



KEEP THE ASSOCIATION GREEN

This course is approved by the DBPR Council of Community Association Managers, for 4 hours of continuing education credit in the area of:
Insurance and Financial Management.

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Introduction

This Financial & Insurance Course discusses terms and strategies related to the investment of association monies. It is equally applicable to condominiums, cooperatives, timeshares, homeowners associations and mobile homes. The course is not designed to provide a specific strategy for any one association, but rather to help the manager and board by providing sufficient information to make informed decisions for their associations.

Some of the information presented in this course may not apply to every community association. However, the DBPR requires that community association managers be familiar with the laws and rules governing all types of associations. Further, by doing so, a manager may find him or herself more qualified to advance within the community association management profession.

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General Discussion

It would be difficult to understate the importance of the proper investment of operating and reserve funds for community associations and their members. Investments in instruments that a prudent person would consider risky or unsafe can result in loss of principal; the unavailability of monies when necessary to operate and maintain association property; loss of potential interest revenue.



Board and committee members may vary widely in their investment experience, philosophy, and tolerance for risk. They may not fully understand constraints placed on them as fiduciaries or that community associations typically limit themselves to a few conservative-type investments.

Many boards of directors diligently prepare operating and reserve fund budgets to serve as a financial plan or road map for the proper operation and continued maintenance of their association's property.

Few boards go through the formalization of an investment policy for the reserve and operating monies that they assess for, although some have policies addressing risk tolerance. Also lacking are strategic plans laddering out investments to mature, as reserve and operating expenditures are expected to arise.

Under Florida law, a board of directors may be held personally liable for losses if they ignore or overrule information and invest imprudently.

Boards often poorly manage their association's operating funds. Directors may require familiarization by their manager or accountant with basic accounting procedures and forms of financial reporting. The manager or financial agent should provide cash flow projection charts or analyses that weigh income and expenses over the twelve months of the budget year with all proposed or adopted budgets, as a basic working tool for managers and treasurers. Boards should consider moving monies not immediately needed to cover anticipated expenses into accounts bearing greater interest.

Many associations, unaware or unconcerned, have deposited in account(s) at given institutions, more monies than are covered by FDIC or SIPC limitations. Managers should investigate each institution for the cash management services they provide to community associations, in addition to the rates of return of their investments.

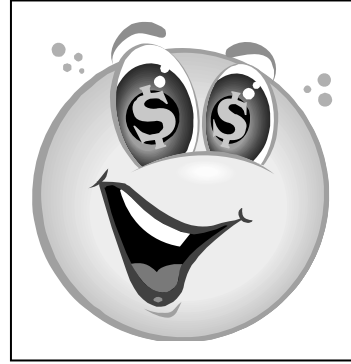
Although maintenance of the physical property is not part of this course, money saved is money earned. Investing in the performance, now, of heretofore deferred maintenance, may result in saving the greater cost, latter, of repairs due to the substantial deterioration of building system components. Planning ahead to purchase materials and services at the best possible prices, should also be considered part of any investment plan.



Lastly, how often have we heard from our boards: "We kept our monthly assessment low...?" That, in and of itself, is not a valid objective of the Board. Boards must, by statute, operate, maintain, and enhance the value of association property. Assessments of unit owners must be adequate to that task.

Exercises

Before we begin to review the course materials, let us take a few minutes to examine financial situations in which an association might find itself and think about what you, as manager, would recommend. At the end of the course, you may wish to look at these examples again, and see if your recommendations have changed.



Exercise 1 – Greenback Acres HOA

Tom Taileyman, the treasurer of Greenback Acres HOA, is preparing the budget for this coming fiscal year. In reviewing the bank statement for the past few months, he notices that the association has a reserve for the swimming pool in an interest bearing account at the local bank. The current balance is \$350,000, and the annualized interest is 2.3%. The association refurbished the pool area 3 years ago, and the pool itself re-coated 4 years ago. Therefore, the Association does not anticipate using any reserve monies for the next 24 months.

Tom has had an account with For Rich or Poor Investments for the last 3 years; his broker has invested his funds in a mix of stocks, bonds and mutual funds, and has averaged a return of 10% annually, plus about another 4% due to growth of the portfolio. His broker believes he can do just as well for the association. When Tom talks with the bank officer, she recommends that Tom consider investing \$250,000 in a 24 month jumbo CD paying 6.8%, with the remainder in GNMA funds that can be sold at any time, paying 5.75%.

What should Tom recommend to the Board and why?

Exercise 2 – Sunny Shores Condominium

Marty Garcia is a new CAM, recently hired by the Sunny Shores Condominium Board of Directors. The Board anticipates a special assessment next year for replacement of the roof. It currently has \$575,000 in the roof reserve, and the lowest bid for replacement was \$1 million.



However, the Sunny Shores Bylaws require that the association have a 10% contingency in the operating budget, and the association averages a balance of \$250,000 a month in its checking account.

The Board wants to keep the proposed special assessment as low as possible and assigns Marty to evaluate the association’s investments and make recommendations to increase the yield over the next 12 months.

What financial factors should Marty consider in her recommendation? What types of investments might she recommend? To whom should she speak about investment possibilities?

Exercise 3 – Troubadour Condominium

The Troubadour Condominium owners recently voted to fund a reserve for all statutory items, for future building repairs, such as elevator modernization, interior refurbishment, and concrete restoration, and for hurricane repairs, as follows:

Item	Amount	Years before Anticipated Use
Painting	\$600,000	5
Pavement	\$200,000	7
Roofing	\$1,000,000	15
Building Elements	\$750,000	10
Hurricane Repairs	50,000	1

Each month, the association will collect approximately \$10,000 for the reserve. The Board wants to assure that it invests its monies to get the best possible return.

The treasurer, a stockbroker, has recommended that the association put 25% of the reserve each month in a stock fund that averages 15% interest and growth annually, 25% in short term CDs, 25% in government bonds, and 25% in blue chip stocks.

Is this a good strategy? Why or why not? What must the Board consider in making its decision on where and how to invest its monies?



Exercise 4 – Dinwiddie Estates Cooperative

The Dinwiddie Estates Cooperative has approximately \$500,000 in reserves. The Board has invested its monies as follows:

Type Investment	Amount	Return
Mutual fund (potential alternative energy sources)	\$ 50,000	.3%
Mutual funds (Technology stocks)	\$ 50,000	12.3%
Mutual Fund (Blue Chip Stocks)	\$200,000	4.5%
Government Bonds	\$100,000	5.2%
12 Month CD	\$100,000	6.3%
6 Month CD	\$ 50,000	5.4%
Interest Bearing Checking Account	\$ 50,000	3.2%

*Includes \$100,000 from the operating budget.

The treasurer, Sammy Swipe, a stock broker, manages the funds for the association, and receives a commission of \$1,000 a year from his firm. The Board President has asked the manager, Billy Bagsley, to review the portfolio as part of the budget process.

What should Billy look at and why? What recommendations might Billy want to make? Why?



Exercise 5 – Bleau Lakes Community Association

The Bleau Lakes Community Association includes four condominiums and a master association. The master manages all the common elements.

Included in the common elements are a restaurant, a health club, and a small convenience store, all of which the master leases out. The restaurant, spa, and store have been very successful; as the master association has opened them to other associations in the area (owners in Bleau Lakes receive a 10% discount).

Bleau Lakes received a net profit of \$100,000 this year. The restaurant has recently negotiated to host the monthly Chamber meetings, which Bleau Lakes anticipate will add another \$25,000 to its

net profit next year. The Bleau Lakes Board needs to develop a strategy for this money.

The Treasurer, Harry Hide, has suggested keeping half as a contingency and rolling the remainder over to offset future monthly assessments. The Secretary, Lola Lacely, active in the Bleau Lakes Social Club, wants \$25,000 set aside for association social events. The President, John Snead, has asked you, as the new manager, to develop a strategy for these funds.

What must you consider in determining your recommendations and why?

The Prudent Investor Rule

The Florida Statutes and Florida Administrative Code relating to various types of CIRAs (Common Interest Realty Associations) do not restrict the types of investments that associations may use to generate a return on their operating or reserve funds.

Boards of directors, in determining investment policy and strategies for their associations, must be guided by both Chapter 518 F.S., titled “**Investment of Fiduciary Funds**,” and their own governing documents, where applicable. Chapter 518 forms part of Title XXXIII, F.S., titled “Regulation of Trade, Commerce, Investments, and Solicitations.”



A **fiduciary**, most simply defined, is one who acts in, in a legal role, in the best interest of others. The board of directors:

- is entrusted with the management of association property;
- given the power to act on behalf of and for the benefit of association members; and
- Has a special relationship of trust, confidence, and responsibility towards said members.

Statute 518.10 defines “**fiduciary**” as “an executor, administrator, trustee, guardian, or other person, whether individual or corporate, who by reason of a written agreement, will, court order, or other instrument has the responsibility for the acquisition, investment, reinvestment, exchange, retention, sale, or management of money or property of another.”

Most important, in connection with investments by fiduciaries, is the “prudent investor rule.” Florida Statute 518.11(1) states:

(a) The fiduciary has a duty to invest and manage investment assets as a prudent investor would, considering the purposes, terms, distribution requirements, and other circumstances of the trust. This standard requires the exercise of reasonable care and caution and is to be applied to investments not in isolation, but in the context of the investment portfolio as a whole and as a part of an overall investment strategy that should incorporate risk and return objectives reasonably suitable to the trust, guardianship, or probate estate. If the fiduciary has special skills, or is named fiduciary based on representations of special skills or expertise, the fiduciary is under a duty to use those skills.

(b) No specific investment or course of action is, taken alone, prudent or imprudent. The fiduciary may invest in every kind of property and type of investment subject to this section. The fiduciary’s investment decisions

and actions are to be judged in terms of the fiduciary's reasonable business judgment regarding the anticipated effect on the investment portfolio as a whole under the facts and circumstances prevailing at the time of the decision or action. The prudent investor rule is a test of conduct and not of resulting performance.

(c) The fiduciary has a duty to diversify the investments unless, under the circumstances, the fiduciary reasonably believes it is in the interests of the beneficiaries and furthers the purposes of the trust, guardianship, or estate not to diversify.

(d) The fiduciary has a duty, within a reasonable time after acceptance of the trust, estate, or guardianship, to review the investment portfolio and to make and implement decisions concerning the retention and disposition of original preexisting investments in order to conform to the provisions of this section. The fiduciary's decision to retain or dispose of an asset may be influenced properly by the asset's special relationship or value to the purposes of the trust, estate, or guardianship.

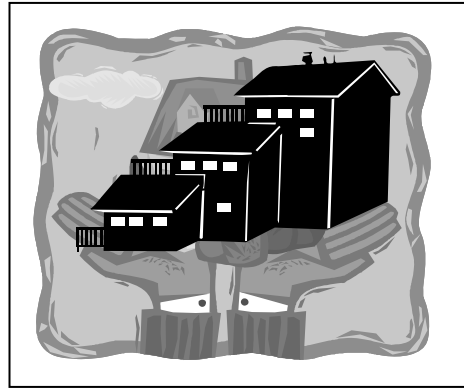
(e) The fiduciary has a duty to pursue an investment strategy that considers both the reasonable production of income and safety of capital, consistent with the fiduciary's duty of impartiality and the purposes of the trust, estate, or guardianship. The portfolio as a whole, and not any particular investment, shall demonstrate if the investment strategy is over or under productive.



(f) The circumstances that the fiduciary may consider in making investment decisions include, without limitation, the general economic conditions, the possible effect of inflation, the expected tax consequences of investment decisions or strategies, the role each investment or course of action plays within the overall portfolio, the expected total return, including both income yield and appreciation of capital, and the duty to incur only reasonable and appropriate costs. The fiduciary may, but need not, consider related trusts, estates, and guardianships, and the income available from other sources to, and the assets of beneficiaries when making investment decisions.

Fiduciary Risk

Boards of directors have the fiduciary duty to *protect, maintain, and enhance association assets*, not to speculate with funds in an attempt to beat the market. Boards should not keep assessments low, but should properly fund operating and reserve budgets to meet the above fiduciary duty. Although boards of directors generally cannot abrogate their responsibilities to their respective associations, they may of course employ professional advisors.



Occasionally, a board may have a director who is a stockbroker, banker, day trader, or has another financial expertise. Before adopting recommendations from this director, the board should determine if he or she has an expertise in community association finances. What is good for an individual or private company is not necessarily good for an association. For instance, a director who is a stockbroker recommends a number of stock funds to the board based upon his return of 15% over the past 3 years. The board should seek the advice of a financial advisor qualified in association investments. This advisor will make recommendations, one of which will be that the stock market is not an appropriate investment for associations under any circumstance – including blue chip funds.

Board of directors who hire financial consultants whose credentials and references they have diligently researched, may be better served than boards whose investments decisions are based solely on the limited personal experience and knowledge of their members.

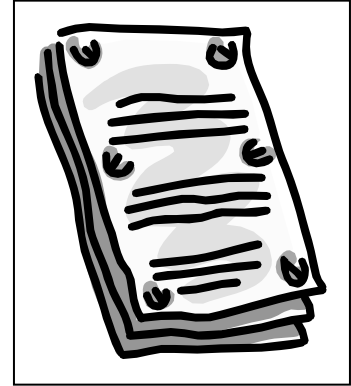
The less prudent the investment, as defined by law and standard industry practice, the greater may be the exposure to risk at which a board places its association and owners.

Directors may be personally liable for losses if investments depreciate in value, where information available to the board is purposely ignored or overruled. Boards whose associations generate little or no excess operating and reserve funds, or amounts that can easily be maintained in insured accounts may not require investment counseling. They may also not be serving the best long-term interests of their associations.



Governing Documents

It is essential that an association's governing documents be carefully reviewed for restrictions serving to limit investments and expenditures, board and officer responsibilities with regard to finances, and the use of any monies received from insurance claims. While the Board is legally responsible for the association, the documents usually identify the treasurer as the individual most responsible for financial oversight.



The following example of restrictive language in investments was taken from the by-laws of a Florida condominium:

7.12 Association Depository. The depository of the Association shall be such governmentally insured or guaranteed depositories as shall be designated from time to time by the Directors and in which the monies for the Association shall be deposited.

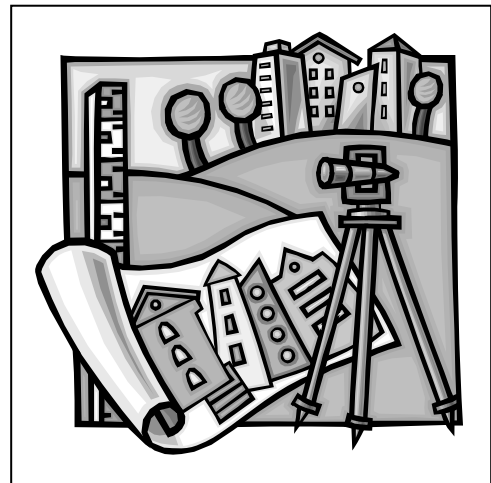
Withdrawal of monies from such accounts shall be only by checks signed by such persons as are authorized by the Directors.

7.13 Commingling of Funds Prohibited. All funds shall be maintained separately in the Association's name. No such funds will be commingled with any other funds. Reserve funds and operating funds of the Association may not be commingled, except as provided by law.

We extracted the following example of restrictive language in expenditures from the Declaration of another Florida condominium:

11.1 Budgets. The Association shall prepare, no less than three months prior to the end of the fiscal year, a budget that provides for necessary maintenance and enhancements to the property and Association. Such budget shall include, but not be limited to, all items required by statute. It shall include such reserves as may be required by statute, as well as reserves for structural components of the building, insurance deductibles, and any other item as determined necessary by the Board of Directors.

11.1.1 Presentation to Owners. The Board of Directors shall, no less than 45 days prior to the end of the fiscal year, send to each owner a notice of the meeting at which the budget shall be approved, with a copy of the proposed budget, including all reserves and improvements. The Board shall provide the minimum statutory notice, but not less than 20 days notice. At the budget meeting, the Board, or its representative, shall present to the owners.



12.1 Special Assessments.

12.1.1 Insurance. By majority vote by the full Board, the Board may approve any special assessment necessary to ensure that the Association, its property, its employees, and the Board of Directors, are properly insured. The Board shall notice as required by these documents and statute.



12.1.2 Changes required to meet Statute or Code. By majority vote by the full Board, the Board may approve any special assessment necessary to ensure the safety and well-being of its owners, or the safety of the property, or required to meet current statute or Code, without a vote of the owners. However, the Board shall provide no less than 30 days notice to all owners of the meeting at which such special assessment shall be discussed. Such notice shall include an estimate of items to be funded.

12.1.3 Material Alterations & Improvements. The Board, by a 2/3s vote of the full Board, may approve materials alterations and improvements to the property anticipated to cost no more than \$50,000, without a vote of the owners. No less than a majority of unit owners must approve materials alterations and improvements to the property that are anticipated to cost more than \$50,000. The Board shall provide unit owners with no less than 30 days notice of such special assessments, and shall include the amounts to be assessed for each item.

12.1.4 Depository. The Association shall maintain all funds collected for each special assessment in a separate account. Under no circumstances may the Board commingle these funds with Operating or Reserve Accounts.

12.1.5 Balance of Special Assessments. At the completion of a special assessment, any excess funds collected shall be used to offset future special assessments, or to offset the next year's assessments, or may be placed into one or more reserve accounts, by a majority vote of the full Board of Directors.

Most associations also have restrictive language regarding the receipt and use of insurance proceeds. Some frequent found clauses include:

- ▶ Insurance proceeds must be segregated from other funds and maintained in a separate account during repairs
- ▶ Insurance monies may only be used for repair of damages identified in the claim
- ▶ Insurance monies may be used to pay for repairs to an owners unit, but cannot be paid directly to the owner



- ▶ Association must use an insurance trustee for large claims
- ▶ The insurance trustee may only disburse monies upon receipt of an invoice for repairs
- ▶ Any remaining insurance funds may be used for purpose identified by the association, if permitted by the insurer.



We have provided an example of such restrictive language below:

14. Insurance. Insurance covering governed by the following provisions: ...

(d) Custody of Policies and Payment of Proceeds. All policies shall provide that payments for losses made by the insurer shall be paid to the Insurance Trustee (if appointed), and all policies and endorsements thereto shall be deposited with the Insurance Trustee (if appointed). ..

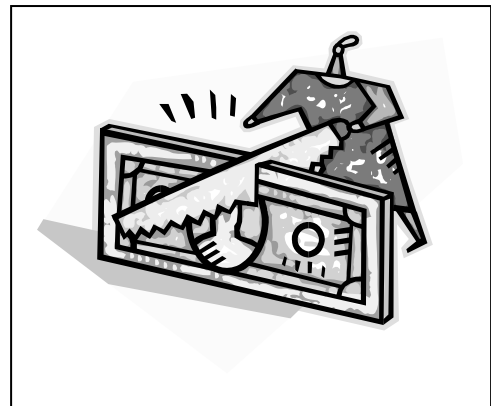
14.5 Insurance Trustee; Share of Proceeds. All insurance policies obtained by the Association shall be ... paid to the Insurance Trustee, which may be designated by the Board of Administration and which, if so appointed, shall be a bank or trust company in Florida with trust powers with its principal place of business in the County... The duty of the Insurance Trustee (if appointed) shall be to receive such proceeds as are paid and to hold the same in trust for the purposes elsewhere stated herein, and for the benefit of the Unit Owners and their respective mortgagees ...

14.6 Distribution of Proceeds. Proceeds of insurance policies received by the Insurance Trustee (if appointed) shall be distributed to or for the benefit of the beneficial owners thereof ...

15. Reconstruction or Repair after Fire or Other Casualty. ..

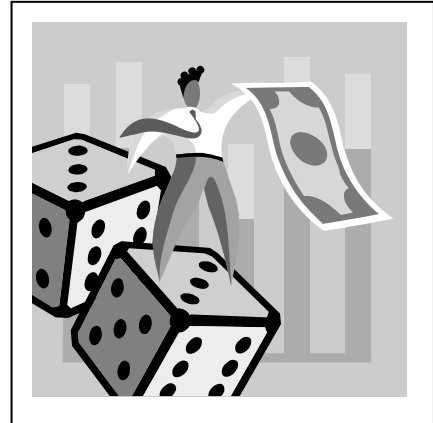
15.6 Construction Funds. The funds for payment of the costs of reconstruction and repair, which shall consist of proceeds of insurance held by the Insurance Trustee (if appointed) and funds collected by the Association from Special Assessments against Unit Owners, shall be disbursed in payment of such costs in the following manner:

(a) Association. If the total Special Assessments made by the Association for the costs of reconstruction and repair which are the responsibility of the Association are more than \$10,000, then the sums paid upon such Special Assessments shall be deposited by the Association with the Insurance Trustee (if appointed). In all other cases, the Association shall hold the sums Special Assessments and



disburse the same in payment of the costs of reconstruction and repair.

(b) Disbursement. The proceeds of insurance collected because of a casualty, and the sums collected from Unit Owners because of such casualty, shall constitute a construction fund, which shall be disbursed in payment of the costs of reconstruction and repair in the following manner and order:



(i) Association - Lesser Damage. If the amount of the estimated costs of reconstruction and repair, which are the responsibility of the Association, is less than \$50,000, then the construction fund shall be disbursed in payment of such costs upon the order of the Board of Administration of the Association. However, upon request to the Insurance Trustee (if appointed) by an Institutional First Mortgagee which is a beneficiary of an insurance policy, the proceeds of which are included in the construction fund, such fund shall be disbursed in the manner provided below for the reconstruction and repair of major damage.

(ii) Association - Major Damage. If the amount of the estimated costs of reconstruction and repair which are the responsibility of the Association is more than \$50,000, then the construction fund shall be disbursed in payment of such costs in the manner contemplated by subparagraph (i) above, but then only upon the further approval of an architect qualified to practice in Florida and employed by the Association to supervise the work.

(iii) Unit Owners. If there is a balance of insurance proceeds after payment of all costs of reconstruction and repair that are the responsibility of the Association, this balance may be used by the Association to effect repairs to the Optional Property (if not insured or if under insured), or may be distributed to Owners of the Optional Property who have the responsibility for reconstruction and repair thereof.¹ The distribution shall be in the proportion that the estimated cost of reconstruction and repair of such damage to each affected Unit Owner bears to the total of such estimated costs to all affected Unit Owners, as determined by the



¹ Note: DBPR Arbitration Decision has found that insurance deductible and insurance funds received are part of the budget. The association must charge all owners for the deductible or additional monies needed, for repairs, and must return any excess monies in accordance with the percentages stated in the documents.

Board; provided, however, that no Unit Owner shall be paid an amount in excess of the estimated costs of repair for his portion of the optional Property. All proceeds must be used to affect repairs to the Optional Property, and if insufficient to complete such repairs, the Owners shall pay the deficit with respect to their portion of the Optional Property and promptly affect the repairs. Any balance remaining after such repairs have been affected shall be distributed to the affected Unit Owners and their mortgagees jointly as elsewhere herein contemplated.

Associations may vary widely in their provisions for investments and expenditures. While one may limit investments exclusively to bank CDs, others may permit investment in government bonds, or even stock certificates. Likewise, while some associations may restrict the Board's ability to impose special assessments without owner approval, others may permit the Board, or even the officers, wide latitude in ascertaining when special assessments are needed.

Generally, most associations have similar provisions overseeing the use of insurance proceeds. While many associations do not appoint an insurance trustee for small insurance awards, it is prudent to appoint one when the association has substantial damage and must make major repairs. Insurance companies may audit the association, to assure that the association properly used insurance funds. In some cases, insurers have demanded that part or all of a claim be repaid when associations did not use them in accordance with insurance policies and governing documents.



Managers and Boards should carefully review their documents before investing monies, considering a special assessment, or utilizing insurance proceeds.

Safety of Principal, Liquidity & Yield

The most important consideration for community associations with any investment policy is safety of principal.

Safety of principal involves both safety of principal and safety of income. Safety of principal refers to whether the full amount of the initial investment will be available at maturity. Safety of income refers to income generated, as expected, from an investment.

Safety of principal also involves both market (systematic) risk and credit risk. Systematic risk is that part of a security's risk that is common to all securities of the same class, such as stocks and bonds. Credit risk is the risk that an issuer will default on a contractual obligation or that an equity investment will lose value because of financial difficulty or bankruptcy of an issuer.

Inflation risk is the chance that the cost of living or cost of repairs and replacements will increase faster than the earnings on an investment.

Interest rate risk is the uncertainty of whether interest rates will increase or decrease, and to what extent.

Liquidity involves the ability to sell, redeem, or convert an investment into cash or a cash equivalent, quickly and without significant loss of value or being subject to penalty. This is particularly important to associations in the instance of unanticipated major repairs or other expenditures. Investments with long-term maturity dates may still be highly liquid where there is an active secondary market. Liquidity can also be tied to laddering, as discussed later in this text.



Yield, generally defined, is the return on an investor's capital investment. Generally, the longer the term of an investment is, the higher is the yield; the shorter the term, the lower the yield. Generally, the safer an investment is, the less it will yield.

The **risk-return trade-off (risk/reward ratio)** concept is that risk equals/ varies directly with return on investment. The higher the return is, the greater the risk and vice versa. An investment in highly speculative junk bonds, by definition, should involve a comparatively high rate of return. A conservative investment in U.S Saving Bonds would involve a comparatively low rate of return.

A well-planned community association investment policy will factor in all three priorities – safety of principal, liquidity, and yield, in that order.

Investment Policy

Boards of directors decide where and when to invest. Although there is no statutory requirement, the governing documents may specify the type(s) of investment products that an Association can make. In addition, a *written* investment policy for all community associations is a critical and highly recommended tool. Such a policy will serve to guide directors, in their exercise of reasonable business judgment and meeting the standard of care required by statute.



Association treasurers, committees, other volunteers, and managers may assist in drafting such policies. The association counsel and financial advisors should review the policies before formal adoption by boards of directors.

Most managers lack sufficient training and expertise to offer investment advice. Common sense dictates that all managers refrain from making recommendations to boards of directors, as to specific investments. Managers, however, should serve to educate board members as to their obligations as fiduciaries: the purpose and general content of a formal investment policy. If a manager has specific experience with development of investment policies for community associations, he or she may wish to help with these decisions. However, it is extremely important that the manager know the limitations of his or her abilities. Keep in mind that F.A.C. 61-20 specifically prohibits licensed managers from practicing in an area in which they are not qualified.

Safety of principal is the utmost investment objective for associations, not high yield or liquidity. An association should not risk principal in exchange for a higher yield.

It is essential (and many association documents require) that all association funds be invested in government insured accounts, or instruments of similar security. Stocks, bonds, and blue chip stock funds typically are not suitable investments for community associations. Balances should not exceed deposit insurance or fiduciaries' insurance (association fidelity bond) limitations.



Brokers, agents, and financial advisors should be competent, properly insured, and subject to regulatory oversight and requirements. Such professionals should specialize in servicing substantial numbers of community associations of your association's given type, and enjoy sound reputations and credentials. All due diligence must be performed by the association or its representatives in checking the references and credentials of its professionals.

The Association should consider the following elements in its policy:

- ▶ Have a statement of purpose
- ▶ Include specific goals & objectives
- ▶ Have an ethics policy
- ▶ Discuss operating, reserve and special assessment funds separately
- ▶ Delegate authority for managing its funds
- ▶ Define certain types of investment for consideration
- ▶ Exclude certain types of investment from consideration
- ▶ Include an investment strategy
- ▶ Include performance standards

The following is a sample community association investment policy:

1. **Statement of resolve or purpose:** To delineate the policies of the _____ Association relating to the investment of its monies and to establish procedural requirements and guidelines for investment management practices, in accordance with the governing documents of the Association and the laws of the State of Florida.
2. **Scope:** The investment policy applies both to reserve account and excess operating funds², to be invested in such amounts as may be authorized by the Board of Directors in accordance with this policy.
3. **Goals & objectives:** Investments shall be guided by the following goals/objectives, listed in decreasing order of importance.

² Florida statutes may permit commingling of reserve and operating monies for the purpose of prudent investment.

- a. Safety and the securing of the principal of all funds of the Association.
- b. Liquidity and accessibility: The ability to change an investment into its cash equivalent on short notice, without penalty. Funds should be readily available for projected or unexpected expenditures through portfolio liquidity and scheduling cash flows.
- c. Yield: Funds should be invested to seek the highest level of return that is consistent with preservation of the purchasing power of the principal and accumulated interest, and with consideration as to the tax liability of interest earnings.
- d. Minimal costs. Investment costs (redemption fees, commissions, and other transaction costs) should be minimized.



4. **Delegation of authority:** Fiduciary responsibility for the investment program under the authority of the Association bylaws lies with the Board of Directors, primarily through the Treasurer. Dual signature by the Association President and Treasurer shall be required for authorizing transactions.
5. **Ethics and conflict of interest:** The Board of Directors shall exercise their powers and duties in good faith and with a view to the interests of the Association, and consistent with Article ____, Section ____ of the bylaws. Directors & officers, Finance Committee members, agents and Association employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Directors & officers, Finance Committee members, agents and Association employees, shall disclose to the Board of Directors, any material interests in financial institutions that conduct business or may be under consideration to conduct business with the Association, and they shall further disclose any significant personal financial/ investment positions that could be related to the performance of the portfolio; they are further prohibited from receipt of any related benefits, credits, discounts or free services.
6. **Investment strategy:** To the extent feasible, maturities of all investments should be matched to projected future cash flow needs and outlay requirements. Therefore, investments shall be made in instruments that possess high liquidity or that can be converted to cash in a short period, consistent with the above-stated goals and objectives. All Association funds affected by this policy, which are not required for short-term cash flow or to maintain balances, shall be invested in interest bearing investments or accounts. To reduce overall portfolio risk while attempting to attain market rates of return consistent with the primary objectives of safety and liquidity, diversification of investment shall be encouraged across types of investments, maturities of those investments, and institutions in which those investments are made.
7. **Authorized investments:** No investments other than those allowed by this policy shall be made without the approval of the Board.
8. **Operating funds:** Excess operating funds shall be invested in cash equivalents limited to institutional money market accounts fully funded by the FDIC (Federal Insurance Deposit Corporation); certificates of deposit fully insured by the FDIC; sweep accounts backed by

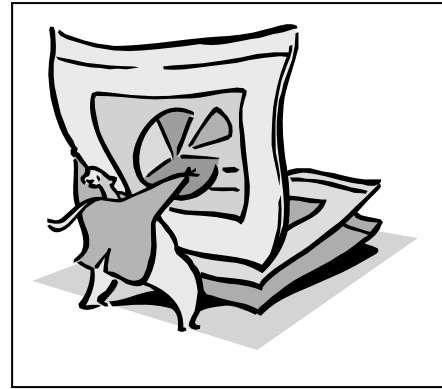
U.S. Treasury securities with maturities of one year or less; U.S. Treasury securities of one year or less.

9. **Reserve funds:** Investments shall be limited to Certificates of Deposit fully insured by the FDIC; United States Treasury fixed-rate bills, notes and bonds; institutional money market accounts fully insured by the FDIC.

10. **Performance standards:** The Association investment portfolio will be designed to obtain an optimum rate of return given the limitations of the authorized investments and consistent with the above stated objectives.

11. **Safekeeping & custody:** Consistent with Article ____, Section ____ of the Association bylaws, the Board of Directors, primarily through the Treasurer, is responsible for insuring that the Association's investment portfolio is properly accounted for. In so doing, they may delegate, work with, and rely upon reports generated by the Association's designated managing agent pursuant to applicable contracts. The Board also may work with and rely on accounting and/or other financial/investment professionals, and the Association's Finance Committee, performing pursuant to the direction of and as approved by the Association.

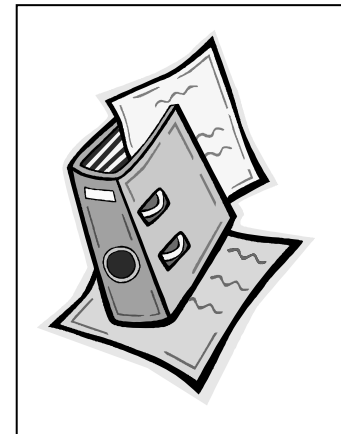
12. **Internal control:** The established process of independent review shall be performed annually as a part of the Association's annual audit as required by the bylaws and the State of Florida, by a qualified CPA, consistent with the AICPA Standards for Accounting for Common Interest Realty Associations. This audit shall be reviewed and adopted by the Board of Directors. Monthly financial reports of the Association shall detail the accounting of current values of investments, income and transactions; include reconciliation of investment accounts, where applicable; be provided, upon completion, to all directors along with copies of regularly issued investment account statements. Investment status reports are to be given by the Treasurer at all duly called regular meetings of the Board and the approval of all transactions verified in the minutes of Association.



Budget & Expenditure Policy

Boards of directors usually determine the budget for an association. They make recommendations regarding reserve accounts, although in condominiums and cooperatives only the owners may determine if reserves will be waived. Governing documents often grant the Board authority to decide how to fund special projects, or shortfalls in the budget. As stated earlier, the governing documents may have specific requirements for budgeting and special assessments.

Boards with little or no excess operating funds may not be serving the best interest of their associations, as they are not planning for unanticipated expenses, such as damages due to hurricanes, or payment of insurance deductibles. Boards that fail to maintain adequate reserves also place their communities at risk: how many owners can afford a \$10,000 or even \$5,000 special assessment for roof replacement, or elevator modernization? Owners subjected to high special assessment often offer units for sale at reduced prices, further diminishing the value of other units.



Boards may be challenged by the changing demographics within their associations to maintain current assessment levels while making necessary improvements. They may have owners who are on fixed incomes who do not want to maintain reserves, or spend money for improvements. Other owners may be more affluent and want to see their property maintained at a higher level, with substantial improvement. The Board must find a policy that fairly weighs the interests of all owners and at the same time provides for necessary maintenance and enhancement, which is not an easy task.



When an association has unplanned expenses, it can sometimes offset the effects of high special assessments through careful planning and use of available financial instruments. Some associations use construction loans while a project is being completed,

As with investments, we recommend a *written* expenditure policy for all community associations; it is a critical and highly recommended tool. Such a policy will help managers provide advice to directors, so that they may exercise reasonable business judgment and meet the standard of care required by statute.

Association treasurers, committees, other volunteers, and managers may assist in drafting such policies. The association counsel and financial advisors should review the policies before formal adoption by boards of directors.

Many managers lack sufficient training and expertise to prepare a budget & expenditure policy. Managers, when possible, should educate board members regarding basic budgetary matters and basic budgetary controls. If a manager has specific experience with development of budgets for community associations, he or she may wish to help with these decisions. However, it is extremely important that the manager know the limitations of his or her abilities. Keep in mind that F.A.C. 61-20 specifically prohibits licensed managers from practicing in an area in which they are not qualified.

Elements that a community association should address in its budget policy include:

- ▶ Purpose
- ▶ Goals & Objectives
- ▶ Delegation of Authority
- ▶ Ethics
- ▶ Budget Strategy
- ▶ Performance standards
- ▶ Procedures for operating and reserve budgets
- ▶ Expenditure & Collections
- ▶ Procedures to handle unanticipated expenses

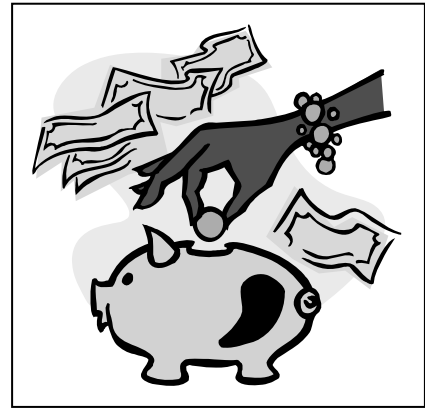


The following is a sample community association budget & expenditure policy:

1. **Statement of resolve or purpose:** To delineate the policies of the _____ Association relating to budgeting and to establish procedural requirements and guidelines for expenditures, in accordance with the governing documents of the Association and the laws of the State of Florida.
2. **Scope:** The budget & expenditure policy applies to operating budgets, reserve accounts, and special assessments, as may be authorized by the Board of Directors or unit owners, as defined by the Association documents and applicable statutes.
3. **Goals & objectives - Budgets:** The Association shall budget based upon the following principles:
 - a. Provide long range funding plans for the extension of the useful life of Association common and limited common elements.
 - b. Maintenance of common elements and limited common elements of the Association, as required by statute and the Association documents.
 - c. Maintenance of personal property of the Association, as required by statute and Association documents, so that the association may operate efficiently, and so that owners, residents and visitors may use designated property for their enjoyment of the common and limited common elements.
 - d. Provide sufficient contingencies to cover unanticipated costs, such as insurance deductibles, bad debt, and hurricane losses.
 - e. Provide funds to promote social harmony among the owners and residents, and to effectively and fairly enforce the rules & regulations of the Association, as defined by statute, the Association documents, and Board action.
 - f. Assure that the Board collects all monies due in a timely and efficient manner, in accordance with its collection policy as adopted by the Board of Directors.
 - g. On a monthly basis, revise the budget based upon actual income & expenses.
4. **Goals & objectives - Expenditures:** The Association shall expend its funds based upon the following principles:
 - a. As part of the budget process, develop an estimated monthly expenditure plan.
 - b. Provide the President (and manager) with authority, pursuant to the governing documents, to expend funds to carry out the goals & objectives of the Association within the limits of the budget category.
 - c. Provide the President (and manager), pursuant to the governing documents, with the authority to authorize unanticipated expenditures to address safety or Code related issues.
 - d. Provide the Board with a monthly budget reconciliation report.
5. **Delegation of authority:** Fiduciary responsibility for the budget & expenditure program under the authority of the Association bylaws lies with the Board of Directors. Dual signature by the Association Treasurer and one other Officer shall be required for authorizing transactions. The President or manager may authorize emergency expenditures up to \$5,000 without approval of the Board.



6. **Ethics and conflict of interest:** The Board of Directors shall exercise their powers and duties in good faith and with a view to the interests of the Association, and consistent with Article ____, Section ____ of the bylaws. Directors & officers, Finance Committee members, agents and Association employees involved in budgeting, collection of assessments and other income, and expenditures shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Directors & officers, Finance Committee members, agents and Association employees, shall disclose to the Board of Directors, any material interests in financial institutions or with vendors, contractors, or employees, that conduct business or may be under consideration to conduct business with the Association; they are further prohibited from receipt of any related benefits, credits, discounts or free services from any financial institutions, vendors, contractors or employees with whom the Association does business, unless said financial institutions, vendors, contractors or employees offers the same free service to all customers.
7. **Budget strategy:** To the extent feasible, the Association shall budget to assure that the majority of anticipated expenditures are paid within 30 business days of service delivery, and that vendor discounts for early payment are realized.
8. **Authorized Expenditures:** No expenditures other than those allowed below, shall be made without the approval of the Board.
9. **Operating budget:** The President (or manager) is authorized to expend funds budget for operating expenses as approved by the Board in the annual operating budget. The President (or manager) shall solicit no fewer than 3 bids for any expenditure of operating funds for contracts exceeding of \$100,000, or 5% of the operating budget including reserves, whichever is less. Such bids shall be presented to the Board, which shall evaluate the qualifications of the bidders, proposed cost of the project, and shall choose one of the bidders, by a majority vote of the full Board. There shall be no requirement to take the lowest bid.

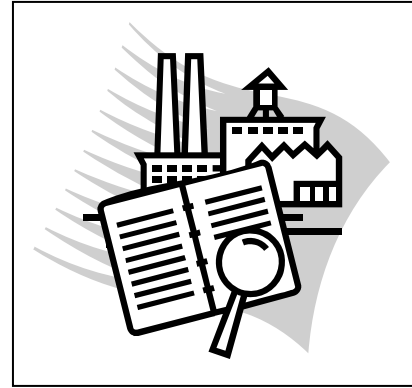


10. **Reserve budget:** The President (or manager) shall expend reserve funds as authorized by the Board of Directors. The President (or manager) shall solicit no fewer than 3 bids for any expenditure of reserve funds in excess of \$5,000. Such bids shall be presented to the Board, which shall evaluate the qualifications of the bidders, proposed cost of the project, and shall choose one of the bidders, by a majority vote of the full Board. There shall be no requirement to take the lowest bid.



11. Unanticipated expenditures & special assessments:

Should the Association experience an unanticipated expenditure, and should it be required to fund such unanticipated expenditure, the Board may at its option and in accordance with applicable statutes and Association documents assess the unit owners in connection with same. The Board shall provide the owners with no less than 15 business days notice of the special assessment, and shall delineate all anticipated expenses. Whenever possible, the Board shall have written estimates as back up for all items listed in the assessment. Regardless, the Board shall include with the notice the basis for the cost of each item listed. Further, pursuant to statute and the Declaration, Article __, Paragraph ____, the Board may with a 2/3s vote of the full Board finance the unanticipated expenditure through a bank or other institution. Any unit owner shall have the right to participate in the loan, or to pay their portion of the special assessment in full within 60 days of the assessment, and shall not be required to pay interest fees. All special assessment fees shall be maintained in a separate account and cannot be commingled with other association funds for any purpose.

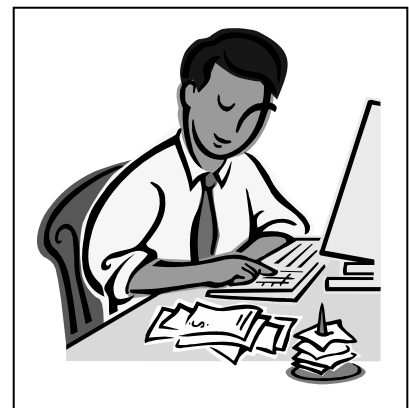


Further, pursuant to statute and the Declaration, Article __, Paragraph ____, the Board may with a 2/3s vote of the full Board finance the unanticipated expenditure through a bank or other institution. Any unit owner shall have the right to participate in the loan, or to pay their portion of the special assessment in full within 60 days of the assessment, and shall not be required to pay interest fees. All special assessment fees shall be maintained in a separate account and cannot be commingled with other association funds for any purpose.

12. Performance standards: The Board shall, no less than monthly, evaluate its expenditures and amend its budget as necessary. Further, the Board shall evaluate and address expenditures that are higher than anticipated.

13. Safekeeping & custody: Consistent with Article ____, Section ____ of the Association bylaws, the Board of Directors, primarily through the Treasurer, shall insure that the Association's budget is properly managed. In so doing, they may delegate, work with, and rely upon reports generated by the Association's designated managing agent, pursuant to applicable contracts. The Board also may work with and rely on accounting and/or other financial/investment professionals, and the Association's Finance Committee, performing pursuant to the direction of the board of directors

14. Internal control: A qualified CPA shall independently review the finances as a part of the Association's annual audit as required by the bylaws and the State of Florida, consistent with the AICPA Standards for Accounting for Common Interest Realty Associations. The Board shall review and adopt the audit. Monthly financial reports of the Association shall detail the accounting of current values of investments, income and transactions; include reconciliation of investment and expenditure accounts, where applicable; be provided to all directors along with copies of investment and expenditure account statements. The Treasurer shall provide status reports at all duly called regular meetings of the Board, and the approval of all transactions and contracts verified in the minutes of Association.



Types of Investments

Associations have many investment options, and with the exception of Chapter 518.11(1) and the prudent judgment rule (and any restrictions contained in their governing documents), few restrictions on using them. However, only a few are typically considered suitable for association funds. These include:

1. Certificates of deposit that are FDIC insured.
2. Money market deposit accounts (savings and checking).
3. Money market mutual funds.
4. U.S. Treasury securities



Associations should avoid investments that require constant oversight or involve a high degree of risk: including stocks, options, futures, commodities, and derivatives. Corporate and municipal bonds, annuities, REIT's (Real Estate Investment Trusts), managed accounts and mutual funds may also be considered unsuitable for association investment. Such investments should be specifically excluded in the association's formally adopted investment policy.

Chapter 617.0833, F.S. states:

Loans, other than through the purchase of bonds, debentures, or similar obligations of the type customarily sold in public offerings, or through ordinary deposit of funds in a bank, may not be made by a corporation to its directors or officers, or to any other corporation, firm, association, or other entity in which on or more of its directors or officers is a director or officer or holds a substantial financial interest, except a loan by one corporation which is exempt from federal income taxation under s. 501(c)(3) of the Internal Revenue Code of 1986, as amended, to another corporation which is exempt from federal income taxation under s. 501(c)(3) of the Internal Revenue Code, as amended. A loan made in violation of this section is a violation of the duty to the corporation of the directors or officers authorizing it or participating in it, but the obligation of the borrower with respect to the loan shall not be affected thereby.

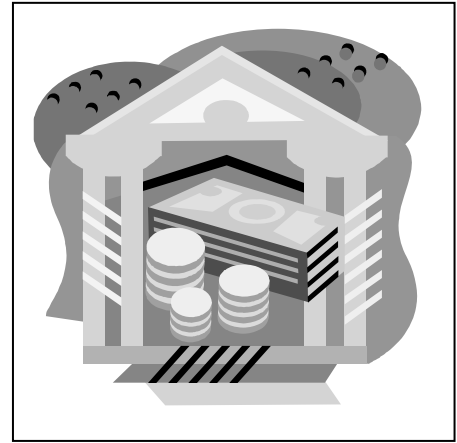
Certificates of Deposit (CDs)

CDs are debt instruments, issued by banks or institutions, which normally (unless issued in discount form) pay fixed rates of interest over a specific period. Interest rates are set by the marketplace. CDs may be issued in amounts as low as \$100, or in denominations of \$100,000 or more. Maturities range from short term to more than 10 years.



The Federally Insured Savings Network website (www.fisn.com) provides information regarding CD rates. Such information can be obtained at bankrate.com and money-rates.com, which also provide rate information for other types of investments. The financial sections of newspapers also provide rate information. Depending on the market, yields on CDs may be lower than those of other investments.

CDs typically pay interest at maturity or every six months. Every CD is different, requiring scrutiny of disclosure statements issued by institutions. Cashing in on a CD prior to its maturity date, if permitted, may incur a penalty of some or all of the interest earned, depending on the original maturity of the CD, where it was purchased, and the issuing institution. The issuer may, in some cases, refuse withdrawal prior to maturity. In the event of an emergency, some financial institutions may honor the release of a CD without penalty.



It may be possible to borrow against a CD as collateral.

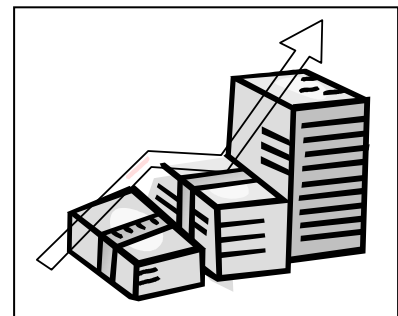
Large CDs traded by dealers and institutional investors and smaller CDs marketed by brokers have secondary market values that rise and fall in inverse relation to prevailing interest rates. There is no secondary market for consumer-size CD bought directly from banks and other issuing institutions. A premature sale on the secondary the market may result in loss or gain of principal. On the other hand, accrued interest might not be lost as a penalty.

Liquidity can be tied to the strategic laddering of CDs, discussed later in this text.

Other than basic types of CDs, including step-up or split rate CDs – where a higher rate is paid earlier in the term; market - index CDs – tied to a market index such as the S&P 500 stock index, where principal is typically guaranteed; variable rate CDs; inflation adjusted CDs; designer CDs – with maturities to suit the customer; convertible-term CDs – which convert from fixed rate to variable rate CDs; jumbo CDs – issued for \$100,000 and up; expandable CDs – which allow adding to the CD at the original rate. These vehicles have certain characteristics inherent in each and may not be suitable for investment by associations, who should consult with professional advisors.

Most brokers provide investors with CDs issued by several banks, effectively keeping funds fully FDIC-insured while holding all of the securities in a single account. In addition, CDs sold by securities firms often carry higher interest rates than those purchased directly by banks. In effect, by purchasing CDs through a brokerage account, a board may be able to obtain higher interest rates and maximum FDIC insurance thereby providing “one-stop shopping” and less work for a volunteer board or a manager.

Not all CDs are protected by the FDIC. Only CDs deposited in subscribing banks and savings and loans are insured, up to \$100,000 by the DIF (Deposit Insurance Fund) a unit of the FDIC.³ An exception to this rule is the CDARS (Certificate of Deposit Account Registry Service), which will insure up to \$30,000,000 from a single bank which it part of the CDARS network. We discuss this later with deposit insurance.



Interest earned on Certificates of Deposit is taxable at both the federal and state levels.

³ Please see the “Deposit Insurance” section of this text for a discussion of the FDIC (Federal Insurance Deposit Corporation).

Money Market Deposit Accounts (MMDAs)

MMDAs have been offered since December 1982 and act much like regular money market accounts. Both the principal and interest on money market deposit accounts are FDIC (discussed later) insured, the accounts are liquid, and they usually yield more than a normal savings account.

MMDAs are opened through banks and select brokerage firms. Only three checks may be drawn on such accounts per month, without penalty, although unlimited transfers may be carried out through an automated teller machine. The interest rates fluctuate and are generally comparable to rates on money market funds, though an individual bank’s rate may be higher or lower. Interest earned on MMDAs is taxable at both the federal and state levels.

Money Market Funds (MMFs)

MMFs are usually non-insured mutual funds that invest in a pool of short term, fixed-income instruments. Most funds invest in high-quality securities, government bonds, and treasury securities, although some funds have purchased lower quality securities to create a better yield. Management’s fee is typically less than 1% of an investor’s assets; interest over and above that amount is credited to shareholders monthly.

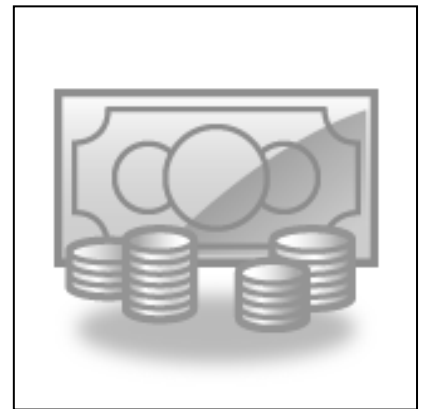
Liquidity, relative safety, and competitive interest rates may make these funds suitable investments for community associations. MMFs are typically used to hold money for an upcoming capital project or to invest current contributions to reserve funds until sufficient amounts have accumulated to invest in a CD or other investment vehicles.



Money market rates are not fixed and may change daily. Yields are usually lower than CDs or equivalent government securities. MMFs are not FDIC insured. Although MMFs are generally considered to be one of the more safe investments, associations who wish to act conservatively, or whose governing documents require FDIC insurance should not purchase them.

Treasury Securities

A Treasury security is a negotiable debt obligation of the United States government backed by its full faith and credit, and issued with various maturities, yields, and denominations. The federal government, to finance activities ranging from daily cash management to the refinancing of long-term bonded debt issues treasuries, issues Treasury securities. The U.S. government is highly unlikely to default on its securities. The low level of risk associated with Treasury securities translates into comparatively low yields. Treasuries have an advantage over CDs in that in that they are easily sold through secondary markets. There are three types of Treasury securities:



- ▶ Treasury bills or T-bills are issued weekly with 13-week and 26-week maturities and monthly with a 52-week maturity, on a discount basis and in denominations beginning @ \$ 10,000 with multiples of \$5,000 thereafter. They are issued through the Federal Reserve System, and investors may bid on a competitive basis, specifying terms, and risking rejection, or on a noncompetitive basis, where the average rate established in the regular auction applies and purchase is assured. T-bills can also be bought for a fee through banks and other dealers, where their amounts may be reduced to \$1,000.

- ▶ Treasury bonds and notes are interest/coupon-bearing, paying semi-annually in most cases, also sold through the Federal Reserve banks and branches on a competitive or noncompetitive basis. Maturities of notes range from 2 to 10 years; maturities of bonds range from 10 to 30 years. Long-term Treasury bonds are not considered good investments for CIRAs (Common Interest Realty Associations), because of their volatile, long-term nature. Both bonds and notes can be bought in denominations as low as \$1,000. Two-year notes are usually sold monthly; other term notes and bonds are offered as the need arises. Outstanding issues with almost any maturity can be purchased in the secondary market.
- ▶ Treasury Inflation Protected Securities (TIPS) are issued at a fixed rate of interest but with principal adjusted every six months based on changes in the Consumer Price Index (CPI). At maturity, TIPS which are issued in January and July as 5-year and 10-year notes and in October as 30 year bonds are redeemable at either their inflation-adjusted principal or their face value whichever is greater. TIPS sacrifice some yield as a tradeoff for inflation protection, and the inflation adjustment is federally taxable annually, although not paid out until maturity.

Other Treasury securities include savings bond Series EE, HH, and inflation-indexed I-bonds.

Zero-coupon bonds are created by separating the principal and interest coupons from Treasury bonds. Zero-coupon bonds are issued at a substantial discount and grow from their low purchase price to their face value at maturity. There are no periodic interest payments. Interest accrues and is taxable yearly during the life of the bond and is paid out in a lump sum at maturity. Associations do not normally invest in zero-coupon bonds.

Strips are U.S. Treasury or municipal securities that brokerage firms have separated into principal and interest, which, represented by certificates, are marketed as zero-coupon securities under proprietary acronyms. **STRIPS (Separate Trading of Registered Interest and Principal of Securities)** are the Treasury's acronym for its own zero-coupon securities.

New issues of bills, bonds, and notes may be purchased through competitive or noncompetitive auction at Federal Reserve banks or directly over the Internet, through Treasury Direct, at www.treasurydirect.com (800-722-2678); bought and sold at commercial banks, securities broker-dealers, and other financial services companies.

Treasury securities bought and redeemed through Federal Reserve Banks and branches are without fees. Purchases and sales through banks or broker-dealers involve modest fees or markups.



If an association purchases Treasury securities using a broker, they are issued in a commercial book-entry form, which means they are held in the name of the association's broker or dealer. Treasury securities purchased through Treasury Direct would be held in the name of the association.

Bills, bonds, and notes enjoy an active secondary market, are highly liquid, and are exempt from taxation at state and local levels. The financial sections of newspapers report new offerings and secondary market yields. Information regarding upcoming auctions, recent auctions of bills, notes and bonds, and information about receiving E-mail reports, can be found at: <http://www.treasurydirect.gov/indiv/products/products.htm>.



Treasuries rise and fall in price in inverse relationship to market interest rates. When interest rates grow, Treasuries that cannot be held to maturity may be sold at a discount on the secondary market, resulting in loss of principal. Inflation can erode the value of fixed-interest payments.

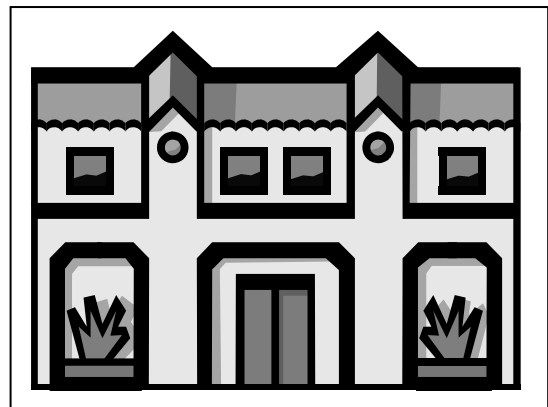
Laddering

Laddering creates the opportunity for a blended long-term rate of various fixed income investments with specific fixed terms.

Laddering means to stagger, with their purchase, the maturities of various, fixed-income investments, to maximize the overall yield, and maintain the safety and liquidity of an association's total funds. Investment in low-yield instruments, money market funds or savings accounts can thereby be minimized. A long-range outlook is emphasized by diversifying the maturity of fixed-income instruments such as certificates of deposit and Treasury securities.

With a properly laddered portfolio, liquidity can be maintained while short-term holdings-mature; there can be flexibility to reassign short-term holdings to long-term investments if interest rates increase.

The total funds of the association can be divided over a given number of CDs and/or Treasury securities with successive maturities each forming a rung (steps) on an investment ladder. Investment in instruments of equal amounts, where feasible, should make for a more blended long-term rate. Subject to the needs of an association as dictated by the need to fund upcoming reserve expenditures, or to access excess operating monies, monies can be targeted for short, intermediate, and long-term maturities. Consultation with the association's accountant and other financial advisors, towards structuring the ladder, may be advisable.



In a rising interest rate environment, laddering the association's investment portfolio allows the board to take advantage of rolling CDs into investments with higher yields. In a market where interest rates are dropping, by locking in rates, the board can be confident that they are outpacing shorter-term investment options while not exposing the board to unwarranted interest rate risk.

Example: The Very Flush Condominium has reserves totaling \$500,000. The roof account has been funded to the required amount of \$100,000. Payments to the roof installer are required in two \$50,000 installments, one in two months and the last in four months. The board has no immediate use for the balance of funds of \$400,000, and feels comfortable with maturities on its investments of up to two years for a portion of these funds.

After consultation with its advisor, the board purchases one \$50,000 CD due to mature in 2 months; another \$50,000 CD due to mature in 4 months.

The board allocates the balance of \$400,000 into four CDs issued by four different FDIC-insured banks in equal amounts of \$100,000.

To build a ladder, it purchases a \$100,000 CD maturing in 6 months, another maturing in 12 months, another maturing in 18 months, and a fourth maturing in 24 months. At the end of six months, the first CD will mature. Assuming no needs for the funds, the CD will be reinvested in a new 24 month CD.

With this structure, the portfolio will always have 25 percent of its reserve funds due in six months. (Of course, interested earned in a condominium must be allocated on a pro rata basis to each of the reserve accounts.)



Laddering longer-term instruments may not make sense when rates are low. A quarterly ladder might make more sense in that instance. An association might, as an example, purchase 3-, 6-, 9- and 12-month CDs and ask their bank to pay their current 12 month rate on all four CDs, with the intent of rolling them back into a 12-month CD at the current rate.

Deposit Insurance

Although there have been few bank failures in recent history, Boards of Directors must consider the deposit limits of accounts insured by the federal government.

Federal Deposit Insurance Corporation (FDIC)

The FDIC is a federal agency established in 1933 that guarantees (within limits) funds on deposit in member banks and thrift institutions.

The FDIC covers the first \$100,000 of an association's total deposits (including reserve and operating funds, checking and savings accounts, CDs, etc.) in accounts held at a given institution. If total deposits exceed that amount, they are not insured. There are institutions that cover up to \$300,000 and more in supplemental deposit insurance.

An association could purchase its own supplemental deposit insurance, but it should not be necessary.

The risk to association funds can be limited by depositing monies at different institutions, so that no one account has excess exposure. Initial deposits should be for less than \$100,000, to allow for growth with interest.

Financial Services Modernization Act of 1999

The Act allowed banks and brokerages to offer a full menu of financial products and services. This deregulation meant that a brokerage could offer the same products and services as a bank, including insuring of accounts by the FDIC.



Certificate of Deposit Account Registry Service (CDARS)

Use of CDARS allows an association to open CDs and offers six different maturity terms with one agreement, one signature card, and one 1099. An association can deposit up to \$30,000,000 with one bank that is a local CDARS network member. You earn one interest rate on CD investments placed through CDARS and do not need to negotiate multiple rates. There are no annual or hidden fees. You can select from a wide variety of maturities.

Securities Investor Protection Corporation (SIPC)

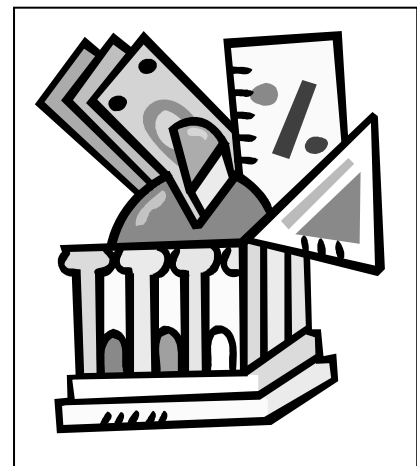
The SIPC is a nonprofit corporation established by Congress under the Securities Investor Protection Act of 1970, which insures securities and cash in the customer accounts of member brokerage firms against the failure of those firms. All brokers and dealers registered with the Securities and Exchange Commission and with national stock exchanges are required to be members of the SIPC. Account holders are covered up to a maximum of \$500,000, with a limit of \$100,000 on cash or cash equivalents.

Institutional Services

In addition to having an investment policy and strategic plan, as well as a budget and expenditure policy, boards of directors must decide where to purchase specific investments, where to place operating, reserve and special assessment accounts, and who to employ for professional advice.

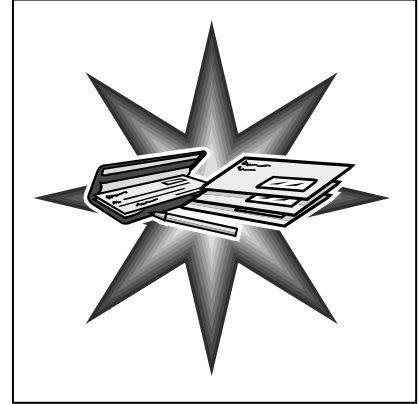
Consolidation in the financial services industry means that banks are offering more brokerage services and brokerage firms are offering more banking services.

There are a number of banks/financial institutions that advertise themselves as offering a wide variety of services of importance to community associations. Some of the questions that an Association should ask about the specific bank or firm include:



- ♦ Does the institution understand CIRAs, Not for Profit Corporations, and the association’s specific needs?
- ♦ Does the institution have representatives who understand community association operations and governing documents?
- ♦ Can the institution provide personalized service?
- ♦ Does the institution have programs, software, and systems designed specifically for associations? (**Note:** Many banks have online banking services designed for community associations, integrated with accounting software for association records.)

- ♦ Does the institution provide real time access to accounts online?
- ♦ Does the institution provide free check writing services? Is there a limit on the number of free checks per month?
- ♦ Does the institution pay interest on its checking accounts?
- ♦ Is there a minimum balance requirement for checking, savings, or money market accounts? If so, can the Association maintain that minimum balance?
- ♦ Will the institution automatically cover overdrafts in accounts, or will checks be returned as NSF?
- ♦ Will the institution accept CDs or other accounts as collateral for loans?
- ♦ Are lines of credit/ loans (short and long term) available, on a competitive basis, to community associations?
- ♦ Does the institution give its customers favored rates and discounts on loan origination fees?
- ♦ Does the institution require that the Association use its appraisers, attorneys and/or other professionals in preparation of title work and other loan documents?
- ♦ Which institution will allow for easier business transactions, such as deposit of unit owner assessments?
- ♦ Does the institution accept electronic transfers? If so, is there a charge that the Association or owner pays?
- ♦ Does the institution offer competitive or above-average yields?
- ♦ Does the institution offer the kinds of investments allowed by the association's investment policy?
- ♦ Can all of an association's investments be sold at the institution?
- ♦ Can funds be easily transferred among accounts within the institution? If so, what is the delay (in days) in transferring funds between accounts?
- ♦ Can funds be easily transferred between brokerage and bank accounts at the institution? If so, what is the delay (in days) in transferring funds between accounts?
- ♦ Can investments be freely transferred to other institutions?
- ♦ What is the schedule of service fees and/or commissions for services offered?

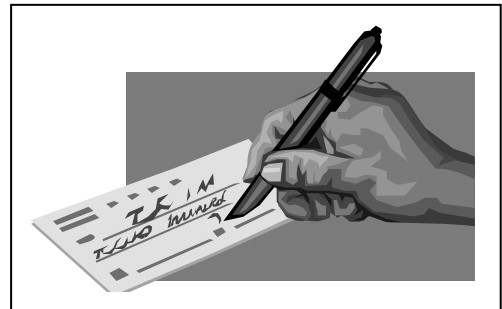


A personal relationship with a local banker may be useful in a variety of ways, including better negotiated rates for loans and terms on investments. Associations must understand the basics of the FDIC and SIPC, and supplemental coverage and insure that all accounts are adequately protected at whichever institution(s) they are held.

Banking Terms

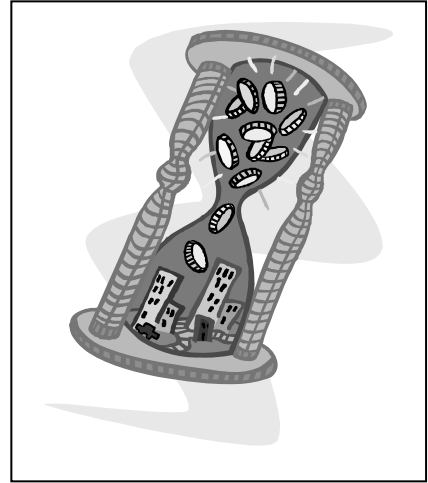
The following are terms used in connection with banking services:

- ♦ **Automated Clearing House (ACH):** nationwide electronic network that processes debt and credit transactions between parties. The ACH can be used to collect assessments and to direct deposit payroll monies into employee accounts.
- ♦ **Balance Reporting Services:** secure web-based reporting of account and transaction information. Offers transaction-specific details on all forms of payment activity, including deposits, checks, wire transfers, ACH debits and credits, investments, etc.
- ♦ **Cash Management or Treasury Management:** efficient mobilization of cash into income-producing applications, using computers, telecommunications technology, innovative investment vehicles, and lock box arrangements.
- ♦ **Check 21:** a federal program used to encourage the switch to electronic payment, as proof of the continuous alterations in the way our money is handled. Check 21 is a banking regulation that instantly confirms bank funds by running a personal check through a machine. The money transfer will be completed within 24 hours, instead of taking days to clear. This basically eliminated the bank float of 2-5 days.
- ♦ **Coupon books:** coupons for unit owners to tender with payment of their assessment charges: may be provided for a fee by the bank.
- ♦ **Electronic Funds Transfer (EFT):** as defined in the Electronic Fund Transfer Act (Title XX of the Financial Institutions Regulatory and Interest Rate Control Act of 1978), any transfer of funds, other than a transaction originated by a paper instrument, that is initiated through an electronic terminal, telephone, or computer or magnetic tape and that orders or authorizes a financial institution to debit or credit an account. A/K/A Wire Transfer.
- ♦ **Lockbox Services:**⁴ assessments are mailed to a bank's lockbox, opened, and deposited. The lockbox may or may not be physically located at the bank. This reduces processing float and puts cash to work more quickly. This benefit must be weighed against the bank's fees for its services.
- ♦ **Online Access to Request Forms:** access by the association's representatives to the banks various request forms.
- ♦ **Online Payment by Credit Card Capability:** allows unit owner payment of assessment charges via credit card.



⁴ Note: Some management companies also provide lockbox services, usually in conjunction with a local bank. However, management companies do not normally have lockboxes on site at the management office.

- ♦ **Online Stop Orders:** allows the association to stop collection of checks for a specified unit(s), especially where there is an ongoing legal collection action.
- ♦ **Payment Activity Image Retrieval:** allows an association's representative to go online and look at actual copies of a unit owner's coupon and cancelled check.
- ♦ **Positive Pay:** is a service whereby the association electronically shares its check register of all written checks with the bank. The bank will therefore only pay checks listed in that register, with exactly the same specifications as listed in the register (amount, payee, serial number, etc.). This reduces check fraud.
- **Sweep Accounts:** an account set up at a bank or other financial institution where the funds are automatically managed between a primary cash account and secondary investment accounts, where the cash is able to accrue a higher return. An average balance is determined for the primary account. Extra cash above the average balance is invested in various easily liquidated accounts/instruments. When the balance in the cash account falls below the pre-determined average balance, some of the investment is liquidated and returned to the cash account.



Tax Obligations

Federal and state tax implications for association budgeting, expenditure, and investment decisions are beyond the scope of this text. Boards of Directors should seek the advice of their tax professionals, before making major budget and expenditure decisions, borrowing money, or making any investment decisions. All associations are required to file federal income taxes every year, even if no taxes are due.



Generally, all investment income is taxable at the federal level except for income derived from municipal bonds and state obligations, which are not recommended here, as investments for community associations. Investment income is taxable even if the association has a net operating loss. Federal tax law and subsequent court cases do allow associations to deduct certain expenses from investment income. As noted earlier, Treasury bills, notes, and bonds are exempt from taxation at the state level.

Although real estate as an investment is not addressed in this course, occasionally a condominium or cooperative association will purchase a unit within their association. If the association rents the unit to create additional income, the income is taxable on state and federal levels. The association can deduct unit-related expenses from the taxable rental income. The sale of a unit may be subject to a capital gains tax.

Associations should always consult a tax professional or CPA to determine tax liability since taxes will have a direct bearing on the types of investments and overall strategy the association employs.

If filing pursuant to Internal Revenue Code Section 528, only non-assessment income may be subject to taxation. If filing as a regular corporation, which are taxed at different rates, all sources of income and expenses may be taken into consideration.

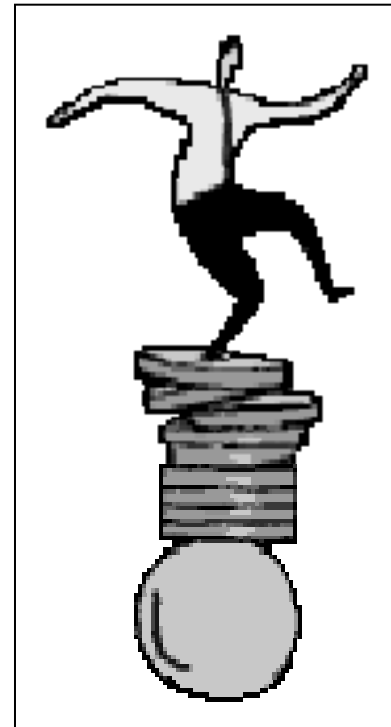
CONCLUSION

It is not the intention of this course to offer financial advice or recommend specific investments, forms of investment, or investment policy to any community association. Individual boards of directors make decisions regarding investments in consultation with their financial advisors and attorneys.

Financial and investment practices are complex. Not one financial strategy will fit all associations. An association should consult with qualified financial advisors to determine the strategy best suited for its particular needs.

Associations should have written policies for budgeting and expenditures, as well as for investments. Associations should carefully review statutes, documents, and laws in developing policies and making financial decisions.

Managers are not usually qualified as financial advisors or tax preparers to community associations. Manager should assure that they do not offer advice in areas in which they lack expertise. F.S. 468 Part VIII and F.A.C. 60-20 have strict requirements that managers only offer services for which they are duly qualified and licensed.



FINAL EXAM

1. Which of the following is true, regarding the prudent investor rule?
 - A. Fiduciaries do not need to review investments when taking over an account.
 - B. It applies to an investment portfolio, as a whole
 - C. Productivity of an investment must be judged individually, not within the investments as a whole.
 - D. It is not specifically addressed in the Florida Statutes

2. In considering different investment options, boards of directors should:
 - A. Give their greatest consideration to the return on/ yield of their investments
 - B. Consider liquidity as paramount to either growth or safety
 - C. Be at times willing to risk some loss of principal in exchange for a higher than average rate of return
 - D. None of the above

3. The Board of Directors of the Mangrove Condominium Association is, together with its attorney and financial advisors, developing an investment policy for formal adoption. Which elements should the Association consider in its policy?
 - A. It should define certain types of investments for consideration
 - B. It should delegate authority for managing the funds
 - C. It should exclude certain types of investments for consideration
 - D. All of the above

4. The Board of Directors of the Manatee Homeowner's Association is concerned for the safety of its investments. Which of the following is true?
 - A. Zero coupon bonds are protected by the FDIC.
 - B. MMFs are FDIC insured. MMDAs are not.
 - C. An association can deposit up to \$30,000,000 in one bank which is a member of the CDARS network and still be protected.
 - D. All certificates of deposit, regardless of amount, are protected by the FDIC

5. The Treasurer of the Brown Pelican Cooperative Association has been researching local banks for services provided to community associations: Which of the following services might be useful to her association?
 - A. Lockbox services
 - B. Sweep accounts
 - C. Payment activity image retrieval
 - D. All of the above

6. Which of the following is true as regards the laddering of an association's investments?
 - A. It applies to fixed-income investments
 - B. It applies to fixed-term investments
 - C. It allows for a blended long-term rate
 - D. All of the above

7. The Sage Palm Condominium Association often invests in U.S. Treasury Securities. Which of the following would not be true?
- A. Such securities are backed by the full faith and credit of the United States government
 - B. T-bills are issued weekly only, with 13, 26, and 52 week maturities, on a discounted basis
 - C. Treasury bonds and notes have maturities ranging from 20 to 30 years and pay interest
 - D. Most associations invest in zero-coupon bonds issued by the Treasury
8. Which of the following is true with regard to the fiduciary duty of board members?
- A. Boards have a responsibility to protect, invest, and enhance the association's assets.
 - B. Directors can never be held personally liable for investment decisions.
 - C. Boards may delegate their responsibility for financial decision making if they employ a professional financial advisor.
 - D. A board should focus on keeping assessments low; it is not necessary to fund reserves or operating funds to address association needs every year.
9. Suitable investments for associations include:
- A. stocks and bonds
 - B. blue chip stock funds
 - C. government bonds
 - D. all of the above
10. Laddering means:
- A. To stagger certain fixed-income investments, to maximize the overall yield, and maintain the safety and liquidity of an association's total funds.
 - B. To schedule maintenance projects over several fiscal years to reduce financial hardships on the ownership
 - C. To purchase T-bills in increasing denominations over a period of a year.
 - D. None of the above.
11. Associations can sell the following in secondary markets:
- A. CDs
 - B. Treasury Bonds
 - C. Both a & b
 - D. Neither a or b
12. A licensed C.A.M. is deemed by the Division of Florida Land Sales, Condominiums, and Mobile Homes, to qualify as:
- A. A financial advisor to CIRAs.
 - B. a tax preparer for CIRAs
 - C. both a & b
 - D. Neither a or b
13. The FDIC:
- A. Is a Florida entity that lends monies to community associations
 - B. Insures deposits of up to \$100,000 in a single institutional member.
 - C. Was established in 1892.
 - D. Guarantees all funds deposited in all banks and financial institutions in case of loss.

14. Which of the following is true?
- A. CDs most typically offer a lower yield than MMFs
 - B. MMFs are FDIC insured.
 - C. Both a & b
 - D. Neither a or b
15. A lockbox must be:
- A. be physically kept at an association's onsite office
 - B. be physically kept at a management company's office
 - C. be physically at a local banking institution
 - D. none of the above
16. Harry Smith, an association's treasurer, has personally invested large sums of monies in select stocks, realizing an average 25% return on his own investments, over the last 6 years. The association's board should:
- A. Follow Harry's obviously expert advice in investing all of the association's reserve fund monies
 - B. For reasons of safety, only invest some of its reserve fund monies in stocks recommended by Harry
 - C. Consult a reputable stock broker or registered securities dealer before any investments are made
 - D. Never invest in the stock market
17. Which of the following is true?
- A. Investing in the association's physical property may result in savings in the future
 - B. Planning is unnecessary; an association can always find a good deals on materials and services
 - C. Associations always manage their monies well.
 - D. None of the above
18. A good budget policy includes:
- A. procedures for collection of assessments
 - B. provisions for reserve budgets
 - C. a procedure for dealing with unanticipated expenses
 - D. all of the above
19. Insurance proceeds
- A. may be placed in the operating budget and used as the association sees fit
 - B. must segregated from other funds for the duration of casualty repairs
 - C. must be paid to the owner for their losses
 - D. may used for routine repairs
20. The person most responsible for assuring the fiscal health of the association, pursuant to the documents, is:
- A. the manager
 - B. the president
 - C. the treasurer
 - D. all unit owners

INSTRUCTIONS

READ CAREFULLY PRIOR TO COMPLETING ANY COURSES.

Step 1 Select the course(s) you need to take. Be sure that you select the appropriate course(s) for your specific needs. No credit is given for taking the same course more than once. (CE requirements are listed in the front of this book or you can contact the CAM Council's office.)

Step 2 Read the course materials for each course you take.

Step 3 Find the "**CAM CONTINUING EDUCATION ANSWER SHEET**", located at the back of this book. ***There is space to complete all courses on the one answer sheet.*** Fill in the "**Student Information**" section and the "**Payment Information**" section. **(Courses will not be processed until complete payment has been made.)**

Step 4 Complete your answers for each course by completely filling in one "bubble" per question. Note: A specific type of pen or pencil is not required.

Step 5 We suggest that you make a photocopy of your answer sheet for your own records.

Step 6 For "**Standard Grading**", mail your Answer Sheet to Gold Coast Professional Schools, Inc., 5600 Hiatus Road, Tamarac, FL 33321. Your Answer Sheet is graded and your course completion certificate(s) will be mailed as soon as possible, usually within 5 business days.

We also offer an optional "**NEXT DAY**" fax service. This optional service is provided for an additional \$10. Fax your completed Answer Sheet to us by 5 p.m. and we will fax your completion certificate(s) to you by 5 p.m. on the following business day. Your original completion certificate(s) will be mailed to you.

To use this service, fax your Answer Sheet to us at: **(954) 485-9865**

Note:

- To use the optional fax service, payment must be made by credit card.□
- The optional fax service is available in the continental United States only.□
- We will attempt to fax your completion certificate(s) to the number you provide up to a maximum of three times. If the third transmission does not go through, your certificate(s) will be mailed to you.□

Step 7 When you receive your certificates, ***verify that you have received certificates for each of the courses you took.*** If there are any errors or omissions, call our office at: **1-800-732-9140** as soon as possible.

Step 8 Under the new reporting procedures, Gold Coast will report your results directly to the DBPR. You should still retain your course completion certificates in case of audit.

Note: Students who do not achieve a score of at least 75% will be required to redo their examination, and pay a \$5 handling fee for the re-examination. If a student does not successfully pass the second time, they will be given a different exam. If a student is not successful on the re-examination they will have one final chance to redo the second examination. Any student who is not successful after two attempts, at two different examinations will not be allowed to attempt another through our school. The tuition paid (excluding handling fees) for the correspondence course will be credited towards the same course, offered in any of our classroom locations.

