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ALTERNATIVE FUNDING OPTIONS FOR HOAS: LOANS AND LINES OF CREDIT

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For homeowners' associations (HOAs), unexpected financial challenges can arise, whether due to urgent repairs, underfunded reserves, or unforeseen emergencies. Having a well-funded reserve account provides the strongest starting point to face such expenses, yet many un-prepared or under-prepared associations find themselves facing significant funding gaps. In such situations, alternative funding options, like loans and lines of credit, can provide a lifeline.

This article explores the pros and cons of these financial tools, highlights the importance of proactive reserve planning, and offers practical insights for HOA boards considering borrowing as a solution.

When to Consider Loans and Lines of Credit

While loans and lines of credit are not substitutes for robust reserve funds, they can be valuable in specific circumstances. For example, if an association needs to address critical infrastructure repairs—such as fixing a collapsed retaining wall or replacing a failing roof—but lacks the necessary funds or political “capital” to pass a special assessment, borrowing may be the fastest way to resolve the issue.

These tools can also help associations manage cash flow during major projects, especially those with high upfront costs. Borrowing enables the HOA to spread the expense over time, reducing the immediate financial burden on homeowners. However, it’s important to recognize that loans and lines of credit come with costs, including interest and fees, which ultimately increase the project's total expense. Simply stated, in budgeted Reserve planning, the bank pays interest to the association, resulting in the least expensive way for homeowners to fund reserve

projects. When borrowing, the association (via its homeowner members) pays interest to the lending institution.

Understanding Loans and Lines of Credit

HOA Loans

HOA loans are typically structured as term loans, providing a lump sum of money to be repaid over a set period, often ranging from five to ten years. Interest rates, terms, and eligibility requirements vary depending on the lender and the HOA's financial health. Associations with a strong financial track record and reliable assessment collections are more likely to secure the most favorable terms.

HOA loans are best suited for funding large, one-time projects, such as major structural repairs or infrastructure replacements. Their predictable repayment schedule can help boards budget effectively.

Lines of Credit

A line of credit functions more like a credit card, offering a pre-approved borrowing limit that the HOA can draw from as needed. Interest is charged only on the borrowed amount, and the credit line is replenished as the association makes payments. This flexibility makes lines of credit useful for managing smaller or recurring expenses, such as emergency repairs or seasonal cash flow gaps.

While lines of credit offer convenience, they often come with higher interest rates than loans, making them less cost-effective for large projects.

The Cost of Borrowing

While loans and lines of credit provide immediate access to funds, they are not without costs. Interest rates for HOA borrowing vary widely based on factors such as the association's creditworthiness, market conditions, and loan type. Additional fees—such as origination, annual, and prepayment penalties—can further increase borrowing costs.

For this reason, funding projects proactively through regular reserve transfers is always cheaper. By saving in advance, associations can avoid the added expense of interest and fees, ensuring that every dollar (plus some of the bank's money!) goes directly toward the project itself.

Borrowing should be viewed as a last resort, not a long-term financial strategy. Associations that rely heavily on loans or credit to cover expenses risk falling into a cycle of perpetual debt, which

can strain homeowners due to the addition of interest payments onto an already stressed budget.

Evaluating Borrowing Options

Before pursuing loans or lines of credit, HOA boards should carefully evaluate their options and assess the long-term implications. Key considerations include:

1. **Project Scope and Urgency**: Determine if the project is essential and time-sensitive. Borrowing may be justified for urgent repairs that cannot be delayed without risking safety or further damage. For less critical projects, it may be better to delay and build reserves.

2. **Repayment Capacity**: Assess the association's ability to repay the borrowed funds. This includes reviewing current assessment collection rates, increased reserve funding to prevent a shortfall during the loan term from other anticipated projects, and other financial obligations. Lenders will evaluate these factors when determining loan eligibility.

3. **Interest Rates and Terms**: Compare offers from multiple lenders to secure the most favorable terms. Be sure to understand the total cost of borrowing, including interest, fees, and penalties, before signing any borrowing agreement.

4. **Homeowner Support**: Transparency is essential when considering borrowing. Communicate openly with homeowners about why the loan or credit line is needed, how it will be repaid, and the potential impact on assessments. Many lenders require homeowner approval before finalizing a loan agreement.

Proactive Planning: The Better Option

While loans and lines of credit can address immediate needs, they are not a substitute for proactive reserve planning. Associations with well-funded reserves are better equipped to handle both routine maintenance and unexpected repairs without resorting to borrowing. This approach not only saves money by avoiding interest and fees but also provides greater financial stability and peace of mind for homeowners.

Proactive reserve planning involves:

- Conducting regular reserve studies to ensure accurate cost projections.
- Adjusting reserve funding annually to keep pace with inflation and deterioration rates.
- Gaining homeowner support by communicating the importance of reserve funding.

By prioritizing these practices, HOAs can reduce their reliance on borrowing and build a solid financial foundation for the future.

Conclusion: Choosing the Right Path

Loans and lines of credit are valuable tools for HOAs facing urgent financial needs, but they should be used sparingly and with caution. Borrowing carries costs and risks that may strain community finances if not carefully managed.

The best strategy is to fund projects proactively through well-planned budgeted reserve transfers, avoiding the need to borrow in the first place. For associations already considering loans or lines of credit, a thorough evaluation of options, clear communication with homeowners, and a commitment to sound financial practices will help ensure the community's long-term stability and success.

By focusing on proactive reserve planning today, HOAs can minimize the financial challenges of tomorrow, creating a secure and thriving community for all residents.