³ the state statute governing probate and trusts gives some possible guidance.⁴ RCW § 11.100.020, “Management of trust assets by fiduciary,” gives specific direction to persons or companies who manage assets – including money and property – for another person as a trustee. The statute provides:

- (1) A fiduciary is authorized to acquire and retain every kind of property. In acquiring, investing, reinvesting, exchanging, selling and managing property for the benefit of another, a fiduciary, in determining the prudence of a particular investment, shall give

¹ 64.34.304(1)(b); 64.34.372

² RCW 24.03 *et seq.*

³ The WCA does provide that associations may “[e]xercise all other powers that may be exercised in this state by the same type of corporation as the association;” (RCW 64.34.304(1)(q)); and the Nonprofit Corporation Act provides that nonprofit corporations may “...lend money for its corporate purposes, invest and reinvest its funds, and take and hold real and personal property as security for the payment of funds so loaned or invested.” RCW 24.03.035(8)

⁴ RCW 11.100 *et seq.*

due consideration to the role that the proposed investment or investment course of action plays within the overall portfolio of assets....⁵

...

(3) Within the limitations of the foregoing standard, and subject to any express provisions or limitations contained in any particular trust instrument, a fiduciary is authorized to acquire and retain every kind of property, real, personal, or mixed, and every kind of investment specifically including but not by way of limitation, debentures and other corporate obligations, and stocks, preferred or common, which persons of prudence, discretion, and intelligence acquire for their own account.

Applying this statute to associations, a board is acting in a role much like a trustee by managing an association's money and property to pay for the current and future needs of the community. Part of this planning for the community could include making investment decisions that will give a greater return to an association over time (with the corresponding risk of loss). A board could, under this scenario, consider investing some association funds in accounts other than CDs, money markets or savings. For example, purchasing real property such as a unit in the Condominium; or purchasing stocks or bonds.

Ordinarily, a person or entity handling money for another has the standard of care of a fiduciary.⁶ A fiduciary is a person who holds a position of power and trust and must put the interests of those he is acting for in front of his own interests. A person charged with acting under a "fiduciary duty" is operating under the highest standard of care imposed by the law. Board members of an association are acting under a duty of "reasonable and ordinary care,"⁷ which is less than the standard of care of a fiduciary. If a board makes decisions based on the criteria set out for a fiduciary of a trust, the board is likely fulfilling its duty to other association members in managing association funds.

Associations must approach the investment of association funds from a "total asset management approach," including giving consideration to all of the assets currently owned by the association and the association's obligations (short term and long term) when making decisions about investments.⁸ Having a qualified advisor assist the board to consider each of the factors under RCW 11.100.020(2) and assist to make decisions about investments may be crucial to complying with the standard set out in the statute.⁹

The factors required to be considered under the statute when applying a "total asset management" approach include:

⁵ RCW 11.100.020(1) (emphasis added)

⁶ See e.g., RCW 11.100.020

⁷ RCW 64.34.308(1)

⁸ RCW 11.100.020(1)

⁹ RCW 11.100.020(2); "...In applying such total asset management approach, a fiduciary shall exercise the judgment and care under the circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, and if the fiduciary has special skills or is named trustee on the basis of representations of special skills or expertise, the fiduciary is under a duty to use those skills."

- (a) The probable income as well as the probable safety of their capital;
- (b) Marketability of investments;
- (c) General economic conditions;
- (d) Length of the term of the investments;
- (e) Duration of the association;
- (f) Liquidity needs of the association (which may be based on a Reserve Study);
- (g) Requirements of the association;
- (h) Other assets of the association, including other earnings and the ability to raise money from members; and
- (i) Effect of investments in increasing or diminishing liability for taxes.

A board must consider every factor set out in the statute. Boards should seek out an advisor who is qualified to represent the particular needs of associations (who has training and experience to understand the unique tax status of associations) to assist with considering the factors and making investment decisions. Boards should realize that a stock broker, Certified Financial Advisor, or Certified Financial Planner **may not be the appropriate advisor for a nonprofit condominium or homeowners association**. Absent some further training or experience, we would not advise a board to rely on a broker, CFA or CFP to assist an association in making investment decisions. Your property manager, attorney or accountant may have suggestions for an appropriate advisor.

Once an association has complied with the applicable legal standards and criteria, it may consider a broad range of investments. There are, however, considerations which are not “legal” that an association should take into account. Meaning, a board should take care to understand the temperament of their community and their community’s tolerance for risk and loss, even if a sound total asset management plan has been created. Some communities simply will not support an asset management plan which may result in any potential capital loss. In other words, some communities will not be able to handle the prospect that their reserves might shrink during the course of an investment plan.

In addition to considering the community’s “risk tolerance,” boards should consider whether they can maintain long-term community support of an investment plan. Some plans will take longer periods of time to result in significant net returns; if the board does not have confidence that the community or future boards will support the long-term investment plan, it may be wiser to avoid starting down that path at all. Educating the community about any investment or asset management plans, and seeking community consensus on investment decisions can make a significant difference in maintaining and growing reserve funds through investments. One word of caution: If you as a board member do not understand an investment product and what risk that product carries, don’t approve buying it. Stick to investments you understand, which may mean CDs and money market accounts.

Finally, it is recommended that an association adopt and publish a “Reserve Fund Investment Policy,” which, at a minimum, sets out: (1) the association objectives of having some funds invested; (2) the criteria the association will consider for an acceptable investment; (3) the percentage of total funds the association will consider investing; (4) those types of investments which are absolutely not acceptable to the association under any scenario; (5) the point at which

an association will pull out of investments based on risk or loss; and (6) the board member or members who have authority to make investment decisions. Examples of investment association policies can be found online and may also be available from your attorney, property manager or accountant.

What does all of this mean? Investing association money in a manner that is not risk free, even if it is a small percentage of an association's total assets, is a controversial topic. Some attorneys say an association cannot make this kind of investment at all. We disagree. Certainly, it is not a decision that should be made lightly. Most associations are corporations managing significant assets in property and cash, with sophisticated owners interested in putting those assets to their best use. It would be unwise for a board *not* to consider how to best maintain those investments for the benefit of the entire association.

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