Funding a big capital improvement project

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Let's say your 120-unit community association next year is facing a huge capital expenditure that includes new roofs and siding. The bill is expected to run more than $600,000. How will you pay for it?

Good question. Ideally, you have a fully-funded reserve study and can simply write a check when you need to. But few associations are in that enviable position. If yours isn't one of them, you still have several options. Here's a rundown of each, along with the pros and cons:

Raise regular assessments. Some owners prefer to pay an additional monthly amount, especially if they don't plan to live in the association for a long time. But it's a slow way to finance a major project. Many governing documents limit or permit challenges to assessment increases.

By the time you collect the money, the components may have deteriorated further and cost even more to replace, said association attorney James Erwin of Erwin & Associates LLC in Chicago.

Levy a special assessment. You can fill the association's coffers in a few weeks by billing owners for their proportionate share, but you won't make friends.

"If you think owners will be upset when you raise the annual assessment a few dollars, imagine how they will feel when you are required to pass a special assessment for thousands of dollars per unit and, by the way, that assessment is due in 30 days," said Craig Finck, vice president of Alliance Association Financial Services in Plainfield.

If you have owners with units in foreclosure, as many associations do, you probably won't be able to collect special assessments from them, said Erwin.

"Special assessments damage the reputation of the building," said real estate broker Sara Benson, president of Benson Stanley Realty in Chicago. "They steer away buyers."

Borrow the money. The major deterrent of a bank loan is the interest cost, although current rates are low. Some associations won't qualify for a loan because of their overall poor financial condition.

When combined with a special assessment, bank financing provides a great degree of repayment flexibility, said Finck.

"Owners who can pay the full amount of the special assessment can pay a lump sum, and their obligation is ended," he said. "Owners who cannot pay a lump sum have the option of repaying their portion plus interest over time."

Phase the work. Instead of doing the entire project, spread it out over a few years. The advantage is you don't have to come up with all the money at once.

Among the disadvantages is subjecting the owners to inconvenience and disruption for what can seem a never-ending length of time, said Finck.

"Over the term of the project, costs for labor and materials can fluctuate dramatically based on the construction market and the particular project being completed," he said.

Not all projects can easily be phased, said Erwin.

Tap your savings. Even if you don't have long-range reserves, you might have a rainy day fund. It's fine to use some of that to offset your project costs, but keep something aside for emergencies, said Erwin.

Vendor financing. In today's economy, some vendors are willing to finance certain projects. They also might offer more favorable pricing on the work when they get financing revenue, said Erwin.

"Not all vendors do that, but it's worth asking," he said.

Do nothing. The advantage is you don't have the aggravation of trying to raise money.

Some owners will be perfectly happy to see their assessments stay the same, regardless of the property condition.

The short-term escape only leads to bigger problems later on, said Benson.

"Buyers always want to see low assessments, but that's a knee-jerk reaction," she said. "I tell them to beware. Whether the developer has set them artificially low or the association is running at a bare minimum, a low assessment almost always guarantees a lump-sum special assessment in the future."

"As painful as some of these decisions may be, and as much wrath as the board may face from the ownership, their job is to get the work done," said Erwin. "If they don't, they face potential claims of breach of their fiduciary duty."