# Is a Loan the Answer?

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

By Harold Blinder

The following article is a reprint from *CondoManagement Magazine.*

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, under-estimation 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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# To Borrow or Not to Borrow:

## The Sequel

By Harold Blinder

The following article is a reprint from *CondoManagement Magazine.*

I wrote the original article during what I consider the infancy of Community Association Lending. My cohorts and I embarked on a sea of uncharted waters, driven by an engine revved up by community associations starved for cash. The funny part is, we didn't know it! During those first few years in the mid 90s, a time I classify as our "stupid" years, we chomped on the bit, ready to entertain any request that drifted through our offices. Delinquency? Rental units? Number of units? Bring them all on; we made them; 9-unit associations, whatever… we found a way. What were the results of these early years? Now that we are "smart," are we too smart? What about competition? How is our industry progressing in servicing community associations? I am going to attempt to bring you up to date. Hey, it's a sequel, what were you expecting, *The Empire Strikes Back?*

Since 1994 we have made over 5,000 community association loans, totaling just under two billion dollars. Over the years our default rate is zero and our portfolio delinquency is virtually nill.

Due to the volume of production, we have adopted guidelines which all new loan requests are subject to. Loan requests which exhibit high delinquency or high rental unit numbers may not make it to approval.

In recent years we have moved to provide our services throughout the country. Each market area presents different challenges and we must adapt to customer attitudes and market conditions. Our rate structure provides prospective borrowers with a tantalizing list of term options and aggressive pricing. We recognize our competitors and respect them as fellow professionals. We, of course, feel that our product packages are the best offered in the industry.

In many areas of the country, association boards have "caught on" to the competitive nature of our business. They seek out several "bids" when seeking financing for projects. In many instances the old "put the cart in front of the horse" syndrome sets in. Rate offers are sought from numerous institutions before any loan is approved. Associations should be cautious during this process. It is likely that many offers provided might not hold up, once actual financial packages are presented and underwritten.

Many of these financing transactions take an inordinate amount of time to "get to the closing table." Why? The inability of the multifaceted boards to make decisions and attempts to "satisfy" every unit owner in the community. Boards must strive to protect the integrity of their properties and provide prudent leadership. Delays in the decision making process can bring the association into an adverse rate environment, or allow advantageous contractual timeframes to lapse. Common sense dictates that you can't please all the people all the time. Directors should rely on professional support to make reasonable decisions; accountants, attorneys, bankers, engineers, architects, reserve study professionals and property managers should be relied on to provide advice and guidance during the decision making process.

Recently, I have stumbled on a new problem we did not face in the "early years." When we first acquainted ourselves with the underwriting process, we would meticulously read the association's condominium or homeowners' association document to make sure the documents allowed the association to enter into the financing transaction. With loan volume at its present level, the bank does not perform this review. Condominium, HOA or cooperative documents are now reviewed by community association counsel. On several recent occasions we have moved through the approval process, only to find prior to closing from association counsel, that language within the documents requires a unit owner vote to enter into the financing transaction. Based on these events, I caution association documents be reviewed for borrowing powers before moving ahead with any application process.

Additionally, many associations provide their unit owners a period of time to pay their share of "up front," thereby avoiding the interest expense on the loan. There are differing views from various attorneys on this issue. Association boards should work closely with their attorneys in formulating this plan. In addition, unit owners who "pay up front," while enjoying the benefits of not paying their proportionate share of interest, are liable if the association should default on the loan or if additional assessments are needed, due to delinquency levels within the association. We have to state, however, that we have never encountered these types of default situations.

A few years ago we added lock box processing to our menu of community association financial services. We struggled to work the "bugs" out of the system and unfortunately disappointed some of our earliest clients. We now can say that we have a state-of-the-art, image-based processing system, which is performing extremely well. We have even begun attracting out-of-state clients. The "hang-up" here has always been the reluctance of unit owners to mail their maintenance payments out of state. I guess people are starting to realize that in reality they are mailing various payments to all sections of the country. Check your mortgage bills, credit cards, car payments, etc. Chances are they are not going to a local entity down the street. In any event, we continue to pursue a nationwide client base in the cash management, lock box business.

So, on an overall basis, how is the banking industry servicing community associations? I serve on the Community Association Institute National Banking Committee. We meet semi-annually at "CAI" national conferences. I have to say that I am amazed at the skill level and professionalism of these folks, representing various institutions from all corners of the fifty states, including Hawaii. Community associations now have an opportunity to avail themselves of professional bankers who are specializing in this industry. This is a win/win situation for the communities and the banking industry.

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