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Securing Financing for Your Association

Homeowners associations (HOAs) and condominiums often require financing to pay for large projects or maintenance expenses, fund reserves, or cover insurance premiums. Unlike any other traditional borrowing experience, the association lending process can be complex and can be a critical lifeline for communities needing capital to maintain their property and amenities. By considering the following, association leaders may be able to anticipate and secure necessary funding while minimizing the financial risk and strain on residents.

Impact of Market Events
We are operating in a volatile market where inflation, construction margins, and legislation have created a perfect storm for rapidly increasing costs. The Federal Reserve continues to increase the benchmark interest rate to combat inflation and banks have had to increase their lending rates as a direct result. While the current interest rate environment is historically favorable by comparison to the last several decades, clever borrowers are taking a harder look at loan costs and considering prepayment flexibility to take advantage of future refinance opportunities.

Legislation Affecting Community Association Loans
Legislation plays a crucial role in regulating the lending industry and protecting borrowers from unfair practices. As an example, a number of states have recently enacted laws to require improved disclosure of information in commercial financing transactions to enhance transparency. Engaging your attorney early can help by making you aware of applicable laws and a number of common legal issues that can slow the lending process. Sometimes the legislation itself can even create the short-term necessity for capital. For example, Florida recently passed legislation for multi-story condominiums that mandates regular structural inspections and full funding of reserves for the replacement of structural components. For

associations that have not adequality funded reserves, a loan may be an attractive alternative to a special assessment.

How Much Do We Need?

Determining the actual amount of money needed for the project or expense is an essential step in the lending process. Community associations may have set aside reserve funds for replacing and refurbishing existing components; however, these funds may not be enough to cover large expenses like unexpected roof replacements or pool renovations. The community's board of directors should engage experts, solicit bids from qualified contractors (when necessary), create a detailed budget, and estimate the project's total cost (including permitting, taxes, project management, and contingencies). In addition to the current need, it’s important to consider upcoming projects that may be needed in the near future and whether it makes sense to include such costs in the current loan to avoid duplication of efforts in a few years.

Evaluating Lender Options

Once the loan amount and budget have been determined, the HOA or condominium can look for qualified lenders. Several options may be available, including traditional banks, credit unions, and private lenders. After natural disasters or wildfires, emergency property damage loans or financial aid may also be accessible through the state, SBA, or FEMA. It is important to shop around to compare rates and terms and find the best loan for the community’s needs. Lenders will typically require certain documents and information to assess the community’s fiscal health and ability to repay the loan. This may include financial statements, tax returns, and copies of the governing documents. To avoid confusion and expedite the process, it may be best to use a bank familiar with association loans. Banks unfamiliar with the industry may require a personal guarantee from the board members or a lien on the community’s assets as collateral for the loan. Association lenders know to require a pledge for accounts receivable and/or a special assessment as collateral, instead of real property.

Loan Repayment

Repaying the loan is also an important part of the lending process. The loan terms will vary depending on the lender and the association’s financial situation. Some loans may have a fixed interest rate, while others may have a variable rate that changes over time. The loan may also have a set repayment period (such as five or ten years) or it may be structured as a line of credit with ongoing payments. The community should have a plan in place to repay the loan and ensure that it does not become an unending burden on the residents. This may include budgeting for loan payments in future years and increasing assessments or fees, if necessary. Loans without a prepayment penalty can further provide flexibility to refinance the note, should rates come back down in the future.

What’s Next?

Once a lender has been selected and the loan is approved, the association can receive the funds to start the project or pay for the expenses. It’s important to use the funds wisely and stay within budget to avoid additional debt and financial stress on the community. The board of directors or governing body should regularly review the community’s financial status and adjust the repayment plan as needed.

It is important to note that not all association projects or expenses can be financed through a loan, and some governing documents may require a vote of the association’s membership. Community leaders should carefully consider each association’s unique financial situation and the long-term impact of taking on debt before pursuing a loan. Lenders will evaluate the overall credit risk by analyzing the association's liquidity and repayment sources and the number of tenant-occupied units, delinquencies, and investors. Sometimes, delaying a project or finding alternative funding sources, like special assessments, may be more cost-effective.

Banking Supported Lending Solutions is part of the valuable services available to community associations managed by Sentry Management. Please ask your Community Manager to contact their Banking Dedicated Services Coordinator for more information.

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Matthew Gassen is the Co-Founder of **HOA Capital**. Matthew's banking experience comes from over a decade in commercial/multi-family lending, where he helps grow and diversify the banks' lending concentrations. HOA Capital knows that every project and every situation is different and leverages its network of lenders to find the best possible fit for each association. Matthew serves on the Board of Directors for the Believe Foundation and enjoys spending time with his young family.

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