By Andrew Ahrensdorf

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Banking & Financial Trends

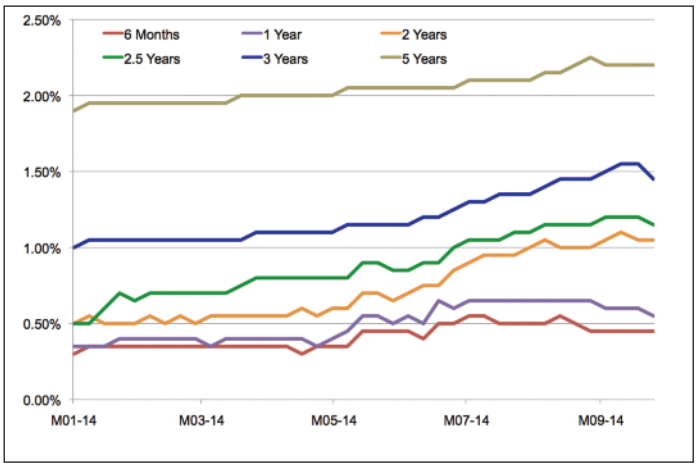
Reserve Portfolio Management

Maximizing Returns in a Historically Low Rate Environment

Every board has a fiduciary duty to ensure that reserve funds are invested responsibly. However, there are many creative ways to manage reserve investment allocations in today's world of low interest rates. Some common questions from Board Treasurers are: What investment vehicles do associations invest in? What are ways to increase yield while maintaining FDIC-insurance and adequate liquidity? What is the most optimal allocation? The answers depend on a number of factors that relate to your community's age, reserve study, by-laws and even geographic location. Each state has its own legislation for association reserve fund management to protect owners and in some ways, guide associations to help support fiscal health. For example, reserve studies are required in many states, including Virginia. Reserve studies are a powerful budget-planning tool to help boards craft a long-term funding strategy to anticipate deterioration of common elements, and to ensure that sufficient funds are available to address common area expenditures.

Since reserve studies help us forecast and understand the expected timing and size of certain expenditures, laddering FDIC-insured CDs remains a popular strategy for investing reserves. However, we have seen many clients decide that since short-term (3–12 month) CDs are presently yielding such miniscule returns, they have opted to keep those balances in liquid FDIC-insured money market accounts. The national averages for a one-year and two-year bank CD have been less than some higher-yielding money market account rates. Why would you lock your money up for two years if you can get the same or better return in a liquid money market account?

So if CD yields on the short end are low and you risk diminishing your return if you buy a long-dated CD and must break it early, at what maturity range should you target CD purchases? The two to three year part of the curve makes the most sense. Yields are currently between 1.00 - 1.55 percent which is respectable in this market. Since January 2014, two-year CD yields have increased approximately 120 percent while one-year CD yields have only risen nearly 50 percent, and five-year CDs have remained fairly stagnant[1]. With the economy sputtering along in an extremely volatile state, economic consensus is that we won't see a rise in the Federal Reserve's target rate until after September 2015. Federal Reserve Vice Chairman Stanley Fischer indicated recently that concerns regarding global growth could lead the Fed to "remove accommodation more slowly than otherwise"[2]. The Consumer Price Index rose 1.7 percent year-over-year through August 2014, which is short of the Fed's 2 percent goal[2]. With inflation in check and global economic growth weakening, two to three year CDs offer the best value for association CD allocations in today's market.



Since risk and return are correlated, typically the longer the term of a CD, the higher the return. Like any investment portfolio, sound diversification is fundamental to managing risk. Therefore, it is important to have adequate liquidity in the form of insured, interest-bearing money market account deposits. Many boards rely on their management companies to provide banking relationships that offer above-average deposit rates. Others do their own research through bank websites or local newspapers to seek the highest regional deposit rates. As far as the "optimal" allocation, focus on having a strong balance between both liquid money market accounts and income-producing CDs in order to maximize returns while maintaining the necessary liquidity buffer if needs arise.

[1] Hotaling Investment Management, October 29, 2014.
[2] Bloomberg, October 22, 2014.