

Caught Short?

What to Expect in Taking Out a Loan

By Rafael A. Martinez

Most community associations hope to never need a bank loan. It just becomes a necessity as a result of events or circumstances outside of an association's direct control. An unforeseen repair is required or it becomes apparent that reserves put aside by a previous administration are inadequate. When the association does find itself short, it is faced with two options:

- Levy a special assessment, or
- Take out a loan from a third party and absorb the cost over time.

Although a special assessment may satisfy the board's fiduciary responsibility, it is often impractical from a timing and collection standpoint. In such circumstances, a third party financing option is a viable alternative. That usually involves procuring a loan from a community bank.

In going to the bank, it is important to examine the realities of the situation from the perspectives of both parties involved. A properly structured loan to a community association is a sound investment for a bank. Unfortunately, these types of loans are not that attractive or well understood by many bankers. By the same token, a bank's business considerations in making these types of loans are not well understood by the borrower. The association must always remember that banks are in business and organized to make money.

When approaching a bank, most associations find it frustrating because it may be difficult to find the right person to talk to. Banks are organized around major business lines: consumer lending, commercial loans, and real estate finance. A loan to a community association doesn't fit neatly into any of the traditional departments. A loan to a community association is probably more like a commercial loan than the other options, so that is usually the best place to start. Finding a loan officer that is familiar with and motivated to undertake this type of financing is another challenge. From the loan officer's standpoint, this type of loan represents something that will take a lot of time without yielding much return, as the loan officer is not cultivating a relationship that will lead to follow-on loans. A loan to a community association won't add much towards the accomplishment of annual loan objectives, and there are other ways most banks fulfill their corporate responsibility to the community.

It is for these reasons that smaller banks are often more receptive to entertaining a community association loan. Community banks may be better organized and facilitate communication to get the deal in the hands of the right person. There is also a stronger sense of community responsibility to do the "right thing." Beware, "doing the right thing" from the bank's point of view can be a double edged sword. The public goodwill earned on the front end can be destroyed

twice over if the loan goes bad and the bank must enforce its rights.

So how does one find out whom to talk to about an association loan? Utilize the sources at hand: Ask other community associations, the community management company, or the proposed construction contractor (for the job the loan is for), and find out what local banks and bankers have a reputation of working effectively with community associations. Don't only get the name of a friendly bank, but also the name of a specific loan officer. Not finding the right person will yield great frustration, time delays, and possibly disappointing results.

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In the beginning, most community associations believe that since a loan makes good common sense, the bank should jump right in, make the loan, and provide a preferred interest rate. Since the association is a collection of homeowners with diversity of cash flow and the organizational structure to support repayment, it stands to reason that the bank should offer a superior interest rate over what a homeowner gets on a residential mortgage and there would never be any strings attached once the loan closes. Not a chance!

Residential loans are homogenous, easy to process for the bank, and consume little overhead on a loan-by-loan basis. No two loans to a community association are alike. Borrower organization may be lacking, assembly of a complete application package can take time, and the consumption of bank overhead in the processing can be enormous.

Remember, this is more like a commercial loan than anything else. Once the loan is made, the bank and the borrower are financially married through thick and thin. Residential mortgage loans are financial commodities that banks sell into a secondary market to replenish cash and do it over again. Commercial, or portfolio loans, are held in the bank's loan portfolio for the duration of the loans – until they are repaid. This means the loan is funded with deposits that are drawn from the community. Deposits such as retail savings, money market accounts, and certificates of deposit are used to fund the loan. As a result of the returns that depositors demand, the bank must charge a higher interest rate on loans in the portfolio to get an adequate return to cover the overhead and take care of the bank stockholders. It also means the bank will need to monitor the investment by obtaining periodic financial reports.

So an association approaching a bank must ask itself: what do we have to offer that will make the relationship worthwhile for the bank? The more business put on the table, the more interested the bank will become and the better interest rate and pricing the association will command. If the association does not offer it from the beginning, most banks will require the association checking account and reserves to be moved to that bank. The more the association approaches the project as a first step in building a long-term relationship, the more receptive the bank will be in accommodating the association's needs.

The bottom line is to be prepared to prove the loan is a good investment and the association's business represents a good business relationship for the bank. Associations that bear the following in mind will be more successful:

- Be prepared with a comprehensive loan application package;
- Find a friendly bank with community association experience;
- Find a loan officer with the necessary experience and desire to do the deal;
- Be realistic with respect to the cost of borrowing;
- Expect to place the association deposits in the very institution that opens its doors to making the loan;
- Recognize the bank will be in the loan for the long haul and the association will need to agree to and report on financial progress. 




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