

Homeowner Association Loans

It is becoming more and more common for homeowners associations to fund large-scale repairs with a line of credit. Reserve Accounts are commonly not fully funded, and owners' abilities to pay large special assessments vary widely.

The HOA loan is a hybrid. It begins life as a "line of credit" and ends as a "term loan". Since the contractor does not get paid all at once and "up front", it makes no sense to be paying interest on money that is not yet spent. So the HOA bank approves the loan as a "line of credit" not to exceed, for example, \$250,000.

The Association only needs to "draw down" on the "line" when the contractor needs progress payments. The bank will have specified a "draw" period, which will closely coincide with the construction period. Let's say the roofing job will start in the month of April and will be completed in July. Given a little extra time to allow for construction delays and the "draw" period might end in September.

During this "draw" period the HOA need only make monthly interest payments on the amount it has "drawn". At the end of the "draw" period, this "line" automatically converts into a "term loan", which will have predetermined, monthly principal and interest payments. The terms can be from 12 to 84 months with the average being 60 months. Loans are available with both fixed or variable interest rates. CitiScape recommends strongly that the association select the fixed rate, and is able to negotiate the lowest possible rates with the banks due to its buying power.

Another feature of the HOA loan is that there is no lien on owner's homes. Instead, this is a loan to the association, and not to the individual owners. The HOA bank will file an UCC-1 with the state of California, which in essence gives the bank an assignment of the HOA's lien/collection rights, against future assessments, to be exercised, in the unlikely event of a default. It is imperative that the association follow its own Collection Policy to collect owners' payments at all times.

The bank does not view this loan as asset based, but instead, makes the approval decision on the level of cash flow of the HOA. The cash flow must be positive. This means that the HOA must have enough cash flow to meet regular expenses, and reserve expenditures with enough cash left over to make the loan payment, with a little bit of cushion, (in case something goes wrong). The HOA bank will analyze this cash flow by reviewing the HOA's financial statements, budget, reserve study, and A/R aging. The analysis will usually be done in spreadsheet fashion and will incorporate the number of years that represents the entire term of the line/loan.

It is wise to be able to demonstrate that you have followed a plan of regular contributions to the reserve fund, have performed routine preventative maintenance, and paid close attention to items that need to be repaired/replaced. Your reserve study is a good tool to start with regarding these issues. It will not be exact, but combined with the annual budget you have the basics to assist in your planning.

If, on the other hand, your HOA has years of deferred maintenance (you know who you are!); has not increased the monthly assessment since Fred Flintstone was a teenager; needs \$500,000 to fix the place up; doesn't want to do a special assessment and; has no money in reserves, you have a very difficult situation. About the only thing that will fix this situation is cash, and lots of it and it comes from the owner's pockets. Under the right circumstances, an HOA loan can help an association play financial catch-up, and help preserve, maintain and enhance the property values of the community!