INVESTING ASSOCIATION FUNDS – THE PRUDENT INVESTOR RULE
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Does your association have a written policy with regard to investment of association funds? If so, does the board of directors monitor the investment to ensure compliance with the policy, and, is the policy reviewed and updated from time to time? If not, is the board of directors exposing itself to needless liability under both Common Law and statutory obligations of prudent management?

Whether your association is a condominium association governed primarily by Chapter 718, Florida Statutes, or a Homeowners association governed primarily by Chapters 607 and 617, Florida Statutes, it is imperative that the governing body of the association invest association funds in a reasonably prudent manner. In serving as directors and/or officers of these corporations, individuals expose themselves to liability for mismanagement and, in many cases non-management, of association funds.

If your association is a condominium association, Section 718.111(1)(a), Florida Statutes, states, in pertinent part, that officers and directors of the association have a "fiduciary relationship" to the unit owners. As such, officers and directors sit in a position of trust and confidence, requiring that their actions be exercised in good faith and in the best interests of all unit owners. For example, since all budgets must include reserves for capital expenditures and deferred maintenance, unless waived in accordance with Section 718.112(2)(f), Florida Statutes, a primary responsibility of the board is the protection of, and hopefully the enhancement of, the association's reserve funds.

If your association is a homeowners association, the same fiduciary relationship exists between the board of administration and members of the association. The Common Law established that directors of Florida corporations have both a "duty of loyalty" and a "duty of care" to the corporation. These fiduciary duties were later extended to officers of corporations, as well. While violations of the duty of loyalty generally involve unfair dealing, violations of the duty of care generally involve corporate mismanagement and waste. Inherent within this duty is responsibility for the protection and preservation of the corporation's assets. The Florida Legislature, by enacting Section 607.111(4) Florida Statutes, codified these Common Law duties. The statute provides, in pertinent part, that a director must perform his duties in good faith, in a manner reasonably believed to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances. This section is commonly referred to as the "Business Judgment Rule," a rule which is normally used to justify the actions of officers and directors of a corporation. The requirements set forth within this section are equally applicable in defining the scope of duty and obligation that the governing body of the association has with regard to the investment, or non-investment, of association funds.

Boards of directors are faced with the delicate task of balancing their financial goals, needs, and obligations. On the one hand, the association wants a strong return or yield on its investment, sufficient to meet the ever-increasing costs of repair or replacement of common areas. On the other hand, it is necessary to maintain sufficient liquidity in the event of an emergency. The security or safety of the investment is equally important. Therefore, boards of directors are faced with legitimate and substantial questions, such as: whether or not to hire a professional money manager, what type of investment policy should be adopted, and how best to monitor the portfolio, once a policy is implemented.

What kind of investments would a prudent board make of association funds? What kind of liabilities attach to the investment decisions which are made? A 1974 case, from a Federal District Court in Washington, DC, provides an interesting and illustrative answer to both questions.

In the case of Stern v. Lucy Webb Hayes National Training School for Deaconesses and Missionaries (381 F.Supp. 1003), a non-profit charitable corporation was established to provide indigent health care in the Washington, DC area. The corporation built a hospital consistent with its purposes. The hospital operated as a separate entity from the charitable corporation. However, for approximately 65 years both institutions were essentially operated by a single Board of Directors. In 1960, after breaking ground for a new hospital, the Board of Directors decided that things needed to be changed. They expanded the Board of Directors, revised the corporate By-Laws, and established Committees for the operation of the hospital, including an investment committee charged with management of the hospital's investments. Unfortunately, the change in the By-Laws did not mean a change in the way money was actually being handled. After the death of two employees who had been acting as all of the committees and the Board, the Corporation's fiscal problems were revealed. Testimony of the other Board Members indicated that neither the finance nor the investment committee had conducted business, or even met, from 1960 to 1971. Approvals of the yearly audit were made as mere formality, and relevant details were never critically examined. Investment decisions were left to the presumed expertise of the Treasurer, who refused to accept any investment suggestions from Board Members. The Court found that in one year nearly $4,000,000.00 was available for investment, yet more than one-third of this amount was in a non-interest bearing checking account. Only $300,000.00 was invested in Treasury Bills, and 1.3 Million Dollars had been invested in Certificates of Deposit, but had not been purchased at institutions offering the highest rate of interest. As if that weren't bad enough, the Court found that other checking accounts and Certificates of Deposit were in financial institutions in which the directors of the hospital were also directors or major stockholders. The Court found the Directors guilty of mismanagement, non-management, and self-dealing.

The Board was guilty of mismanagement because the directors had defaulted in their fiduciary capacity. Even though a corporate director may delegate his investment responsibility to fellow directors, corporate officers, or even agents, directors must continue to exercise general supervision over their delegates. Directors cannot delegate fundamental responsibilities. A corporate director is permitted to rely on the expertise of those to whom he has delegated investment responsibility, but such reliance is not an excuse for dispensing with or ignoring the delegate's reports. The director must still interpret the reports and use those interpretations as a basis for decision making. Directors who fail to acquire information necessary to supervise corporate investment policy, or who consistently fail to attend meetings at which such policies are considered, violate their fiduciary duty to the Corporation.

The Board was guilty of non-management because the directors had not acted as a Board. They made no independent decisions. The Court took notice of the fact that the specially-created committees had rarely met and that no one seemed to notice or care. The Board was also guilty of self-dealing when the directors allowed their individual interests to come ahead of the interests of the hospital.

The conclusions to be drawn from this are as follows:

1. While a director can delegate investment authority to fellow directors or third parties, directors must continue to exercise general supervision over the activities of agents. Responsibility must be maintained even though authority may be delegated.

2. Appointment of an executive or other investment committee is authorized under corporate law. However, such appointment will not relieve all directors from responsibility for supervising the committees on a periodic basis. If there are committees, make sure they meet and conduct the business they are charged with. Final decisions should be made or ratified at a meeting of the board.

3. Total abdication of the supervisory role is improper under every corporate principle. Directors who fail to acquire information necessary to supervise investment policy, or consistently fail to attend meetings in which policies are considered, violate their fiduciary duty to the corporation.

4. In those rare cases in which a director has an interest in an outside company dealing with the investments, the director should make sure to disclose the interest and abstain and assert a conflict of interest on any vote which involves contracting with the company with which he is involved.

5. Finally, the board should adopt a specific corporate resolution detailing the investment program to be utilized by the association. The plan should leave the choice of investment to the board of directors with or without certain guidelines, such as: limiting investments to a list of permitted investments (such as "A" bonds, federally insured Certificates of Deposit, etc...); or limiting, by dollar amount, the total funds to be invested in any single investment. The governing documents of the association should be carefully examined to determine whether there is language hindering the investment plan. The governing documents may need to be amended to implement the investment policy.

Even though your association may not have millions of dollars to invest, the guidelines of the aforementioned case are worth following. If your board of directors determines that it is in its best interests to hire a professional money manager, be careful to review the contents of any contract between the association and the professional. The contract should provide that the professional carefully read your documents and acknowledge that any investment decision will be undertaken in accordance with the documents and in accordance with Florida Law. Other important criteria of the contract might include: an express limitation on authority to invest investment objectives and limitation on dollar investments in any particular area and the necessity of bonding any person who handles the association funds.

Remember, some association documents contain specific limitations on the type of depository in which association funds may be placed. For a review of your documentary provisions or for further information, contact your Association attorney.

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