The following article is a reprint from Condo Management

Is a loan the answer?

To borrow or not to borrow? That is the question!

By Harold Blinder

Condominium and homeowner association properties are aging. Even the best maintained property cannot avoid this process. Professional managers and directors with fiduciary responsibilities face an era of serious decision making to maintain property values. The following information provides an overview of the financial tools available to facilitate property repairs and replacements.

Reserves

Many community associations have adequate reserves based on their reserve studies. Those associations will be able to utilize reserve funds for their major repair and replacement projects. In some cases, reserve funds will be inadequate to fully pay for the project because of timing differences, underestimation of costs, or perhaps it's an unexpected problem. A partial special assessment or another source of funds will be needed to supplement available reserve funds.

Up-front special assessment

"Special assessments" are the ultimate dirty words for community association directors and managers. The membership has always voted down reserves. The ten-year roofs are now 15 years old. It's time to pay the piper. Remember those monthly board meetings with five attendees? Post that special assessment meeting notice and suddenly you need a football stadium for your meeting.

The loan

A loan is another option. The borrowing option is still an excellent alternative for consideration. When borrowing funds for repairs or replacement projects, the association avoids the unpleasant specter of assessing unit owners up front. These upfront assessments can come with high price tags and become financial burdens for unit owners. By borrowing the funds and extending repayments over the loan term unit owners can budget the monthly allocated payback without seeking their own equity loans or tapping into savings accounts. The association can either pass a long-term special assessment or include the payback as part of its annual budget preparation for each year the loan continues to have an outstanding balance. Some associations can utilize a portion of their reserve accounts and/or their operating accounts as compensating balances with the lending institution to reduce the interest rate and fees for the loans.

What type of loan

A line of credit allows an association to borrow funds by utilizing a credit account, similar to a credit card. If a repair or replacement project takes a period of time and the contract requires progress payments, a line of credit may be beneficial. The association will only pay interest monthly on those funds drawn. Normally these credit lines have a specific term and are automatically converted to a term loan. A term loan is the credit facility that retires the amount borrowed over a specific time period. The term loan allows an association to make repairs and pay the money back over time. This is much more attractive than an upfront special assessment, since the payments are spread over a multi-year period.

The basic application process

Managers and directors should have a basic understanding of those procedures they will encounter when a lending transaction is completed. The directors and professional staff will have determined that the association has the authority to enter into the borrowing arrangement.

Individual association analyzed

The financial institution will ask for pertinent financial records to underwrite the loan. Maintenance payment delinquency trends will be of great importance. Upon approval by the bank, the association should receive a commitment letter, outlining the terms and conditions of the loan. This document should be reviewed with association counsel. Upon acceptance of the commitment, a closing will occur, and project funding can begin. Associations should allow one full quarter for the entire process, from planning and due diligence until closing.

By borrowing, an association can maintain and enhance the community without completely draining liquid reserves. The board will then have access to reserves for other repairs. A loan may also provide contracting advantages. By completing the whole job at once, discounts may be obtained for time and materials.

Associations should expect efficient service from their bank. Select a bank that is familiar with condominium and homeowners associations. Your banker should be able to answer all of your questions. Remember, if you have ample allocated reserves, use them as needed. If not, borrowing may be the answer.

This article is provided as general information and not intended to constitute legal or financial advice. You should rely on the advice of your own legal and financial counsel regarding specific issues pertaining to your association.

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