

HOA Funds

Investing Reserve and other HOA funds: fiduciary responsibility and mitigating risk

“Are Your HOA’s Funds Being Properly Handled and Invested?”

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Management and operation of a homeowners association (“Association”) results in the Association coming into possession of large sums of funds to cover operating expenses and HOA reserves. Over a period of time, the reserve for HOA funds can grow to a very large amount of money and decisions that are made by Association directors concerning how those HOA funds are handled can have a tremendous impact on an Association.

State laws and/or an Association’s governing documents may include provisions that specify rules and policies about the handling of the Association’s funds. Association members and management personnel should be aware of what the existing laws and/or rules and policies provide. If an Association does not have a specific policy for the handling and investment of its HOA funds, it is a good idea to consult with an appropriate experienced professional (typically legal or accounting) to create one. This will ensure that the Association’s funds are treated consistently from year-to-year and that Association directors, managers, and members are aware of and understand the policy.

The directors of an Association are charged with a fiduciary duty that is owed to the Association’s members. That duty mandates that the Association’s directors make prudent decisions concerning the investment of the Association’s funds that are not being utilized for current operating expenses. Prudent investment decisions should include a consideration of risk and return. While it may be more desirable to invest funds in a manner that will generate a larger return, such as a higher interest rate, the funds should never be jeopardized by a risk of loss. Association board members and management personnel should make sure that the Association’s funds are always in accounts that are insured by the federal government. The amount of funds that are maintained in any one bank account should never exceed the maximum amount that is covered by the insurance. It is also a good practice to use separate accounts for operating and reserve account investments.

In considering how to invest Association funds, directors should keep in mind that funds required for daily operations which are typically generated by the members’ payment of monthly assessments, need to be readily available and maintained at a level that will cover all of the Association’s normal monthly operating expenses, plus a sufficient cushion to cover the unexpected. Funds that are maintained for reserves typically involve larger sums that are not be utilized the same way as the operating funds and thus, require less liquidity. As such, reserve funds can generally be maintained in bank accounts that require larger balances and earn more interest. While state laws and/or an Association’s governing documents may permit the commingling of operating and HOA reserves for investment purposes, it is a better practice to always use separate accounts for investment purposes as well. Always keeping the reserve funds separate and apart from the operating expense funds facilitates better controls and protects against the possibility of mistakenly utilizing the reserve funds for items that they are not intended to cover.

An Association's board of directors frequently changes and by nature, consists of individuals that have a variety of educational backgrounds and experience, which may or may not include an understanding of finances and investments. Decisions on the handling and investment of an Association's funds are critical to the financial future of the Association and Association boards are well advised to ensure that they are aware of requirements imposed by laws and the Association's governing documents and that the Association has adopted a specific policy that details how the Associations funds are to be handled and invested. If such policies do not exist, it would be prudent to consult with an appropriate advisor to create same.