



LYNN WEALTH MANAGEMENT
RESERVE FUND MANAGEMENT

White Paper #4

An authoritative guide designed to help board members make educated decisions.

Types of Risk & How to Reduce Them

For Community Associations' Reserve Funds

Credit Risk

The possibility that an investment will default, by failing to repay principal and interest in a timely manner. This risk can be avoided by investing in securities that are backed directly by the U.S. Government or by an agency of the U.S. Government. (FDIC insured CDs)

Reinvestment Risk

The risk of an investment maturing during when rates are lower than when the original investment was made. This risk can be reduced by staggering the maturities of CDs (Laddering).

Interest Rate Risk

This can occur when a CD is purchased and interest rates subsequently increase, thus making the yield of that CD less attractive. Like reinvestment risk, Interest rate risk may also be reduced by laddering maturities of CDs.

Most associations' Board of Directors are aware of *credit risk* and avoid such risk by purchasing Certificates of Deposit (CDs) in amounts within the \$250,000 FDIC limit at various financial institutions. However, many Boards tend to neglect to consider *reinvestment risk* and *interest rate risk* even though there are strategies available that help mitigate such risks.

Obviously, an association wants to have enough money available to meet their anticipate cash flow needs. For example, if a major reroofing project is planned for early next year, the board will want to have money available in time to meet that expense. This is most often accomplished by having a CD, or multiple CDs, mature in time to meet the anticipated outflow. When no major expenses are anticipated over the next 2 to 3 years, an association is often best served by evenly spreading CD maturities out over that period rather than having an exceptionally large percentage of their total reserves mature at once.

For more information contact us at dave@lynnwm.com

CDs are insured by the FDIC, an independent agency of the U.S. Government, up to a maximum of \$250,000 (including principal and accrued interest) for all deposits held in the same insurable capacity (e.g. individual account, joint account, IRA etc.) per CD depository. Investors are responsible for monitoring the total amount held with each CD depository. All deposits at a single depository held in the same insurable capacity will be aggregated for the purposes of the applicable FDIC insurance limit, including deposits (such as bank accounts) maintained directly with the depository and CDs of the depository. For more information visit the FDIC website at www.fdic.gov.

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Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

The views expressed herein are those of the author and are subject to change without notice. Neither the information provided nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. Past performance is no guarantee of future results.

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