## Legally *Speaking...*

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# The Basics of Condominium Borrowing

By Adam J. Cohen, Esq.

Connecticut's condominiums are not getting any younger. The legacy of aggressive condominium development in the 1980s is, today, decades-old buildings which need major repairs and restorations. As these communities are coming to learn, financing capital improvement projects is not always easy. Condominium loans do not work like home mortgages, and navigating the prerequisites can be daunting. Along with increased demand and defaults across the nation has come tighter bank scrutiny and governmental regulation. Boards which anticipate needing loans for capital improvement projects must familiarize themselves with the basics of condominium borrowing.

The initial consideration is the extent to which the associations have power to borrow money. Most condominiums in Connecticut are organized as nonstock corporations, to which state law grants the power to take out loans unless their governing documents say otherwise. This means that the typical condominium association can borrow money except as specifically restricted by its declaration and bylaws. For example, some declarations allow borrowing for only certain purposes or up to certain amounts. The declaration or bylaws may also require approval of the unit owners – either for any loan, for certain security pledges, or for the uses to which the money would be put. If they do not, then the directors can approve and execute the loan themselves at a properly-noticed Board meeting. If the declaration or bylaws are unclear or contain provisions which could compromise the community's ability to repay the loan, a bank might require that they be amended as a condition of the transaction.

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The second important consideration is that the loan is not a mortgage and will not be structured like one. Condominiums usually do not own any real estate, since the common areas are owned not by the association itself but jointly by all of the individual unit owners. Therefore, the only thing these communities can offer a bank as collateral is a pledge of their right to collect common charges and special assessments from the unit owners. The security for the loan is an interest not in real estate, but in income. To protect and monitor that collateral, the loan documents will usually require that common charges paid by unit owners be deposited at the lending bank itself. This might be structured as a "lockbox" in which the association maintains an account at the bank where this income is automatically directed and strictly controlled. Some loan agreements might even entitle the bank to force the Board to increase common charges as needed to repay the loan over time. If the condominium defaults, the bank may be authorized to seize the money in the account and even bypass the Board to collect common charges from the unit owners directly. Obviously, the effect of a significant default can be devastating to a community.

Because condominium loans are complicated legal transactions, boards must get an attorney involved early. The declaration and bylaws will need to be carefully analyzed and perhaps amended, and the loan paperwork itself must be scrutinized to protect the association's interests. Meeting minutes, board resolutions, insurance policies, governmental filings, and other records must be compiled and reviewed. Defects, errors, ambiguities, or unfavorable items in any of these documents could prevent the closing or cause serious problems afterward. Any litigation pending or threatened against the association must be evaluated for potential impact on its repayment abilities. In fact, in virtually all instances, lenders will not make a loan until the condominium hires a lawyer to provide an opinion letter confirming that all of the association's documents are in good order, that the transaction is enforceable against the association and the collateral, and that the officers of the association have the legal authority to bind the association.

Finally, the Board must issue the appropriate notices to the community about the anticipated project and financing. Under a law which went into effect in 2007, at least fourteen days before closing on any loan, all condominiums in Connecticut must send every unit owner a written summary of the loan's terms and its estimated effect on common charges. This might be complicated if the balance or rates will fluctuate over time. The unit owners must also be given a reasonable opportunity to submit written comments to the Board about the loan. The comments should be thoughtfully considered, although the new law does not make them binding on the Board. Anticipated loans also generally have to be disclosed to unit purchasers on resale certificates even before the details are finalized or the closing is held. Of course, a condominium's declaration or bylaws might impose additional notification requirements or require unit owner approval, which means a special meeting must be scheduled according to its own notice procedures.

Financing capital construction projects may not be easy, but improving condominium buildings can ultimately contribute to enhanced comforts and property values for all residents. Boards which approach these projects with the right information and professional advice will be best equipped to succeed. ■

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