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Financing a Cash Shortfall: An Attractive Option!

Condominium Boards are continually faced with the competing objectives of keeping common expense fees low and properly maintaining and repairing common elements.

This dilemma invariably leads to situations where there is a shortfall between the reserve fund and the cost of repairs and replacements. These deficiencies may occur for a number of reasons that are often beyond the control of the Board and in many cases, the Board inherits a shortfall that has compounded over time and needs to be addressed sooner rather than later.

Reserve Fund Studies are valuable tools to plan for substantial future common expenditures but they do have limitations that may contribute to shortfalls. The accuracy of the forecast is based largely on the reasonableness of the assumptions made, the expertise of the company engaged to do the study and the cost of replacing a certain common elements may be higher and/or the life expectancy may be shorter than originally assumed. Also, unexpected damage may be found when undertaking certain common element projects as costs are often unpredictable until the work is assessed.

Faced with a cash shortfall, there are realistically three options available; namely, defer, assess or borrow.

OPTION 1

Deferral is effectively delaying dealing with the issue until the common element absolutely has to be replaced. The delay will not avoid having to deal with the cash shortfall at some point. It may in fact increase the risk of further damage and expose the condominium corporation to escalating costs. In addition, buildings with unaddressed common element issues will be less desirable in the marketplace.

OPTION 2

A second option is a one-time special assessment. In this case, current owners are paying the full cost of repairs with future owners benefitting from the new components. Owners may have been faced with this situation for a previous shortfall hence increasing the anger and resentment of facing another assessment. This is also a difficult situation for owners with

small savings or weaker credit. If they are able to secure the financing, it may be at a high cost and the additional debt may affect their ability to borrow in the future for other personal requirements. Owners who cannot pay on time or at all are faced with expensive lien claims against them and the real possibility of losing their home. The special assessment presents a real risk of dividing the owners and affecting the spirit and cohesiveness of the community.

OPTION 3

The third option is to borrow to cover the cash shortfall and make payments over time. The condominium corporation borrows the funds via a loan agreement as opposed to the individual unit owners forced to come up with the funds under the previously described special assessment option. Funds are available immediately or in the case of a longer term project, funds are drawn to pay for work as it is performed, incurring interest only as funds are extended. Loan financing can also be a viable option for Boards when considering substantial additions and/or improvements to enhance quality of life and market value yet are restricted from using the reserve fund by the *Condominium Act (1998)*.

Loan payments are included in the annual budget forming a part of regular monthly maintenance fees. Amortizations periods from 5 to 20 years are available and typically match the estimated useful life of the repair or replacement. Payments are fixed for the term of the loan (typically 3 to 10 years) and, with interest rates at historically low levels, it is a great opportunity to lock in long-term financing at very attractive rates. Condominium Boards can obtain non-binding term sheets from lenders that outline interest rates and financing terms.

Another situation where financing should be considered is in the area of energy retrofits where projected energy savings combined with government rebates can offset some or all of the costs of borrowing. With energy prices continuing to increase, looking at saving energy through higher efficiency boilers, building automation, and efficient lighting and paying for the capital investment over time by way of a loan may be a sound strategy for a Condominium Board to consider.

In summary, using the financing option to overcome a cash shortage provides a number of benefits. Owners have the ability to pay for capital expenditures over the useful life of the asset with a fairer distribution of costs over time. Owners are not required to individually seek financing on their own and will benefit from the condominium corporation's ability to secure financing at attractive long-term market rates. In addition, the financing does not affect the owners' access to future credit or result in a charge against their condo unit. Financing may also be a great solution to facilitate taking advantage of energy saving initiatives that provide relatively short payback periods but require a substantial up front investment.

Pierre Sauvé is the Director of Originations at Maxium Condo Finance group. He has 25 years of experience in the financing industry offering structured loan solutions to clients across Canada.