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Condominium Loans to Fund Capital Improvements And Repairs under the Condominium Act

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New York condominiums are statutorily governed by the Condominium Act, which was enacted in 1964. When the Condominium Act was originally enacted, Condominium boards were not specifically authorized to obtain loans on behalf of the condominium from financial institutions. As a result, when condominiums were in need of capital repairs, replacements and improvements, board members had limited options and relied on either the condominium's reserve fund or assessments to raising money to fund the repairs and improvements.

However, boards' options to fund capital improvements were later expanded with the amendment of the Condominium Act in 1997 to add section 339-jj, which enables condominiums to fund repairs and improvements by borrowing from lending institutions. Specifically, section 339-jj created two new powers for board members: (1) the power to incur debt on behalf of the condominium, and (2) offer lenders collateral to secure the loan.

Further, section 339-jj(1) provides that the board may incur debt in the following two circumstances: (1) to the extent authorized by the condominium's declaration or by-laws and (2) for the purpose of funding major and minor maintenance, repairs, additions, improvements, replacements, working capital, bad debts and unpaid common expenses, depreciation, obsolescence and similar purposes, provided that the debt is incurred no earlier than five years from the first sale of a unit and provided that a majority of the unit owners vote to approve the debt.

The board's power to offer collateral to secure the loan is provided in section 339-jj(2), which authorizes boards to: (1) assign the condominium's rights in and to receiving future income and common charges to the lender, and (2) create a security interest in, assign, pledge, mortgage or otherwise encumber funds or other real or personal property that the board holds (but not unit owners' units). Therefore, under section 339-jj, when board members obtain financing on behalf of the condominium from a lender, lenders secure their loans through liens secured by common charge income stream or potentially a superintendent's unit or other units owned by the condominium.

While section 339-jj grants board members the power to obtain financing on behalf of the condominium, board members are still limited by the terms and conditions of the condominium's declaration and by-laws. Many condominium declaration and by-laws limit the loan amount, loan purpose and require consent of a majority of the unit owners to approve the loan. As a result, before considering obtaining a loan as an option to fund a condominium's capital improvement

project, boards should first refer to the condominium's governing documents to ensure that the amount and purpose of the loan being sought is in compliance with the governing documents.

Additionally, as part of the due diligence process, board members should also inquire with potential lenders about the details of the loan process and the terms. Some lenders offer a five to ten year fixed rate loan, with fixed loan payment amounts that are structured to repay the loan amount plus interest over the term of the loan. Other lenders structure their loans in two phases, by first giving a one to three year credit line at a floating rate followed by a five to ten year fixed rate loan.

Condominium loans authorized by the Condominium Act provide a viable alternative to large assessments to fund capital improvement projects. The first step in the process is for the board to review the condominium's declaration and by-laws to determine restrictions (if any) and whether unit owner approval is required. If unit owner approval is required, then the next step is to obtain unit owner approval. Thereafter, the lender can proceed with closing on the loan. It would be a good idea to simultaneously consult with legal counsel and lenders early in this process to ensure that obtaining a loan is feasible and handled properly.

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