HOA Loan Essentials

Board Member Guide

Overview

Does your HOA need to borrow funds?

If so, as a board or association member you should have a practical understanding of the process. This guide will give you with a basic overview of HOA loans.

Loans made to HOAs are unique in that they are typically made to the association as a corporation, as opposed to each individual member.

The association usually levies a special assessment against the owners to repay the loan, which includes principal plus interest. Lenders prepare legally binding loan documentation to ensure that boards earmark these funds for loan repayment.

Loan Structure

Short-term loans

Sometimes, a bridge loan or short-term line of credit is all that is needed. These loans can help HOAs manage funding gaps for insurance or vendor payments or working capital needs that are short-term in nature. Short-term loans can also be used to obtain early payment discounts for large purchases when the savings outweigh the cost of the loan.

These types of loans are subject to bank underwriting guidelines. They are typically structured with interest rates that are variable as opposed to the fixed rates that are more commonly associated with longer-term loans.

Long-Term Loans

Most loans for major repairs, construction or capital improvements occur in two phases. The initial phase consists of an interest only loan for up to one year or the end of construction (whichever comes sooner). During this period, the association may choose to use reserves first and then borrow money from the loan as needed to pay for the work in progress. Typically, the association makes “interest only” payments to the lender based on the amount they have borrowed during this phase.

Once construction is completed, the second phase of the loan typically begins. The outstanding balance on the short-term construction loan is converted to a longer term loan for the agreed upon period. In many cases if a fixed rate was chosen, the fixed rate will be determined and go into effect upon conversion. In other instances, a borrower and lender may agree to have the fixed rate pre-set before or during the short-term drawdown period. This is referred to as a delayed-start on the loan’s interest rate. The advantage of this structure is that interest only accrues on the actual borrowed funds.

Often times, these loans can be structured with 5, 10, 15 or even 20 year maturities. Much depends on how the funds will be used as well as the useful life of the project.

Paperwork and Documentation

Prior to the funding of a loan and often before the underwriting process can begin, the lender will require an attorney's opinion letter. This letter must include specific content that will be satisfactory to the lender that the HOA has the legal authority to enter into a loan. To avoid delays in securing the association's attorney's opinion letter, we recommend the engaging legal counsel early in the borrowing process.

Lenders will also want assurance that the association is in good standing with their State as well as updated proof of insurance.

Most importantly, lenders will want to understand how they will be repaid. In order to evaluate this, they will look at a great deal of financial information about your HOA.

Diversification of risk:

Lenders will want to know the number of units in your association. If you only have 3 or 4 units a large percentage of the HOA is delinquent if 1 unit falls behind. Whereas if there are more than 50 members, it takes a larger number of potential delinquent households to impact the percentages.

Ownership breakdown:

Lenders frown upon HOAs with high percentages of non-occupied members. The general thought is that people are more invested and committed to their primary places of residency. There is also concern when a few members own enough multiple units to cause concentration issues. Again, if a member who controls a significant percentage of homes gets into financial problems, the financial profile of the entire HOA can rapidly decline.

Proposed changes in dues:

Most lenders will be very focused on the dues increases that will be needed to service the new debt. If dues will need to double in order to repay principal and interest, lenders will be concerned. Will the proposed increase in dues force some members into financial hardship? Will the proposed increase in dues make the HOA uncompetitive with respect to similar HOAs in the region? On the other hand, lenders will want to understand if the proposed repairs or renovations will actually increase the value of the neighborhood.

HOA’s Current Financial profile:

Before a HOA should raise their hand for a loan, it is always a best practice to think about their current financial profile. Lenders will want to look at current and historical delinquency numbers, financial statements, tax returns, pending foreclosures and bank-owned properties. And any liens that the HOA has placed on households.

Lenders will want to look at collection policies and board minutes. In many instances, they will also require a recent reserve study.

Use of Funds

Banks will also need a thorough understanding of the use of the funds. They will want to see construction bids and a professional project management team (for more complex and larger loans).

They will want to fully understand the timeline for disbursement and project completion. On larger projects, lenders may impose progress inspections during the construction phase.

Role of a Loan Broker

Given the size and importance of these types of transactions, many boards are more comfortable outsourcing the process to an expert. They want an advocate who will help prepare a professional and complete loan package. When lenders are given a well-presented loan package, they understand that they need to be competitive. They see that the request for a proposal is salient, well thought out and comprehensive.

A professional loan broker is also uniquely positioned to know what aspects of a proposal can be negotiated, thus they bring bargaining power to the transaction. Often times, lenders do not put their best foot forward with the hope that they are the only provider at the table. They know that is not the case though when working with a loan broker. Lenders understand that a loan broker will bring multiple proposals to their client, so it’s in their best interest to be competitive on their loan terms.

Additionally, lenders assume that HOAs are unlikely to be repeat customers, at least not in the near future. However, the loan brokers are constantly seeking proposals, and lenders want to be on their call list. This is yet another reason that loan brokers generally get better loan terms than HOAs working independently.

A qualified broker should be an advocate working on behalf of the association. They are typically responsible for bank-related materials and interactions, while the HOA retains responsibility for the overall process. The following chart outlines the duties of loan brokers and HOAs in more detail.

Responsibilities of HOA vs. Loan Broker

HOA	Broker
Identify scope of the repair and timetable. Estimated project costs. Identify construction manager (> $2 million). Execute construction contract for renovation and validate contractor Insurance. Appoint a contact person. Authorize loan application fee typically around $1,000 (usually refundable if the lender declines the loan request or applied loan). Deliver a list of unit owners and their mailing addresses. Provide association's current collection policy. Disclose details of any noncompliance of any building codes or environmental laws (if any). Produce a Reserve Study in a form acceptable to the Bank. Study must be less than three (3) years old. Share minutes of the annual meetings: ● Reflect the election of directors. ● Pass a borrowing resolution. ● Determine which board members will be authorized to execute the loan documents and request disbursement(s) for the loan. ● Pass and levy the special assessment passed by membership.	Work with management company to prepare executive summary. Work with banks to: ● Solicit multiple proposals. ● Complete applications. Work with association's attorney to: ● Assert the association's legal authority to borrow. ● Provide recorded copy of the association's Articles of Incorporation, Declaration of Covenants and Bylaws, along with any amendments. ● Provide details of any litigation, judgments or settlements (if any). Coordinate with HOA's Accountant to: ● Provide a copy of the HOA's current budget and proposed budget for the upcoming fiscal year. ● Provide copies of other financial information: − Most recent interim and fiscal year-end financial statements − Balance Sheet and Income Statement for the last 3 years − Tax returns for the last 3 years ● Obtain a copy of the association's most recent bank or brokerage statements. ● Produce an Assessment Delinquency Report for the most recent three (3) months. ● Coordinate with Insurance Agent to obtain current insurance documents for the association's property, D&O and liability policies.

About US

Arch Capital Solutions is a full-service HOA loan broker who acts as an advocate for your HOA. We have relationships with lenders who specialize in HOA loans.

In many states, the board may actually have a fiduciary duty to make financial decisions that are in the best interest of their members. Arch Capital Solutions can satisfy those fiduciary duties acting as the HOA's financial advisor. We help HOAs obtain financing and choose the best proposal from multiple lenders.

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