Condo Insights #26   Managing a Major Project Part 4

When faced with an unexpected and unplanned major project, the Association Board not only must face the challenges of performing a major replacement, renovation, or rehabilitation but also how to pay for it. Most Associations have reserve funds but most likely not enough to finance an unexpected major capital project. Ultimately the Association members will have to pay for the project but raising a substantial amount of money in a short period of time may cause financial hardship for some members.

A condo Board must have funds available before it enters into a contract. If the Association does not have adequate cash on hand but needs major work to be done, bank financing may be an option. The Association can apply for a loan or line of credit to finance the project. Bank financing ensures a contractor that the Association has funding for the project. A line of credit gives the Board flexibility to borrow only what is necessary when it is necessary, whereas a loan may obligate the Association for more than is necessary sooner than it needs the funds.

A line of credit allows the Board to offer options to unit owners. Without a line of credit, the Board would assess unit owners before the project can begin and unit owners would likely have to come up with a substantial payment in a very short period. A line of credit allows the Board to offer unit owners payment options. Depending on individual financial situation, unit owners can still make one up-front payment, but a line of credit may allow unit owners to make periodic payments while the project is on-going and the Board would use these periodic owner payments to pay the contractor as work progresses.

A line of credit also allows the Board to give unit owners the option to pay when the project is complete (in which case their respective assessments would include finance charges). A line of credit converting to a term loan allows the Association an option to offer unit owners fixed monthly payments over an extended period of time (similar to an auto loan), also with finance charges.

The line of credit should extend for the duration of the project. The Association can expect to receive payments from owners during this time and use those funds to pay project costs to minimize draws from the line. The Association would borrow from the line of credit for the balance for project costs unable to be paid timely by owners. The end of the term for the line of credit should coincide with the closeout of the project. At that time any outstanding balance on the line will convert to a term loan, typically to be repaid over a period of years.

Extended financing allows an Association to fund major projects while being flexible to Association members with different financial situations. As with all borrowing and extended financing there will be interest expense. Financing options for Association members come with high interest rates. The Association is not a lender. The interest rate charged to members by the Association should be substantially higher than prevalent market rates to encourage owners to seek financing elsewhere. The Association incurs risk that owners may fail to pay their assessments and subsequently the rest of the members may incur additional assessments to make up for owners that were unable to pay. The Association should essentially be the last financing option for owners. The Association may require owners to sign a promissory note or put a lien on a unit as security for Association financing. This is necessary to protect the Association in the event of a default by the unit owner.

Some banks actively solicit condominium association loans. Since a bank can’t foreclose on common elements in the event of a default, Association loans are guaranteed by the pledge of unit owner assessments. Banks will require depository relationships with the initial deposit drawn from the line of credit. The likelihood of an Association defaulting on its loan obligations is low. In the event of default, the bank would petition a court to assign a receiver or special fiscal agent to take control over the Association finances until the loan is repaid. Terms, conditions, and interest rates for bank loans can vary widely.

Associations with existing banking relationships and stable, documented financial history and strong cash reserves can expect to obtain better terms compared to associations that have little cash reserves and a history of condo fee delinquency. Self-managed Associations lacking professional accounting records and adequate cash reserves may find they have limited financing options for unexpected and unplanned major projects.

Eventually every community and condominium association will face a major renovation, rehabilitation, or replacement project. Associations that follow accepted accounting practices and Boards that operate their Association like a business will be better prepared to manage a major project. The guidelines and recommendations included in this series of columns will assist condominium Boards and unit owners as they navigate this process.

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