



ASSOCIATION LOANS: A BEACON IN A TURBULENT ECONOMIC CLIMATE

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Understandably, few community associations have escaped the impact of the troubled mortgage market. Sub-prime interest rates are up and home sales are in decline. With more homeowners' income being used to pay increasing mortgage payments, the risk of assessment delinquencies increases. Further, associations must contend with inflation, and increases in the cost of utilities and vendor service contracts. Budgeting for bad debt in your communities' operating budgets is today's reality.

Raising assessments on the paying owners to cover the budget increases and delinquencies may drive others into delinquency. For an association contemplating a long-term maintenance project, an unanticipated repair, or the need to address an item of deferred maintenance, a special assessment may not be a viable option; the most viable option may be a long-term loan.

In recent years, loans to community associations have become a widely available and accepted option for associations seeking to complete a significant improvement project but without adequate reserves to fund it. Often the community is aged and suffers from deferred maintenance. A loan provides a means to address the repair items in the short term and pay for it over time, leading to a relatively quick improvement in appearance and property values. Loans allow for the completion of needed repairs without the financial impact of a substantial special assessment. Today, there are more lenders available to community associations than ever before giving associations the ability to "shop" competitively for the best loan for their community.

Traditionally, association loans have been relatively easy to qualify for, do not require the owners to pledge their homes as security for the loan and, allow the associations to repay the loan over an extended period of time (often 5 to 7 years) with a special assessment. Often, owners are provided the option of making a comparatively low monthly special assessment payment for the life of the loan or, paying the owner's portion in one lump sum.

Major factors community association lenders look to in making their decision to approve association loans is as follows:

Delinquencies

Likely, the most significant obstacle is the association's delinquency history. The percentage of owners who are delinquent and the age of the delinquencies reflect the association's ability to repay the loan. If delinquencies carry forward for several months without significant collection efforts, banks contend this as an increased risk of default by the associations, particularly in economic times where budget line items for bad debt are on the rise. The lender wants to see a reasonable number of delinquencies relative to separate interests, and track record of collection.

Currently, lenders are considering the comparative market value of assessments; declining to extend a loan to an association whose assessments are seen as too high relative to the market for similar communities as a disproportionately high assessment rate negatively impacts market value.

Size of Community

The size of the community is viewed in tandem with delinquency history. Some lenders won't loan to a community of less than 20 owners. A smaller community is viewed as less able to absorb an increase in assessment delinquencies. To obtain a loan, smaller communities must have a cleaner financial history.

Owner/Tenant Occupancy

This factor is not as critical as previously thought, so long as your delinquency rate is within tolerable limits. Tenant occupancy rates as high as 30% do not appear to be an impediment to loan approval.

Reserves

As expected, the lender will look to whether the association is meeting its reserve funding requirements pursuant to a current reserve study. If the association's reserves are not funded the lender should be satisfied if the association has in place a reserve funding plan.

CC&Rs Requirements

Before embarking on the loan application process, look to the association's CC&Rs to determine whether an association can meet the approval requirements. The security for a loan is the association's pledge or assignment to the lender of the association's assessment rights. Many association's CC&Rs require not only homeowner approval but also approval of a percentage of the owner's mortgage holders in order to assign assessment rights to the lender. Determine in advance what the association's CC&Rs require, and whether the association has the wherewithal to see it through till the end.

In all, an association loan may allow associations the ability to weather this financial storm without putting insurmountable pressure on the owners, while preserving the value of the community by meeting repair and maintenance obligations.