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Federal Reserve Interest Rate Changes Awaken Discussions on Investing Association Funds

In an effort to curb inflation, the Federal Reserve, by virtue of the Federal Open Market Committee, recently increased the benchmark interest rate for the tenth time in just over a year. At the same time, several financial institutions are responding in kind and increasing the rates they offer to their deposit clients. Notwithstanding inflationary pressures, this is good news for associations with sufficient funds to cover regular operating expenses and fund major repair and replacement projects; however, there are several factors to consider before scouring the internet to find the highest available interest rate and transferring association funds.

First Consideration: Fiduciary Duty of Board Members

When deciding how and where to invest association dollars, board members should consider a balance between risk and return while also considering capital needs. As a fiduciary of the association, boards have a duty to act in the best interests of their community and its members. By doing so, directors and officers should exercise reasonable care in all decisions without placing undue risk on the association. Accordingly, board members should make good-faith investment decisions with the same level of care that an ordinarily prudent person in a similar position would make under the same circumstances.

Investment Policies Set the Stage for Success

Boards governing sizeable operating and reserve funds should consider adopting a formal written investment policy (if one is not already in place) which outlines specific guidelines for how the association will protect and invest their surplus funds. This strategic document should start with an examination of the association’s specific governing documents and state statutes to determine what (if any) restrictions may exist concerning investing association funds. The policy should obligate at least a majority of the board to openly discuss the important decision of prioritizing safety, liquidity, and yield - typically in that order. Financial decisions are extremely important to the association; therefore, the board of directors should dedicate adequate time and attention to the financial decisions that could affect the entire membership.

If an association has a significant surplus of operating or reserve funds, an investment policy could further provide that the board may engage a qualified investment counselor to assist in formulating a specific investment strategy within the parameters of the association’s covenants and policies. Since this type of independent professional investment assistance often comes at a cost to the association, many association boards choose instead to limit their investments to traditional interest-bearing savings accounts, like money market or certificate of deposit, which prevent the risk of loss, maximize access to funds, and earn steady competitive returns. Higher-risk investments like stocks, mutual funds, and non-governmental bonds are not commonly permitted in association covenants or found in investment policies since these types of investments may come with withdrawal penalties, offer no return, or have the possibility of principal loss. For this reason, board members considering investing in such riskier investment classes should first consider speaking with their attorney to ensure no regulations or conflicts. With the endorsement of the association’s counsel, the board may then engage a qualified investment professional (one without any direct ties to any board member or unit owner to avoid conflicts of interest) to outline the investment objectives and qualify performance expectations.

Safeguarding Funds While Invested

Since the safeguarding of funds is paramount, Boards should ensure that all deposit funds are insured by either the Federal Deposit Insurance Corporation ("FDIC"), the Securities Investor Protection Corporation ("SIPC"), or utilizing a comparable private depositor/surety bond. For large deposits, reciprocal deposit networks offer specialized investment products that protect cash deposits by spreading them across multiple banks. For instance, IntraFi’s “ICS” (Insured Cash Sweep) and “CDARS” (Certificate of Deposit Account Registry Service) financial products divide funds into amounts under the FDIC insurance limit and place them into interest-bearing accounts at multiple FDIC-insured banks. This ensures that funds are fully protected beyond the $250,000 FDIC insurance limit, with the added benefits of working with a single “relationship bank” to access the service, receive consolidated statements, and earn higher interest rates than a traditional savings account.

It should be noted that opening and supervising investment accounts can take time, which may require multiple board members to take action, provide personal verifying information (like a passport, driver’s license, or voter’s identity card), and sign documents (sometimes in person). Therefore, it's essential to research and compare the rates, fees, and services offered by different institutions before deciding. Further, keep in mind that advertised rates posted online can be promotional, unavailable to commercial depositors, and may have additional qualifying requirements and transactional fees to take advantage of higher yields.

While this rising rate environment may be around for the immediate short-term, sage boards will focus on the long-term strategy of codifying lasting policies and investment practices that protect the association’s assets and prepare the association for economic changes in the future.

The information contained in this article is provided for informational purposes only and should not be construed as legal advice. No recipient of this content should act or refrain from acting without seeking the appropriate legal or other professional advice. The FDIC insurance maximum per insured depositor per bank is $250,000. Published bank interest rate information from institutions that specialize in community association banking is part of valuable services exclusively available to community associations managed by Sentry Management. Banking rates and associated banking services are subject to change and can always be confirmed by assigned Community Association managers at any time.

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