

Community Association Loans: Did You Know Your Association Can Borrow?

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There are a number of reasons that community associations may need to borrow funds to finance capital improvements or repairs. Reserves may be inadequate, homeowners may be reluctant to approve a special assessment for the total project cost in one year, there may be contracting advantages for completing the entire improvement at one time, or there may be a desire to spread the expense among existing and future owners who will benefit from the improvements. As communities age, there is often a need for capital improvements such as roof replacements, conversion to vinyl siding, driveway resurfacing and central mechanical system upgrades. When these large projects prove to be greater than the reserves on hand, project-specific borrowing is a viable option.

Unlike traditional commercial loans which use real property as collateral, banks generally take a lien on the association's assessment income as collateral to secure this kind of loan. The loan is given to the association as a corporate entity and there is no personal liability for the owners or directors. While specific loan terms vary by project, typical proposals include:

- ▶ Repayment terms between 3 and 7 years
- ▶ No prepayment penalty if the loan is paid off early by the association from association funds, but there may be a pre-payment penalty for refinancing
- ▶ Loan amounts from \$25,000 to \$25 million

In order to qualify for a loan, however, lenders will want to see a delinquency rate not exceeding 5% of an association's gross annual income. Further, banks like to see replacement reserves equal to or greater than 10% of gross annual income and debt service that does not increase more than 30% after the loan, although higher amounts are sometimes allowed.

✎ Getting Started. If an association is interested in pursuing a financing alternative for planned capital improvements, the first step is to review the community's documents to

determine the ability to borrow and pledge assessments as collateral for the loan. The association must also determine whether a vote of the membership will be necessary to approve the borrowing.

A typical example of borrowing authority in governing legal documents for community associations include the following:

Spending and Borrowing. The Board of Directors shall have the right to spend and/or borrow money for the purpose of maintenance, repair, restoration or improvement of the Community Property and facilities, if necessary; provided such obligations do not exceed Five Thousand (\$5,000.00) Dollars. If spending for a non-budgeted item or borrowing exceeds Five Thousand (\$5,000.00) Dollars, the obligation must be approved by a majority of the Members of the Association who are present, in person or by proxy, at a duly called meeting.

Notwithstanding anything to the contrary herein, if maintenance, repair, restoration or improvement of the Community Property is necessary after damage by fire or other casualty, the above referenced spending limitation shall not apply and the Board may spend money for such maintenance, repair, restoration or improvement without approval of the members of the Association.

In the above example, the association's board of directors must obtain approval by the membership in order to borrow funds in excess of \$5,000. This type of membership approval can be time consuming and should be undertaken prior to seeking a loan from a lender, if possible.

Another example of authority issues exists where an association may have the authority to borrow without a vote of the members, but cannot pledge the association property (real or personal) as security for a loan without the consent of the members. Your association's lawyer can check your declaration, bylaws and articles of incorporation (and any applicable state statutes such as the Georgia Condominium Act or Georgia Property Owners' Association Act) to determine the association's borrowing authority and ensure compliance with the association's governing legal documents. Many declarations provide that each owner shall have the non-exclusive right, privilege and easement of use and enjoyment in and to the association's common areas, subject to certain conditions. These conditions often include the right of the association to borrow money for the purpose of improving the common areas, acquiring additional common area, or for constructing, repairing, maintaining or improving any facilities

located within the common areas. However, if the declaration also requires consent of the membership in order to pledge any association property as collateral, this would include pledging the assessment revenue and a vote would be necessary before the board moves forward with the loan application process.

λ The Loan Commitment. Most financial institutions will provide a written offer to make the loan to the association in the form of a commitment letter. A commitment letter details the amount, interest rate, loan terms, collateral and any other information required from the association to provide the loan. Most commitment letters require an application fee and a signed acceptance by the association. A board member signing should be aware that a commitment letter is a legally binding document. Once signed, should the association decide not to go forward with the loan, the application fee is generally not refundable. For these reasons, it is a good idea for an association to have legal counsel review a commitment letter prior to signing it.

The typical documents required by the lender are those generally maintained in the normal course of business by the association. These include the recorded declaration, bylaws, articles of incorporation, certificate of existence, annual budget, and a listing of accounts receivable. Direct loan related documents required include a resolution regarding borrowing, minutes of the board or association meeting approving the loan, evidence of insurance naming the lender as an additional insured, and a title search to determine if there are any encumbrances such as judgment liens or tax liens against the association. In addition, the lender will require a copy of the construction contract and an attorney opinion letter. Occasionally, an environmental questionnaire must be completed by the association. For larger projects and borrowing amounts, the lender may require construction contracts on an approved AIA contract form. Payment and performance bonds may be required from the contractor and

an architect or engineer may be required to review draw requests from the contractor and approve payments for work performed.

Overall, community association loans are a great way for boards of directors of many community associations to meet the capitol repair and improvement needs of the community, while keeping annual assessments low. If your community has deferred maintenance needs or is looking to make improvements, considering looking into a loan as an option to help meet those needs.

Closing the Loan and Obtaining Funds

While the process of obtaining a loan may appear complicated, most lenders making loans to associations have streamlined the loan approval and closing processes. The loan documents typically required at a closing of this type include:

- Promissory Note;
- Loan and Security Agreement;
- Assignment of Assessments and Association Rights;
- General Certificate with the following exhibits attached:
 - ◇ articles of incorporation and bylaws;
 - ◇ copies of board resolutions authorizing operating budget and delivery and performance of loan documents;
 - ◇ copy of declaration and any amendments;
 - ◇ copy of schedule of assessments and accounts receivable; and
 - ◇ copies of board resolutions authorizing general assessment to cover operating expenses and debt service.;
- Pledge of Accounts; and
- Form W-9

Other items required to be provided to lenders include:

- An original Borrower's Opinion of Counsel Letter;
- An opinion from title agency regarding the UCC, tax and lien search;
- Certified Articles of Incorporation;
- Certified copy of the Certificate of Existence (Certificate of Good Standing);
- Evidence of insurance naming lender as loss payee/additional insured.