Tackling a Capital Improvement Project:

FUNDING REPLACEMENTS AND MAJOR REPAIRS

2015 SC CAI CONFERENCE & EXPO
OCTOBER 2, 2015

SOUTH CAROLINA CHAPTER
community
ASSOCIATIONS INSTITUTE

Presented by:
Kellie Dickerson, BB&T Bank
Peter Miller, RS Miller +Dodson

Housekeeping Note:

Entire presentation is available for download at:

www.millerdodson.com/resources

Topics:

- Capital Replacements versus Capital Improvements
- Project Funding & Sound Business Judgment
- When to Use Reserves, Special Assessments & Bank Loans
- Bank Loan Process

Capital Replacement
or
Capital Improvement

Capital Replacement:

Replacement or major repair of existing Capital Component.

Capital Improvement:

New physical component not currently part of the Community Association.

What Is a Capital Component:

- Owned “in common” by the Association;
- Will require replacement or major repair;
- Has a finite Life (example: roof vs foundation)
- Not Maintenance or Operation expense.
  - Reference: Governing Documents, Board Resolution, common practice.

Fiduciary Duty of Board

Includes but not limited to:

- Loyalty & Care;
- Act in the interest of all owners;
- Sound business judgment.

Meet Mrs. Jones…

- Retired school teacher,
- Lives on a fixed income,
- Has lived in her HOA for 20 years,
- As a member of the Board of Directors,

you are foreclosing on her home!

Funding options for Capital Replacements

- Reserve Fund
- Increase Normal Assessments
- Special Assessment
- Commercial Bank Loan

Reserve Funds

Pros:

- Is immediately available.
- May be spent without vote;
- Doesn’t require increased assessments;

Cons

- May deplete Reserve Fund

Increase Normal Assessments

Pros:

- Can be done gradually over time;
- Less traumatic than Special Assessment;
- Doesn’t require vote of membership.

Cons:

- May effect home values;
- May take time to build up to goal;
- May trigger delinquencies.

Special Assessment

Pros:

- May be done relatively quickly;
- No interest

Cons

- May effect home values;
- May be unpopular;
- May require vote;
- May trigger delinquencies.

Commercial Bank Loan

Pros:

- May be done relatively quickly;
- May not require vote of membership;
- Does not deplete the Reserve Fund.

Cons:

- Association may not qualify;
- Requires interest payment.

Which Funding Method to Use

- Small to Moderate Project

	Use Reserve Fund	Increase Normal Assessment	Special Assessment	Bank Loan
Long-Term (5 years or more)	x	x		x
Mid-Term (3 to 5 years)	x	x		x
Near-Term (1 to 3 years)	x	x	X*	x

* May back up Special Assessment with Bank Loan

Which Funding Method to Use

- Moderate to Large Project

	Use Reserve Fund	Increase Normal Assessment	Special Assessment	Bank Loan
Long-Term (5 years or more)	x	x		x
Mid-Term (3 to 5 years)	x	x		x
Near-Term (1 to 3 years)	x	x	x*	x

* May back up Special Assessment with Bank Loan

Questions

Bank Loan Process

- Underwriting Components
- Application
- Collateral
- Typical Terms
- Other Considerations

Loan Underwriting Components

- Financial condition of the association
- Operating budget
- Balance sheet and income statement
- Reserve accounts
- Delinquency rate

Loan Underwriting Components (cont.)

- Community documents
- Board minutes regarding the loan process are reviewed to ensure all legal conditions are met
- Number of rentals
- Unit value, age of the complex, and management stability

Loan Application

Most loans require additional financial information for loan requests, including:

1. Most recent interim financial statement
2. Two years' year-end financial statements
3. Current delinquency report showing 30-, 60- and 90-day accounts
4. Budget with statement of reserves

Loan Application (cont.)

5. Set of association governing documents (recorded copy)
6. Board minutes approving loan request
7. Special assessment minutes and notice to unit owners if being repaid by special assessment
8. Proof of insurance (declaration page showing association's property coverage)

Loan Application (cont.)

9. Construction contract or description of the use of proceeds
10. Engineer’s report (if available or required)
11. Unit owner roster
12. An attorney opinion letter

Bank Loan Collateral

1. Banks normally do not mortgage the individual units or the association’s common areas as security for these types of loans. Generally the units already have mortgage liens in place.
2. The bank should require an assignment of the accounts receivable of the community association.

Bank Loan Collateral (cont.)

3. Typical receivables consist of special assessments and monthly maintenance fees.
4. The association is still responsible for collecting all receivables and taking action on delinquent accounts.
5. The only time the bank should directly collect these receivables is if the association defaults on the loan.

Bank Loan Typical Terms

1. For special assessment financing, the term of the loan usually is matched to the term of the collection of the special assessment.

2. Payments are monthly or quarterly, and generally do not exceed a 10-year year period.

3. During construction and large repair projects, interest-only payments may be permitted until the project is complete, followed by regular installment payments to reduce the principal.

Bank Loan Typical Terms (cont.)

4. A line of credit or a draw loan also may be used whereby the client pays interest only on the funds drawn out.
5. Simple interest installment loans also are made to finance hazard and flood insurance premiums.

Bank Loan Other Considerations

- If a bank holds an assignment of the receivables, that does not affect the daily operation of the association, such as selling a unit or other operating decisions.
- The bank also may lend money based solely on the association's operating budget. In this case, a special assessment is not required. However, the repayment terms typically are short.
- The association may have the ability to pledge a certificate of deposit as collateral. Since the association is borrowing its own funds, the interest rates are very favorable.

Interest Rates

- Interest rates vary depending on several factors, including:
  - Dollar amount of the loan
  - Repayment term
  - Financial status of the association
  - Amount of deposits at the bank

Questions?