



## Policy FIN-07

### RESERVE ACCOUNT INVESTMENT

#### 1.0 REFERENCE(S)

- CC&R Article III, Sec. 3.05, Assessments
- ISHOA Policy FIN-05, Reserve Accounts
- Revised Code of Washington (RCW) Title 64, Chapter 64-38, Homeowners' Associations

#### 2.0 BACKGROUND, PURPOSE AND DEFINITIONS

2.1 **Background.** The Board of Directors of the Indian Summer Home Owners Association (ISHOA) has a fiduciary responsibility to properly manage the funds of the ISHOA, which are divided between the Operating Account and the Reserve Account. Operating Account funds are generally held in a checking account that is managed by the currently contracted management company, in carrying out its responsibility to collect ISHOA fees and pay ongoing operational expenses. Cash management is the focus of the Operating Account funds. Reserve Account funds are the ISHOA's long-term savings designated to pay the costs of major maintenance, repair and replacement of ISHOA assets. The ISHOA Board of Directors established the Reserve Account and prepares a 30-year reserve study, which is annually updated, in accordance with Washington State laws.

Prior to the initial approval of the Reserve Fund Investment Policy in 2016, the practice was for the ISHOA Board Treasurer to invest Reserve Account funds only in certificates of deposit and money market accounts. For several years economic conditions resulted in record-low interest rates, thus preventing any meaningful return or interest income from certificates of deposit or money market accounts. This trend was not expected to significantly change any time soon. The protracted low interest rate environment meant that investment income assumptions had not, and most likely would not be met if ISHOA Reserve Account funds were only invested in certificates of deposits and money market funds.

In late 2015 the ISHOA Board President tasked the ISHOA Board Treasurer with reviewing investment alternatives for the Reserve Account with the goal of achieving investment returns that would support investment income assumptions used in the 30- year Reserve Account study while maintaining and managing an acceptable level of risk. In response to this assigned task, and as provided in the ISHOA Bylaws, the ISHOA Treasurer recruited a Finance Advisory Committee to provide assistance to the Treasurer in developing an investment policy for the Reserve Account. The Board approved Policy Fin-07 on April 21, 2016.

As allowed in Article IX of the Bylaws, the Board appointed a Finance Committee in April 2020. The Finance Committee includes the Treasurer and reports directly to the Board of Directors. The Finance Committee Charter provides that the Finance Committee, on behalf of the Board and in collaboration with the Treasurer, accepts direct responsibility for implementation and execution of Policy FIN-07 Reserve Account Investments.



**2.2 Purpose and Scope.** The Reserve Account Investment Policy was created with the goal of providing for the safety, liquidity and adequacy of ISHOA Reserve Account assets while (a) maintaining the purchasing power of the Reserve Account funds, (b) achieving investment returns that support the conservative assumptions utilized in the Reserve Study and (c) identifying, monitoring and managing inherent investment risk. In doing so this policy:

1. Establishes a framework for investment of Reserve Account funds according to Prudent Investor Standards as established by legal and regulatory laws, policies, procedures and guidelines.
2. Establishes the investment goals and objectives of the Reserve Account.
3. Defines and assigns the principal duties and responsibilities of all concerned parties concerning the management of Reserve Account funds.
4. Offers guidance and limitations regarding Investment Securities utilized by the Reserve Account.
5. Establishes requirements for monitoring, evaluating and reporting investment activity and performance.
6. Establishes the relevant investment horizon for which the Reserve Account funds will be managed.
7. Serves as a review document to guide the ongoing oversight of Reserve Account investments.

**2.3 Definitions.** For purposes of this document, the following definitions will apply:

- **“Agency Securities”** shall mean investment securities issued by federal agencies or private entities, such as the Federal National Mortgage Association and the Federal Home Loan Bank Board, that are also known as government sponsored enterprises.
- **“Asset Class”** shall mean a group of investments that tend to behave similarly and are subject to the same market forces, for example, cash equivalents, stocks or bonds.
- **“Board”** shall refer to the ISHOA Board of Directors as elected by ISHOA members in accordance with the ISHOA Articles of Incorporation.
- **“Cash Equivalents”** shall mean any short-term investment securities that have maturity periods of 90 days or less. These include banker's acceptances, Treasury bills, commercial paper and other money market instruments.
- **“Exchange Traded Fund (ETF)”** shall mean a type of investment security that involves a collection of securities, such as stocks and government or corporate bonds, that often tracks an underlying index, although they can invest in any number of industry sectors or use various strategies. ETFs are in many ways similar to mutual funds, however, they are listed on exchanges and ETF shares



trade throughout the day just like ordinary stock.

- **“Fiduciary”** shall mean any individual or group of individuals that exercise discretionary authority or control over fund management or any authority or control over management, disposition or in administration of ISHOA Reserve Account funds.
- **“Finance Committee”** shall refer to ISHOA members who, in accordance with the ISHOA Amended Bylaws, are selected by and report to the Board to work in collaboration with the Treasurer on tasks specified in the Finance Committee Charter.
- **“Investment Horizon”** shall be the time period over which the investment objectives, as set forth in the statement, will be met.
- **“Investment Policy”** shall refer to the document designed to address the objectives, constraints, unique circumstances and oversight procedures that govern investment-related activities of the Reserve Account funds.
- **“Investment Risk”** shall refer to any uncertainty with respect to “Investment Securities” that has the potential to negatively affect the Reserve Account. Examples of such uncertainties include inflation risk, market volatility, general business environment, ease or tightening of liquidity, currency fluctuations, excessive concentration in companies, industries, etc. and country specific geo-political activities. All investments carry some degree of risk which must be identified, monitored and managed.
- **“Investment Securities”** shall refer to the individual US Government and agency securities, cash equivalents, ETFs, mutual funds, corporate stocks and corporate bonds that are defined as acceptable in this statement.
- **“ISHOA”** shall mean the Indian Summer Home Owners Association.
- **“Mutual Fund”** shall mean a type of investment security made up of a pool of money collected from many investors to invest in securities like stocks, bonds, money market instruments and other assets. Mutual Funds are operated by professional money managers, who allocate the fund's assets and attempt to produce capital gains or income for the fund's investors. A mutual fund invests in a vast number of securities and its portfolio is structured and maintained to match the investment objectives stated in its prospectus. Each shareholder participates proportionally in the gains or losses of the fund. Unlike ETFs, mutual funds do not trade during the day like stocks. The share price of a mutual fund is determined after the close of the trading day.
- **“Professional Investment Manager”** shall mean any independent, compensated and properly licensed and registered individual, or group of individuals, that manage the investment of all or a part of the ISHOA Reserve Account. Examples of investment management services include (1) selection of various securities in order to meet specified ISHOA investment goals, (2) providing advice on investment objectives and/or asset allocation, (3) managing investment advisor searches or (4) monitoring



investment performance.

- **“Prudent Investor Standards”** shall refer to the expected approach by a fiduciary when managing assets for others. Prudent Investor Standards have recently evolved to an approach of nuanced risk management rather than categorical risk avoidance. As a result, fiduciaries should manage assets with an overall investment strategy having risk and return objectives reasonably suited to the specific organization. In addition, Prudent Investor Standards mean that fiduciaries (1) will diversify the investments of an organization and (2) have an ongoing duty to monitor investments and make portfolio adjustments as deemed appropriate given overall investment strategy.
- **“Reserve Account”** shall mean long-term funds designated by ISHOA for major maintenance, repair and replacement of common elements.
- **“Reserve Study”** shall mean the 30-year plan for ISHOA, which is annually updated and estimates the amount of funds to set aside for major maintenance, repair and replacement of common elements during the study period. Key inputs to the Reserve Study include assumptions regarding investment income and inflation rates, monthly contributions to Reserve Account and identification of common area assets (components) appropriate for Reserve Account funding.
- **“Separately Managed Accounts”** shall mean a portfolio of individual securities managed on behalf of ISHOA by a professional asset management firm. Unlike a mutual fund, the Reserve Account owns the individual securities in a Separately Managed Account and therefore it participates directly in each security's gains and losses.
- **“Treasurer”** shall refer to the individual ISHOA Board member who is elected in accordance with the ISHOA Amended Bylaws to hold the office of Treasurer.

### 3.0 PROFESSIONAL INVESTMENT MANAGER(S)

3.1 The Board will engage a Professional Investment Manager (third-party consultant). The Finance Committee, in collaboration with the Treasurer, will recommend a Professional Investment Manager to the full Board after obtaining a formal proposal from a minimum of two different brokers.

The investment manager will assist in:

1. Establishing investment policy, objectives, and guidelines
2. Selecting investments
3. Reviewing such investments over time, measuring and evaluating investment performance and other tasks as deemed appropriate.

Professional Investment Managers will be held responsible and accountable to achieve the ISHOA objectives. Any change in investment strategy must be reviewed and approved



by the Board.

The Professional Investment Manager has discretion to purchase, sell or hold the specific securities that will be used to meet the investment objectives.

All expenses for Professional Investment Managers must be customary and reasonable, and will be borne by the investment account as deemed appropriate and necessary. Professional Investment Managers are expected to adhere to investment management styles for which they were retained and will be evaluated regularly for adherence to investment discipline.

### **3.2 Selection of Professional Investment Manager(s)**

The Board selection of Professional Investment Manager(s) must be based on prudent due diligence procedures. A qualified investment manager must be a registered investment adviser under the Investment Adviser's Act of 1940, or a bank or insurance company. The Board requires that each investment manager provide, in writing, acknowledgment of fiduciary responsibility to the Board.

### **3.3 Investment Manager Performance Review**

Performance reports generated by the manager shall be compiled at least quarterly and communicated to the Board and Finance Committee for review. Investment performance of the total portfolio, as well as asset class components, will be measured against commonly accepted performance benchmarks. Consideration shall be given to the extent to which the investment results are consistent with the investment objectives, goals, and guidelines as set forth in the policy. The Board intends to evaluate the portfolio's total return over at least a 3-year period but reserves the right to terminate a manager for any reason including the following:

1. Investment performance which is significantly less than anticipated given the discipline employed and the risk parameters established, or unacceptable justification of poor results.
2. Failure to adhere to any aspect of this policy, including communications and reporting requirements.
3. Significant qualitative changes to the investment management organization.

The Professional Investment Manager shall be reviewed regularly regarding performance, personnel, strategy, research capabilities, organizational and business matters, and other qualitative factors that may impact their ability to achieve the desired investment results.

## **4.0 RESPONSIBILITIES**

- 4.1 **Delegation of Authority.** The Board is a Fiduciary and, as such, retains overall authority and responsibility for approving, monitoring and managing the investment of Reserve Account funds as specified in this policy. The Board delegates the implementation and execution of this policy to the Finance Committee in collaboration with the Treasurer.



The Board will employ one or more Professional Investment Managers to attain the Reserve Account's investment objectives. See Section 3.0

**4.2 Responsibilities of the Board.** The Board has a fiduciary responsibility to properly manage Reserve Account funds while adhering to Prudent Investor Standards. The Board's principal responsibilities related to investment of Reserve Account funds include:

1. Review and approve the ISHOA Reserve Account Investment Policy.
2. Approve selection of a Professional Investment Manager after considering recommendation from the Finance Committee, in collaboration with the Treasurer.
3. Require best efforts of Professional Investment Manager for achievement of ISHOA investment objectives.
4. Review and approve any change in investment strategy proposed by the Professional Investment Manager.
5. Review quarterly reports from Professional Investment Manager and consider any related comments or suggestions provided by the Finance Committee, in collaboration with the Treasurer.
6. Annually review and update the ISHOA Reserve Account Investment Policy after considering recommendations from the Finance Committee, in collaboration with the Treasurer.
7. Annually review and approve key inputs to the Reserve Study, which is a key planning tool utilized by the Board, Treasurer and Finance Committee. The Reserve Study helps determine liquidity needs from the Reserve Account.
8. Review performance of Professional Investment Manager after considering recommendation from the Finance Committee, in collaboration with the Treasurer.

**4.3 Responsibilities of the Finance Committee and Treasurer.** The Finance Committee, in collaboration with the Treasurer, is delegated the responsibility for implementation and execution of this policy. The principal responsibilities related to investment of Reserve Account funds include:

1. Monitor Reserve Account investments and recommend portfolio adjustments, as deemed appropriate given overall investment strategy, to the Professional Investment Manager.
2. Perform a semi-annual review of the Reserve Account investment portfolio holdings for purposes of monitoring investment risk. Suggested portfolio adjustments resulting from these reviews are forwarded to the Professional Investment Manager.



3. Perform a semi-annual review of the Reserve Account investment returns for purposes of comparison to the Reserve Study interest rate assumption. The timing for this review should be coordinated so that the resulting information is available for the annual update of the Reserve Study and preparation of the next year's budget. Suggested changes resulting from these reviews are forwarded to the Board for consideration.
4. Annually review Professional Investment Manager's performance and recommend to the Board either their continuation or dismissal. Generally, performance over a period of at least three (3) years will be considered.
5. Perform an annual review of this policy to ensure that all language and content reflect current fiduciary views and remain aligned with long-term objectives. Suggested changes to this policy resulting from these reviews are forwarded to the Board for consideration.

#### **4.4 Responsibilities of Professional Investment Manager(s)**

The Professional Investment Manager's role is that of an advisor through the Finance Committee to the Board. Investment advice on investment management of funds will be offered by the manager, and will be consistent with ISHOA investment objectives, policy and guidelines. Specific responsibilities of the manager include:

1. Assisting in the development and periodic review of the investment policy via verbal suggestions.
2. Conducting investment research when requested by the Finance Committee, in collaboration with the Treasurer.
3. Monitoring and communicating the performance of the investment portfolio to provide the Finance Committee and the Board with the ability to determine the progress toward the investment objectives.
4. Reviewing historical capital markets performance and contents of this investment policy to any newly appointed members of the Finance Committee or Board.
5. Acknowledging in writing its acceptance of responsibility as a fiduciary.
6. Each manager will have full discretion to make all investment decisions for the assets placed under its jurisdiction, while observing and operating within all policies, guidelines, constraints, and philosophies as outlined in this policy.
7. Discretionary investment management including decisions to buy, sell, or hold individual securities, and to alter asset allocation within the guidelines established in the policy.
8. Reporting, on a timely basis, quarterly investment performance results.
9. Obtaining Board approval in advance for any change in the investment strategy.



10. Communicating any major changes to economic outlook, investment strategy or any other factors that affect implementation of investment process, or the investment objective progress of the operating funds investment management.
11. Informing the Treasurer regarding any qualitative change to investment management organization: examples include changes in portfolio management personnel, ownership structure, investment philosophy, etc.
12. Voting proxies, if requested by the Board, on behalf of the Reserve Account, and communicating such voting records to the Treasurer on a timely basis.

## **5.0 INVESTMENT GUIDELINES**

### **5.1 General Guidelines**

- 5.1.1 Reserve Account investments shall be made solely in the best interests of ISHOA.
- 5.1.2 Reserve Account funds shall be invested utilizing Prudent Investor Standards: with care, skill, caution and diligence that a prudent investor, under the circumstances then prevailing, acting in like capacity, and familiar with such matters, would use in the investment of funds of like character and with like objectives.
- 5.1.3 Investment of Reserve Account funds shall be so diversified as to minimize the risk of material loss, maintain the purchasing power of the Reserve Account funds, achieve investment returns that support the conservative assumptions utilized in the Reserve Study and provide for the safety, liquidity and adequacy of Reserve Account funds unless, under the circumstances, it is clearly prudent not to do so.
- 5.1.4 Reserve Account cash is to be employed productively until it is required for eligible expenditures.
- 5.1.5 The Board will employ one or more Professional Investment Manager to attain the Reserve Account's investment objectives.



**5.2 Asset Allocation.**

As explained in more detail in Sections 5.3 and 5.4 below, the Professional Investment Manager will adhere to the following asset allocation guidelines:

	Minimum	Maximum		
Certificates of Deposit, Cash Equivalents and US Government & Agency Securities	70%	100%		
Corporate Stocks and Bonds	0%	30%		
Corporate Stocks in a moderately conservative portfolio	0%	12%	Maximum Up to 40% of 30% =	12%
Corporate Bonds in a moderately conservative portfolio	18%	30%	Minimum at least 60% of 30% =	18%
Total in Corporate Stocks and Bonds				30%

**5.3 Certificates of Deposit, Cash Equivalents and U.S. Government and Agency Securities**

5.3.1 **Investment Strategy.** The investment strategy for 70% of Reserve Account funds is to minimize investment risk by investing in certificates of deposit, cash equivalents, U.S. Government and Agency securities. The key objectives of these investments are:

- Preserve capital
- Maintain liquidity
- Provide current income

5.3.2 **Investment Guidelines.** This portion of Reserve Account funds may be invested only in certificates of deposit, cash equivalents, U.S. government securities and separately managed accounts, mutual funds and / or ETFs of such assets.

Certificates of Deposit (CDs) will be purchased only from financial institutions offering FDIC insurance. The fixed term of a CD will be no longer than five (5) years. The combined total of all CDs, deposit accounts and accrued interest thereon with the same financial institution must be less than the FDIC coverage limit, currently \$250,000.

Fixed-income maturity restrictions are as follows: maximum maturity for any single security is 5 years.



When investing in mutual funds or ETFs, decisions regarding duration will be cautiously made after consideration of current market conditions and trends.

Money market funds selected shall only contain securities whose credit rating, at the absolute minimum, are rated investment grade by a reputable rating company or agency (e.g. Standard & Poor's and or Moody's).

In order to achieve a prudent level of portfolio diversification no single investment will exceed 10% of the Reserve Account unless such investment is federally insured (e.g. certificates of deposit and then only up to the limit of federally insured). Additionally, this portion of the portfolio will be diversified as to maturity of fixed income investments (including laddering of maturities when appropriate) and coordinated with the Reserve Account spending plan, as documented in the Reserve Study.

## 5.4 Stocks and Bonds

**5.4.1 Investment Strategy.** The Board expects to achieve a conservative rate of return on the investment of Reserve Account funds as documented in the most current Reserve Study. There are times when extended economic conditions will not allow any meaningful return from cash and certificates of deposit. To reach the expected rate of return, the Board authorizes investment of **up to 30% maximum** of Reserve Account funds in a moderately conservative allocation portfolio, including income producing mutual funds and/or exchange-traded funds ("ETFs"). Considerations for such investing include market conditions, interest rates, risk management, time horizon, inflation and spending plans. Investment in individual stocks or bonds is not allowed with the exception of use of a Separately Managed Account. In such an instance involving a diversified corporate bond portfolio, each bond must be rated AA or better and each bond must have a remaining term of no more than 5 years at the time of purchase.

The investment strategy for up to 30% of the Reserve Account funds is to emphasize total return, that is, modest capital appreciation plus dividend and interest income.

The key objectives in the investment in equity or fixed income mutual funds or ETF's are:

- Preserve purchasing power over the investment horizon to achieve returns exceeding the rate of inflation.
- Maintain liquidity.
- Maintain appropriate levels of risk.

**5.4.2 Investment Guidelines.** Investments involving stocks and bonds will only be made via low risk, low cost, well diversified, highly liquid and income generating mutual funds, ETFs and Separately Managed Accounts. Bonds include instruments that are neither US Government nor agencies securities. Investments will not be made in individual stocks or bonds, with the exception of use of a Separately Managed

Account. In such an instance involving a diversified corporate bond portfolio, each



bond must be rated AA or better and each bond must have a remaining term of no more than 5 years at the time of purchase.

Selection of specific mutual funds, ETFs and / or Separately Managed Accounts will be such that the up to 30% allotment will reflect a moderately conservative investment portfolio. Standard and Poor's Morningstar, Reuters or other reputable rating companies will be used to measure the quality of funds, determine "best of breed" and provide documentation for the investment choices made. When investing in mutual funds or ETFs, decisions regarding duration will be cautiously made after consideration of current market conditions and trends.

## 6.0 PROHIBITED INVESTMENTS AND TRANSACTIONS

Prohibited non-liquid investments include, but are not limited to the following:

- Commodities and futures contracts
- Private placements
- Options
- Venture capital investments
- Interest only (IO), principal only (PO), and residual tranche CMOs
- Derivative securities

Prohibited transactions include, but are not limited to the following:

- Short selling
- Margin transactions

## 7.0 RISK MANAGEMENT

**7.1 Liquidity Risk Management.** The Board requires that all Reserve Account funds be invested in liquid securities, defined as securities that can be transacted quickly and efficiently with minimal impact on market price. To ensure liquidity, investments will be limited to those listed on the following exchanges: New York Stock Exchange, American Stock Exchange and NASDAQ over-the-counter market.

To minimize the possibility of a loss occasioned by the sale of a security, forced by the need to meet a required payment, the Finance Committee, in collaboration with the Treasurer and the Board, will periodically review the Reserve Account's expected net cash flow. The Finance Committee will recommend portfolio adjustments to the Board and to the Professional Investment Manager so that upcoming cash needs are met. For unplanned cash requirements the Board establishes a \$50,000 minimum balance of cash and cash equivalent investments, which may be held either in the account with the Professional Investment Manager or in a designated money market account managed by the currently contracted ISHOA management company.

**7.2 Interest Rate Risk Management.** Certificates of deposit and U. S. government securities will be purchased with the intent of holding them to maturity thus avoiding premature liquidation and possible loss of purchasing power. The maximum maturity for any individual investment will be 5 years. During periods of probable future rising



interest rates, maturities will be kept appropriately short to allow for re- investment at higher rates as they

**7.3 Purchasing Power Risk Management.** A key objective in the investment of Reserve Account funds is preservation of purchasing power. It is important that, over time and with consideration of risk tolerance, investment income offset the impact of inflation on the cost of major common area repairs and replacements. There may be times when economic conditions are such that the portfolio does not generate sufficient return to preserve purchasing power and increasing risk tolerance is an unacceptable choice. In such situations the Operations Account may need to increase the annual funding of the Reserve Account.

**7.4 Diversification Risk Management.** In order to achieve a prudent level of portfolio diversification no single investment will exceed 10% of the Reserve Account funds unless such investment is federally insured (e.g. certificates of deposit and then only up to the limit of federally insured). Additionally, the portfolio will be diversified as to maturity of fixed income investments (including laddering of certificate of deposit maturities when appropriate) and coordinated with the reserve spending plan.

## **8.0 ANNUAL FORECAST OF RESERVE ACCOUNT**

The Reserve Study is the 30-year plan for ISHOA, which is annually updated and estimates the amount of funds to set aside for major common area repair and replacement expenditures during the study period. Key inputs to the Reserve Study include assumptions regarding investment income and inflation rates and monthly contributions (transfers from the Operating Account) and identification of common area assets (components) appropriate for Reserve Account funding. The Board and Finance Committee will meet annually to review and agree on these key inputs. The Finance Committee, in collaboration with the Treasurer, uses the Reserve Study when carrying out their responsibilities, thus it is very important that the key inputs are as accurate as possible.

## **9.0 INVESTMENT POLICY REVIEW**

To assure continued relevance of the guidelines, objectives, financial status and capital market expectations as established in this policy, the Finance Committee, in collaboration with the Treasurer, will review this policy at least annually and forward recommendations to the Board for consideration.

## **10. EFFECTIVE DATE AND RECORD OF AMENDMENTS**

**04/21/2016**, Original policy approved per Board Motion 2016-012 and subsequent notice sent to owners, effective 7/1/2016.

**06/13/2016**, Reformatted and renumbered policy to FIN-07 (per new policy ADM-01, Policy Numbering and Format and Board Motion 2015-011).

**06/15/2017**, Revised as follows: Section 2.3 Definitions, added "Separately Managed Accounts"; Sections 4.3.1 and 4.3.2, changed 30% of Reserve Funds to "up to 30-50%"; Section 5.0 Prohibited Investments, deleted "Limited partnerships" and deleted "Real estate properties." Approved by Board Motion 2017-040

**08/17/2020**, Overall revision, adding language to hire a professional investment manager, adding language to formalize the finance committee, approved per Board Motion 2020-062