Frequently Asked Banking Questions (and Answers)

The following is a compilation of frequently asked questions and answers primarily pertaining to community association financing. Be advised that banks that serve the association market vary in their requirements, underwriting and documentation.

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What type of collateral is required for Association loans?

Normally the collateral is a lien on all the assets of the corporation, which formalized with a UCC filing at the Secretary of State. No real estate (including common elements) is taken as collateral.

Are there any problems for individual owners to sell their home if a loan is made to the Association?

No. Since the loan is to the Association (secured by the association's assets) and not the individual, the association loan would not change the way homeowners sell their individual units.

Do you require personal guarantees of the board members for Association loans?

No. This is not a requirement for loans made to Associations.

How long does it take to process a loan application and receive the funds required?

This depends somewhat on the financial institution, but it should typically be no more than 15 business days (usually less) from the receipt of a complete loan package to process the loan application. Closing generally takes 30 to 45 days from receipt of the signed commitment letter and depends primarily on the association's attorney's lead time.

How should we select a contractor for our project?

At least three bids should be obtained from professional contractors for the improvements. Also, the reputation of the contractor and its ability to complete the project in a timely manner should also be considered.

What type of projects can be financed?

Generally all repairs and replacements to the common elements can be financed. Loans to purchase capital assets (like engineer's units, parking garages, etc.) are also available.

What type of loan options do the banks offer for financing?

Most loan programs are tied in to the source of repayment. Some associations pass a special assessment due within a year and apply for a Construction Line of Credit to only fill the gaps between the assessment collection and the payments due to the contractors. Interest only is due monthly and the full principal is due on maturity.

In other cases, increases to Operating Assessments are the best choice. For these loans, Construction Lines of Credit allow the association to borrow the money to pay the contractor(s) as the project progresses. Interest only is due monthly, allowing the association to best manage it cash flow and minimize interest expense. Then the loan is converted to a term loan and the association pays principal and interest monthly. The special assessment or increase in operating assessments should include the cost of the capital improvements as well as all costs associated with the loan.

What will be my interest rate?

Most banks price loans based upon the relationship the borrower has with the bank (Do you have your reserve accounts with the bank? Your operating account? Other services?). The bank will also evaluate the loan risk and the cost of the funds to the bank over the term of the loan. For short-term loans, most banks offer a floating interest rate based on Prime. For a term loan the interest rate is usually fixed to provide best practices of implementing and collecting special assessments to best meet cash flow requirements to repay the loan. In order to get the best rate available, the borrower should find a bank that is familiar with this type of lending. The borrower should also be willing to move their deposit accounts to that bank and create a relationship.

Do we have to pledge reserve accounts?

No. The association needs its reserve funds to operate as a business.

Do we need to have a reserve study before we can get a loan?

Most banks require a reserve study before they will make an association loan. This is necessary to make sure that the Association has been keeping up with necessary repairs and that adequate reserves will be available when other repairs are necessary.

What are Community Associations allowed to invest their reserve funds in?

The Declarations and Bylaws usually tell the Association what they can invest in. It is most common for them to invest in checking, money markets, savings, certificates of deposit, or United States Government Securities like Treasury Bills. Refer to the Investment Policy adopted by the Board of Directors for further information. If the association does not have an investment policy, contact us for assistance.

If the Association has a special assessment and the unit is sold, who pays the special assessment? The buyer or seller?

It depends on the Association's governing documents. Many have a "Due on Sale Clause" which requires any unpaid balance of the special assessment against an individual unit will be due and payable upon the close of escrow of the unit. The terms of this payment is normally negotiated between the buyer and seller. These funds must also be forwarded to the bank and deposited in the Prepaid Special Assessment account for future application to the loan.

Do you need to have a resolution approving a special assessment?

Yes, it is critical that the special assessment be passed in accordance with the association's governing documents and that the amount of the special assessment be sufficient to repay the principal amount of the loan as well as the estimated costs including interest and fees. Please contact the association attorney for further information.

What is the usual term for an association loan and is it variable or fixed?

The usual term of an association loan is from 1 to 7 years, averaging a 5 year repayment period. Many times associations want to stretch out the repayment of the loan to keep the payments lowers and the increases in assessments smaller. However, the interest cost for the longer repayments are much higher and may not be the best choice. Consider different repayment options and the entire financial picture. The interest rate can be variable or fixed. The rate for Construction Lines of Credit can be up to 1 to 2 points above the Prime rate and fixed rates are usually tied to the respective maturity index like U.S. Treasuries.

Does the bank require a management agreement to set up an operating and reserve account?

If the bank is familiar with the management company, a Letter of Direction is required. If the bank is not familiar with the management company, it may require a copy of the management agreement to verify that the property management company is authorized to act on behalf of the association. The resolution to establish the association's bank accounts should be approved and completed by the Board of Directors, not the management company.

For a special assessment, do you need board approval or is it up to the homeowners?

A special assessment must be voted on in accordance with the bylaws, including a resolution of the board of directors. Contact your association's attorney to do this correctly. Nevertheless, we always recommend you communicate communicate communicate with the homeowners on all association matters.

Is there usually a fee to apply for or obtain an association loan?

We do not charge an application fee at this time. Commitment fees can be up to 1% of the loan amount. Due to the specialized nature of these loans, customized loan documentation prepared by an attorney is often used. The bank will require that these out of pocket costs be paid for by the association. A deposit is required at the time of acceptance and it is normally refundable, less any bank out of pocket costs incurred, if the loan is not approved.

Is the Board of Directors personally liable for the Community Association Loan?

No, the borrowing entity is the Association. The Board of Directors act on behalf of the Association to sign the

Loan documents, however do not personally guaranty the loan.

Is membership approval necessary to obtain a Community Association Loan?

The Association must read their governing documents (and refer to the association attorney) to verify if a vote is necessary to obtain financing, increase assessments, and/or pledging assets.

How is the loan repaid?

From the timely collection of assessment due to the association and any special assessments as may be required.

What about prepayment penalties?

Prepayment penalties generally do not apply to prepayments based on the association's own cash flow (for example, prepaid special assessments, judgment awards, insurance claim proceeds, etc.). Prepayment penalties generally do apply if the loan is refinanced with another financial institution.

What are the costs and benefits of obtaining a Community Association Loan?

1. Loans cost money. Interest expense is expensive and adds to the cost of doing the project.

2. Loans can help and offer options to unit owners when the association must finance large capital improvements and the size of a special assessment is unreasonable for the majority of the unit owners to pay in full. Loans can reduce the amount of a special assessment or large increase in assessments by spreading the payments over a longer period of time.

3. Loans can help the association receive favorable bids and pricing on projects by completing all the work at once. It also improves the quality of life by getting the work done and the contractors off the property.

4. Loans can allows the Association to maintain healthy reserves and not use all available cash.

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