CONDOMINIUM LOAN FINANCING – A PRACTICAL ALTERNATIVE TO SPECIAL ASSESSMENTS!

– Blake Barrigar, Director, Originations, CWB Maxium

Condominium Corporations and Property Managers are continually faced with the goal of maintaining reasonable and appropriate condominium fees while adhering to their responsibility to repair and replace common elements to an agreed upon standard. This goal can often lead to a situation where there is a shortfall between the funds held in the corporation's Reserve Fund account and the cost of the repair or replacement of the common elements being considered at a given point in time. A shortfall of available funds may occur for any number of reasons, including the mismanagement of funds by previous Boards or property managers, unexpected repair or replacement requirements, unforeseen environmental or legal mandates, poor construction, artificially low initial condo fees, rising supplier costs and potential limitations to Reserve Fund studies. Often these reasons are beyond the control of the current Board and Property Manager and a current shortfall may be the result of something that has compounded over time. Irrespective of the reasons and notwithstanding the shortfall, ultimately the condition of the common elements must be addressed much sooner than later.

The aforementioned Reserve Fund studies are an invaluable tool when it comes to planning for future common element expenditures and are often considered to be the best road map for a Board's financial planning. But unfortunately they may have limitations that can contribute to funding shortfalls. The accuracy of a 20 to 30 year expenditure forecast is based largely on the reasonableness of the assumptions, at a point in time, along with the expertise of the provider of the study. It's not uncommon that the cost to replace common elements in the future ends up being higher than estimated or the life expectancy of a significant common element ends up being shorter than that originally assumed. Further, unexpected or unforeseen problems and damages may be discovered when addressing an accurately identified future common element project, resulting in aggregate costs exceeding even the best projections.

When a Board is faced with a cash shortfall, there are realistically two options available and to lesser degree a third one that we'll consider briefly. The options include; levying a special assessment on unit owners, borrowing funds as a corporation and lastly, deferring the repair or replacement. Deferring the issue now will probably not avoid having to deal with a cash shortfall in the future, unless the deferral is indefinite. And we all probably agree that that is not realistic and will serve only to increase the risk of other potential problems including escalating costs, incremental damage, unit holder unease, or worse, a mandate from a local authority to perform the repairs or replacement. In addition, buildings with unaddressed common element issues tend to negatively impact unit market values.

Of the two viable options to fund a shortfall, the first one we'll consider is the levying of a special assessment. When considering a special assessment, we should recognize that the financial situation of unit owners within a condominium community is wide ranging and while it's true that some unit owners will be able to afford an assessment, others may not be able to afford it nor be able to access the amount being levied in a timely manner or without consequences. Under this option, the assessed current unit owners pay for the full cost of repairs or replacements now, with the benefits of the completed projects being enjoyed and utilized by unit owners for many years to come. Considerations relating to an assessment include; have owners endured a similar situation during the previous few years and at this point may have just had enough? What is a fair and reasonable assumption in terms of a majority of unit owners regarding their financial position? Will owners be able to pay the assessment if savings are limited or access to individual credit is too costly, if available at all? Even if unit owners are able to secure personal financing it may be to the detriment of other plans they have and could affect their ability to borrow in the future for other personal requirements. In a worse case scenario, unit owners who are unable to pay the special assessment could have liens registered against their units and face the possibility of losing their home. Lastly, incremental administrative work and costs may be incurred by the corporation and their property manager to effectively levy and collect a special assessment. The special assessment option, while potentially a quick and decisive one, also presents a real risk of dividing owners and

affecting the spirit and cohesiveness of the condominium community.

Another option to consider is Condominium Loan Financing. Under this option the condominium corporation may borrow up to 100% of the funds necessary to cover the cash shortfall as opposed to unit owners being assessed individually. Corporations should consult with a qualified lender and their legal counsel to determine the requirements set out in their Declaration and Bylaws relating to borrowing. Subject to a lender approving a loan facility and the documentation being signed by the Board, funds will be available immediately to pay for contractor for work as it is performed and interest will be incurred only on amounts advanced. Once the project is completed and the final amount of the loan is determined, loan payments begin based on the agreed upon term and amortization period. Loan payments are made by the corporation to the lender and are included as part of the annual budget, forming a component of both the condo fees collected and the expenditures. In order to service the debt, the corporation will typically consider a number of options in order budget the cash requirement associated with the loan payments. Unit owners' monthly condo fees are typically increased proportionately on a unit factor basis, however other considerations including cost savings and future reserve funding requirements may be taken into consideration. When a unit is sold, the debt service component that is part of the monthly condo fee remains with the unit and continues to be part of the monthly condo fees collected by the corporation from the new owner.

Amortizations periods from 5 to 25 years are typically available and match the estimated useful life of the repair or replacement being undertaken. Payments are fixed for the term of the loan, typically for 5 to 10 years. With interest rates at historically low levels, many corporations consider the availability of a longer fixed term to be a great opportunity to lock in long term financing at attractive rates and set a material component of their budget for the foreseeable future.

In summary, loan financing can be a viable option for condominiums to consider when repairing and replacing common elements that are required to maintain a mandated standard and quality of life and to ensure unit market values are maintained or improved for years to come. Common element repairs and replacements that may be eligible for loan financing include, but are not limited to: roofing systems; windows and doors; balconies and patios; building envelopes; parking lots, garages and walkways; lighting retrofits and energy saving initiatives; boiler systems and HVAC; and building interior components including elevators and lobbies.

Using a financing option to overcome a cash shortfall can provide a number of benefits. Owners have the option to pay for material capital expenditures over the useful life of the project that is being financed with a fair distribution of costs over time. Owners are not required to individually seek financing and will benefit from the condominium corporation's ability to secure financing at attractive long-term market rates. Loan financing does not affect the owners' access to future credit or result in a charge or registration against their condo unit. Financing may also be a great solution to facilitate embarking on projects that were being indefinitely deferred or for energy saving "green" projects that result in immediate savings and a short payback period, but require a substantial up front investment. Finally, the timing for considering loan financing for condominium corporations has never been better as interest rates are currently at historically low levels.

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