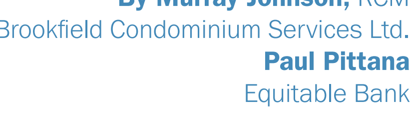
Financing



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What to Do When Shortfalls Occur

Condo Corporation Loans Can Provide a Positive Solution

When faced with a significant reserve fund shortfall, one of the most difficult choices a Condo Board and unit owners will face is how to raise the money to complete necessary capital repairs. It usually boils down to two possible choices: levy a special assessment against all unit owners, or seek a condo corporation loan from a lending institution. Unfortunately, this normally happens due to unforeseen circumstances that may require funds beyond what was collected in condo maintenance fees. This is not a pleasant situation to be in, and often forces a Board to make important, yet painful, financial choices in order to restore financial stability to the condo corporation. Condo corporation loans can provide a positive solution to help manage a rather undesirable situation.

While typically it's inexperienced condo corporations that seek financing, we can flip this around and look at how a financially healthy condo corporation could strategically borrow and use the money to its advantage. Perhaps the condo corporation could use the money to fund a major capital repair or replacement sooner, or implement an energy retrofit, or refinance an existing high interest loan. In each of these scenarios, the condo corporation could implement a loan strategy and potentially realize significant savings in the long run. This article will demonstrate some positive and creative ways Boards have used a condo corporation loan to benefit unit owners.

Before elaborating on these examples, it is important to understand how a loan to a condo corporation impacts the corporation's finances.

A loan on a condo corporation's balance sheet is shown as a note payable under its liabilities, which will decrease net assets. The loan can be viewed as detrimental to the condo corporation's financial position, as the liability will sit on the corporation's financial statements for years. On the other hand, the loan might actually benefit a condo corporation's budget, by improving cash flow for the corporation. If financing a condo corporation creates financial stability, and perhaps in some situations a more positive cash flow for its unit owners, then the loan can be viewed in a positive way, improving the condo's financial well-being.

Let's now take a look at three actual situations where Boards have used condo corporation loans to benefit their unit owners:

Early Window Replacement

There are many well-managed condo corporations with adequately funded reserve funds that would never even consider a condo corporation loan. After all, why would they need to borrow if they are properly budgeting and allocating sufficient monies to their reserve fund and following the recommendations of the reserve fund study? On the other hand, a Condo Board that thinks proactively could evaluate a current situation and come up with a creative way to complete capital projects sooner, creating significant savings in the long run. Let's take a look at one such situation.

The condo corporation was well fund-

ILLUSTRATION BY JASON SCHNIDER

ed, with a current reserve fund balance of close to $2 million. The most recent reserve fund study concluded that the reserve fund was adequate to meet the future financial obligations of the condo corporation. Although the study suggested that a full window and sliding door replacement would not be required for another 10 years, the Board had received a number of complaints about leaky windows and doors from unit owners in the past few years. The previous Board had looked into an earlier window replacement but decided not to pursue the project because they chose not to levy a special assessment against unit owners. When the current Board received a quote on the window project that was substantially higher than a quote obtained by the previous Board, they were concerned about escalating costs and how much more the window project might cost in the future.

The Board considered undertaking the project earlier in order to avoid unnecessary expenditures on piecemeal repairs over the next few years, while realizing substantial cost savings in the long run. The Board was able to secure five-year term financing for the entire project at a cost of $1.5 million. By deferring some lower priority projects and redirecting the portion of annual reserve fund contributions relating to the future window replacement, this enabled the condo corporation to pay off the loan in five years, while still maintaining sufficient reserve fund balances to complete other necessary repairs as suggested in the reserve fund study. The Board concluded that the risk of inflation driving up the cost of deferring the window replacement, as well as the ongoing repairs, outweighed the added interest expense over the term of the loan.

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The net effect: *The unit owners in the condo received new windows and doors today, took on a $1.5 million loan that was paid for by redirecting a portion of annual reserve fund contributions towards the loan, resulting within five years, with no net impact to monthly condo fees. While the balance sheet may show debt, quality of life improves and cash flow remains positive.*

Refinancing of superintendent suite/guest suite mortgage:
Many newly built condominiums include superintendent units and/or guest suite units as part of the common elements. Builders typically include vendor take-back mortgages on these units and the newly registered condo corporation assumes the mortgages, sometimes at

pre-determined rates that may be much higher than current rates. What if a Condo Board could find a lender that would be willing to re-finance these units at a much lower rate and save the condo corporation thousands of dollars over the life of the mortgage? Let's take a look at how one condo corporation was able to save thousands of dollars simply by refinancing.

A newly registered condo assumed the builder's mortgages for the superintendent unit and two guest suites at a total cost of $1 million. Each of the mortgages was a 10-year term at a rate of 8.0%, with a 10-year amortization period. With monthly payments of $12,064.09, after five years in this mortgage, the condo corporation would have paid principal and interest payments of $723,845.40, and the balance of the loan after five years would have been $596,839.22.

One year after registration and paying the builder's mortgage for 12 months, the balance was $931,497.52. The Board then considered consolidating the mortgages into one condo corporation loan.

> Although the costs may be partially offset by government financial assistance programs, Boards must determine how to pay for the up-front costs of these energy-efficiency projects

As there was no penalty to break any of the mortgages, the condo Board was free to re-finance at no cost, incurring only legal fees. A lender came forward with an attractive re-financing solution. The new terms were at a rate of 4.50% for a 5 year term, with a 9-year amortization to match the remaining amortization period of the mortgage so that a borrowing by-law would not be required for the new loan. In this case, the monthly payment starting in year two (i.e. the first year of the new loan) dropped to $10,486.59, a $1,577.50 (or 13%) decrease from the original monthly payment. Over the first five years, including the initial year of the original mortgage, the condo corporation would make principal and interest payments of $648,125.40, and the balance after five years would be $563,074.81.

The net effect: The condo corporation realized reduced borrowing costs of $109,484, including $75,720 in lower principal and interest payments, and a loan balance that was $33,764 less after five years. With today's low interest rate environment, it made sense for the Board to seek a cost saving solution from another lender.

Energy Savings Offset Cost of Loan: With energy costs on the rise, many Condo Boards are seeking ways to reduce their energy bills. Some older condos are enlisting engineers or energy

Podcast:

Contract Tendering

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management firms to conduct energy audits and identify energy cost-saving measures. Energy savings will surpass the cost of energy-savings measures, in many cases with payback periods of less than 10 years. Although the costs may be partially offset by government financial assistance programs, Boards must determine how to pay for the up-front costs of these energy-efficiency projects. One way for a condo corporation to fund all, or a portion of, large energy retrofit projects is to borrow money.

In this case, the condo corporation was looking at a half million dollar replacement of two year old boilers to higher efficiency boilers, variable frequency drives (VFD's), re-piping, lighting upgrades and other lesser energy retrofits with a basic payback of less than three years. As with our previous example, they were also burdened with a vendor take-back mortgage on two guest suites at a rate of 10%. By borrowing enough money to cover the energy project and top up the reserve fund to where it was anticipated it should be in five years, the Board was able to maintain fees flat for five years and went public with that statement.

The net effect: *Reserve fund annual increases, energy savings and minor operating efficiencies all offset the loan repayment and included fee stability projected for up to seven years. None of this would have been possible without a lower interest loan and a lender that was willing to think innovatively.*

At the end of the day, a loan to a condo corporation, when viewed with a creative outlook, can actually be used very strategically to benefit the collective good of all unit owners and improve the corporation's cash flow. We get trapped into the traditional thinking that the debt on the balance sheet is a negative thing. Balance sheets are not cash flow and it is cash flow that establishes the quality and affordability of life in a condominium community. Taking a more strategic approach opens up possibilities, such as moving three or four years of construction into one year, topping up reserve funds to future balances, paying off mortgages and green loans at lower rates… but all with the eye on cash flow and the impact on fees. It's not for every situation, but without an open mind you'll never know what you might be losing out on. CV

Collaborating with Condominium Residents, Managers, Engineers & Boards

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