
RESOLUTION PROPOSAL

DATE: November 17, 2009

SUBJECT: Amend PM 4.02Q Financial Management: LMOA Investment Policy to clarify language and purpose of the Emergency Reserve Account (ERA) and restore language consistent with restrictions of 1998 vote of the membership

SPONSOR: Treasurer Harrison

BACKGROUND INFORMATION:

At the September 12, 1998 Special Meeting of Members of the Lake Monticello Owners' Association, the membership approved the sale of the Lake Monticello Service Company, a then wholly owned subsidiary of the Lake Monticello Owners' Association, to Aqua Source, Inc.

The membership also voted:

[t]o approve the principal from this sale be invested and under the care of the Members requiring a vote of the Members for the principal to be used. ***The interest from this principal shall be available to the Board of Directors for use in maintenance, upkeep, general care of the amenities and assets of the corporation and capital needs.***

[emphasis added]

The proceeds from the sale of the Service Company were originally invested under the following direction:

The investment objective for the funds derived from the sale of the Lake Monticello Service Company is to preserve and enhance the capital. ***The original principal of the fund is to be kept intact until determined otherwise by a vote of the members of the Owners' Association.*** Interest and dividends earned by the fund may be used as determined by the Board of Directors of the Owners' Association.

[emphasis added] (4.02Q, February 25, 1999)

TAB 10.2

In July 1999, LMOA obtained a legal opinion, which is now generally available within the LMOA community, from Mays and Valentine L.L.P. regarding Uses of Proceeds of Sale of Stock of Lake Monticello Service Company. On page 2, the opinion reads in pertinent part, that “[t]his letter does not address whether any of the principal may be invested in a manner which could result in a **loss of its value** or in a capital loss. Nevertheless, we believe it would be prudent **if only income from the principal is invested in a manner which could result in a loss in order to avoid any questions or conflicts regarding this issue ...**” Neil S. Kessler [emphasis added].

In April 2009, the then Board of Directors approved certain changes to 4.02Q that allow the Treasurer to withdraw interest and dividends from the investment account regardless of the value in the account.

At the direction of the Treasurer, **interest and dividends received into the ERA may be withdrawn for use by the Board of Directors in the maintenance, upkeep, general care of the amenities and assets of the corporation and capital needs.**

The Board of Directors may authorize **additional withdrawals** from the ERA **provided the Value of the ERA following said withdrawal will be greater than the Principal**. Any withdrawal **other than interest or dividends** after which the Value of the ERA will be less than the Principal will require approval of the members.

[emphasis added] (4.02Q, April 23, 2009)

In May 2009, concerned residents raised issues with the above changes. Several BOD members expressed concern about the application of this policy and suggested that the issues be addressed after the election of board members at the July 2009 Annual Meeting.

Subsequent to the election, two principal issues have been in discussion, the first being defining the value of the ERA, and the second being whether or not it is allowable to continue to withdraw investment income, even if the market fluctuation takes the Value below the Principal of \$6,630,063. The question is whether any withdrawal, including investment income would require a member vote if the Value is below the Principal.

The current policy allows the Treasurer to make withdrawals of funds for use by the Board of Directors. The proposed change would elevate this to require a majority vote of the Board of Directors to withdraw any funds above the Principal and approval of the members for any use of the Principal.

STAFF RECOMMENDATION: Concur

PROPOSED FINANCIAL IMPACT: Preservation of the ERA as per commitment to property owners. If this motion is approved, the Board would be unable to use investment income earned from the Principal until the value is returned to above the \$6,630,063 amount. In a downturn of the economy where sudden market declines take the Value under \$6,630,063, the Board of directors would need to make cuts in the budget to eliminate the shortfall created by not being able to use investment income and would lose discretionary funding to make up shortfalls in other areas.

PROPOSED SOURCE OF FUNDING: No costs to be incurred unless another legal opinion is sought.

STRATEGIC PLAN REFERENCE: Meeting BOD's legal obligation to preserve the ERA principal and transparency to financial handling of the ERA

POSSIBLE MOTIONS:

There are two motions required. The first motion has two choices and resolves policy on withdrawals, elevates withdrawal decisions to a Board of Directors vote and restricts withdrawals of investment income when the Value of the ERA is less than the Principal. The second is to approve the balance of other changes, including defining the Value of the ERA.

Motion 1a.

Move that the Board of Directors change the policy on withdrawal of investment income to read as follows:

By majority vote of the Board of Directors, interest and dividends received into the ERA may be withdrawn for use in the maintenance, upkeep, general care of the amenities and assets of the corporation and capital needs.

The Board of Directors may authorize withdrawals from the ERA provided the Value of the ERA following said withdrawal will be greater than \$6,630.063. Any withdrawal after which the value of the ERA will be less than the Principal will require approval of the members.

Motion 1b.

Move that the Board of Directors change the policy on withdrawal of investment income to read as follows:

By majority vote of the Board of Directors, interest and dividends received into the ERA may be withdrawn for use in the maintenance, upkeep, general care of the amenities and assets of the corporation and capital needs.

The Board of Directors may authorize withdrawals from the ERA provided the Value of the ERA following said withdrawal will be greater than \$6,630.063. Any withdrawal **other than** interest or dividends after which the value of the ERA will be less than the Principal will require approval of the members.

Motion 2.

Move that the Board of Directors approve the changes to PM 4.02Q as presented at the November 19, 2009 meeting as modified by (Motion 1a or Motion 1b).

PERSONS RESPONSIBLE FOR FOLLOW-UP: Treasurer and General Manager

Summary of changes between First Reading and Second Reading

VII. EMERGENCY RESERVE ACCOUNT (ERA)

B. Source and value of funds

The “Principal” in the ERA are the funds initially invested after being obtained from the sale of the Lake Monticello Service Company (LMSC) in the initial investment amount of \$6,630,063.

The “Value” of the ERA is the current ~~market~~-value of the securities and cash in the Account, less any interest and dividends that have been received but not withdrawn. ~~Securities which~~**The Value of the securities in the ERA shall be the lesser of**

- i. **current market value; or**
- ii. **maturity value, for securities that will mature and for which there is both the ability and intent to hold until maturity**~~may be valued at maturity value.~~

D. Investment Objectives

The ~~objectives of the~~investment **objective for the funds derived from the sale of the Lake Monticello Service Company is to preserve and enhance the value. The Principal of the fund is to be kept intact until determined otherwise by a vote of the members. Investment income earned by the fund may be used as determined by the Board of Directors.** Investment of funds in the ERA are ~~the~~**for** preservation of capital and, to the extent possible, maintaining and increasing the ~~value~~**Value** of the fund by prudent investments so as to preserve and increase the purchasing power of the fund. The management goal for the long term will be to diversify into several sectors of the market. The primary strategy to meet this goal will be to establish over time a diversified portfolio of mutual funds in addition to fixed income securities.

E. Investment Policy

Investments of the ERA shall be managed for total return, giving careful attention to such factors as business (or credit) risk, market risk, interest-rate risk, price-level risk, fixed income allocation, diversification, type and investment quality of individual securities, the past performance and volatility of the financial markets, and the effects of inflation. With investment, the ERA ~~principal~~**Principal** is at risk and may drop below the ~~initial principal~~**Principal** of \$6,630,063 due to market fluctuations. ~~The investment policy is to attempt to retain the original principal amount. If the ERA falls below the original principal, it shall require a majority vote of the Board of Directors to withdraw investment income.~~**In this event, investment income may still be used for its intended purpose..**

I. Withdrawals

~~At the direction~~**By majority vote** of the ~~Treasurer~~**Board of Directors**, interest and dividends received into the ERA may be withdrawn for use ~~by the Board of Directors~~**in** the maintenance, upkeep, general care of the amenities and assets of the corporation and capital needs.

The Board of Directors may authorize ~~additional~~ withdrawals from the ERA provided the Value of the ERA following said withdrawal will be greater than ~~the Principal~~**.\$6,630.063**. Any withdrawal other than interest or dividends after which the ~~Value~~**value** of the ERA will be less than the Principal will require approval of the members.