FINANCING IS AVAILABLE FOR CONDOMINIUM BOARDS CONSIDERING CAPITAL IMPROVEMENTS

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One of the most important tasks that a co-op or condo board can be faced with is how to plan for unexpected capital improvements. Theoretically, buildings maintain a healthy reserve fund to hedge against any unexpected expenses of this nature. However, we oftentimes find that buildings do not have a reserve fund large enough to cover the cost of capital improvements and end up issuing a significant assessment to raise the capital. Obviously, issuing an assessment is not ideal for the unit owners and the marketability of any units for sale. Co-ops have always had the ability to refinance or take out an underlying mortgage (with potentially a revolving line of credit) for items such as capital improvements. Condominiums do not have this option, as they are real property which the individual unit owners own, as opposed to co-ops, which are shares in a corporation and not considered real property.

A product that all condominium boards should familiarize themselves with is "common interest realty association lending" (CIRA). CIRA loans are not issued by most banks, but are becoming a very popular mechanism for condos to obtain financing in a similar concept as an underlying mortgage for a co-op. In a situation where a condo is going to conduct capital improvements, they should consider financing the entire cost and factor in the monthly mortgage payment into their annual budget and determine if a surplus (if any) can cover the cost, or if a minor common charge increase or assessment will do so. Being able to spread the cost over a loan term of up to 10 years would certainly decrease the initial cost to the condominium and the unit owners.

Now, the first question you may ask is: what collateral does the condominium have to offer if the condominium does not have any assets and the units are all owned by individuals? The interesting thing about CIRA loans is that they are unsecured to a degree. The bank does not actually take any hard collateral. Instead, they will typically file a UCC-1 against the condominium for any assets they may own, which essentially is only common charges and the right to future common charges. That way if the condominium is ever in default of their mortgage payments, the bank can require the unit owners to remit the common charge payments directly to the bank and not the condominium. Under this structure, the condominium and unit owners both have an implicit interest in making sure the loan payments are being made, even if it results in an increase in common charges or an assessment. Therefore, in the eyes of the bank, there is a very minimal chance of default. Additionally, there are no personal guarantees of any of the unit owners or board members.

In issuing an unsecured loan, the bank will conduct a thorough analysis on the health of the condominium to ensure its ability to be able to make their mortgage payments. The first item to analyze is the cash flow of the condominium and financials of the building. As discussed above, having any surplus would be beneficial, and the buildings may potentially have to increase common charges to make up for the additional expense. An analysis of the occupancy of the units will be necessary. The analysis will want to confirm that the sponsor no longer owns any units in the building, the owner occupancy rates are high (i.e. 70 percent or more), there is a very low level of common charge delinquencies and the principal loan amount does not exceed more than 5 percent of the total value of all of the units.

The concept of CIRA loans stems from that of an underlying mortgage. While different in nature due to the lack of hard collateral and co-op versus condo, the purpose is really to issue a conservative credit facility which the principal sum is a very small percentage of the overall value of the building (i.e. 5 percent). During the post-subprime lending meltdown, credit was not readily available in many areas of real estate. However, the lending towards underlying mortgages was never an issue, and now we are seeing that same sentiment in the CIRA products.

Condominiums should take a conservative approach in obtaining debt. The purpose of the CIRA product would be to reduce the impact of the cost, and the boards will need to determine how this added expense (principal and interest payments) would affect their operating budget. If the added expense would result in a deficit for the condominium, then the board should conduct an analysis comparing the benefit of the increased cost over the term of 10 years versus an assessment spread over the course of a year or even a few years.

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