



Navigating the Association Bank Loan Process... and Borrow Money for Your Association

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Your roof is leaking, your decks need repair, your balconies are crumbling, and disaster is right around the corner. What if you've gotten termites, and the walls are getting ready to fall down around you. Should you sell your unit and just get out? But how can you sell now, with all the work that needs to get done? You don't want to lose your equity by having to lowball your price and drive everyone else's values down. You had good intentions and meant to reserve for this, but you wanted to keep your assessments low and you thought you had more time to save. Besides, who ever thought bugs could eat you out of your house and home? It's not a pretty picture.

Or how about...you want to put in a new community pool, you would love to add new gates, and that new satellite system that you can get would give our whole community 200 channels of quality TV. That sounds great!

Either way, the odds are that your association needs money that it just doesn't have. Action needs to be taken, and the Board of Directors has decided that a special assessment is the way to go. How can the board, with help from your community manager and your banker get the special assessment passed? And once it is passed, what are the options available to get the money?

Educating your members is the key to a successful vote. Understanding the process is the key to getting the money.

Here's how:

Have a plan. Work with your manager and/or your bank to make a thorough presentation to your members. ***Make sure your board or manager knows the ins and outs of passing the assessment, and work with a bank that specializes in banking associations and has a program established for this specific type of lending.*** Your members want to understand what they are getting themselves into and what impact it's going to have on their lives and their property. If you need to approach a bank for a loan, they will want to understand the same things too.

The most important reason to pass the special assessment is to maintain or improve the association's assets and its property value. Structural problems, which must be disclosed to potential buyers, will slow sales, or worse, lead to falling prices. Real estate agents want to show properties that are well maintained, and buyers are savvy about checking on the association's finances. The association, on the other hand, has a fiduciary responsibility to repair its common area facilities, and if it hasn't reserved the funds, a special assessment may be the best and fastest way to build funds quickly to make needed improvements.

Once the cost of reconstruction or improvements is identified and a special assessment is being considered or has passed, the members have four options available to them to pay their portion of the assessment.

Homeowner Payment Options

- ***Pay cash*** - if everyone has the ability to simply write a check by drawing down on their savings or liquidating an investment, the association gets its funds quickly and efficiently, and the process of making the improvements is underway.
- ***Apply for financing*** - by getting a second mortgage or equity line of credit. These type of loans will take much longer to fund, the individual owner must put up their own unit as collateral -- but the payment can be spread out over a long period of time. Homeowners, however, should consult with their tax advisor to determine whether or not certain types of loans offer tax advantages.
- ***Use a credit card*** - and get a cash advance. Normally this would be the least desirable option due to high interest rates and no tax benefits
- ***Pay monthly and have their assessment become part of the commercial loan payment made by the association*** - interest rates are reasonable and they may be able to be fixed over the life of the loan. No personal information will be required from individual homeowners, and the loan will be the obligation of the association as a corporate entity.

Advantages of Borrowing

- ***Downward slide of property values can be slowed or eliminated*** when you improve the appearance of a property and eliminate any structural integrity problems.
- ***Needed repairs or improvements can be completed more quickly***, as total funds become available much faster than through the traditional assessment process. Remember, passing the assessment and collecting all of the money are two different things.
- ***The financial impact on homeowners can be reduced***, since homeowners can pay their share over time.

Disadvantages of Borrowing

- ***Monthly assessments may increase to support the loan payment***, even though some of this may be offset by reduced reserve contributions.
- ***Interest costs may be high***, depending on where interest rates go. Fixed rates, however, can lock in the cost of borrowing, making planning for the future easier. Also, compare the cost of borrowing to the increasing costs of construction if the work is delayed or spread out over many years. Plus, your unit may be the last one that gets repaired.

Get the Vote of Your Members

The Board of Directors needs the power to assign association assets. This can require a vote of the members. Even if your CC&Rs don't require a vote, having one ***is important because***:

- The membership has given the board the ***power to assign association assets***.
- The membership has been ***notified and is well aware of what is going on***.
- The majority of the members (or a higher percentage of members, if required in the CC&Rs or By-Laws) have voted for the assessment and to get a loan, offering some ***protection for the association, the management company and the bank from potential litigation from disgruntled members***.

Loan Features

Rates, fees and other terms vary from bank to bank, so shop around and make sure you deal with a financial institution that knows association lending. Generally, though you will find that:

- **A “non-revolving” line of credit is put in place during the construction phase**, usually from six months to one year. Interest only is paid on the amount borrowed during this period.
- After construction is complete, **a term loan from one to seven years** pays off the outstanding balance.
- **Variable and fixed rates** are available.
- **Application fees and loan points** are usually charged.
- The loan is secured by an **assignment of the association’s assessments plus the association’s lien and assessment rights** - personal guarantees or trust deeds against individual units are not taken.
- There may be **prepayment fees** for paying off the loan early, and there may be a charge to re-amortize the loan if too many people prepay as a result of selling their unit during the life of the loan.
- **Minimum loan amounts vary**, but \$50,000 - \$100,000 is typical.

What are the FAQs (Frequently Asked Questions)?

The best defense is a good offense. **Be prepared to answer these questions** and it will make your experience with your members and the bank much easier. Better yet, **put it in writing** and present it to your members for the vote and send it to the bank with your loan application. Your members want to live in a well-maintained community, and the financial institution wants to make the loan as long as it can satisfy its credit requirements. And remember, everyone wants to know what’s going on.

- **Why do we need to do this project?** Write out a brief history of the problem that needs to be addressed or the improvements that you want to undertake. Let everyone know what the impact will be if repairs are not done.
- **What will it cost?** Provide a detailed list of the work that needs to be done, along with explanations of the cost breakdown.
- **Are these items covered in the Reserve Study?** Explain which components are going to be repaired and if reserve funds are going to be used to help offset the costs.
- **How are we going to pay for this?** Explain how the special assessment is going to work and if it will have any impact on the general assessment or future reserve contributions.
- **What are my options to pay?** Provide some options to paying the special assessment, such as payment in full by a specified date; a 50/50 plan, where half is paid up front and half is paid over time; or pay the whole thing over time.

- ***Is it possible for only some of the owners to pay their assessment as part of the commercial loan payment made by the association, with others electing to pay a lump sum payment?*** Yes, since the loan is made to the association as a corporate entity and not its individual members, the Board of Directors can determine how its members can pay their share (e.g. monthly or lump sum).
- ***If the association defaults on its payments, would a lien be placed against the property of all owners, or just the owners that didn't pay lump sum?*** The bank will rely on the association to follow its collection policy to collect past due assessments, including placing liens and foreclosing on members who do not pay their special assessment. While the association may place liens on the units that didn't meet their obligation, the association as a corporate entity is still responsible for the total loan payment. This may include the need to pass an additional assessment against all of the members to make up any uncollected difference. In this sense, the loan payment is no different than any other association obligation that isn't being met by the ongoing cash flow of the association.
- ***Is the proportional interest on the loan tax deductible by each owner?*** No, because the loan is made to the association and is recorded on its tax ID number. Members who opt to pay their portion by getting a mortgage loan against their unit may get a tax benefit. They should consult with their own tax advisor.
- ***What information will the bank need in order to process our request?*** It varies from lender to lender, but be prepared to provide information about the association (including your presentation made to your members), financial information, collection policies and collection history, a current reserve study, operating budgets, CC&Rs and By-Laws, and cost breakdowns of the work to be done. Your lender should provide you with an application and a list of what's required.
- ***What might they look at when reviewing the loan?***
 - ***Size*** - How large is your community? Associations under 25 units may find it difficult to get a loan since the risk is spread over a much smaller number of units and one or two delinquencies can cause a cash flow problem.
 - ***Cash Flow*** - Can your association assessments cover the loan payment and fund future reserve items? Is there a plan in place to cover expenditures required during the term of the loan?
 - ***Reserve Study*** - Is it current, prepared by an experienced company, and does it have a presentation of future cash flow requirements?
 - ***Delinquencies*** - Is there a high level of delinquent owners, either by units or by dollars? More than 10% is usually a warning sign of problems. Is the association following its collection policy, or letting its members fall behind?
 - ***Financial statements*** - Are they reviewed or audited by a qualified CPA with experience in the HOA industry?
 - ***Stability*** - Is there high turnover in the units? Do you have a high percentage of non-owner occupancy (more than 30%)? Is there any litigation pending among the owners or with the developer?
 - ***Management*** - Do you use professional management that is experienced in handling community associations and carry professional designations such as

PCAM or CCAM? Have you engaged a construction manager to help the association manage the project.

A lot to think about, and a lot to do for the association, the manager and the potential lender. It's important to remember that some of these loans can be in excess of \$1 million, and understanding the project is vital to everyone concerned. ***Passing an assessment and getting a loan for any amount requires thought, patience and understanding of what's required.*** Follow the steps and your membership will be well informed about how your project will work, the lending institution will be in a position to make an informed credit decision, and your community will have a good chance to get the improvements that it needs.