A PRACTICAL GUIDE TO REFINANCING

By Patrick Niland

With interest rates so low, are you rushing to refinance? Don't. Take the time to plan your future. Refinancing your underlying mortgage is "open-heart surgery" on your cooperative's financial structure. It will affect not only the monthly maintenance but also the market value of every apartment. You don't want to rush into such an important decision.

Don't rely on the board treasurer to know what to do. Get involved. Refinancing is the most important decision that your board will make during its tenure. All board members should play a role. And it makes sense to consult all of your co-op's professional advisors.

Do a Background Check

Ask your attorney to verify that your existing loan will allow you to refinance when you want to. Check whether other liens or violations have been filed against your property. Getting an early start on the legal aspects of refinancing can prevent a lot of last-minute headaches. Don't be like the board member who recently told me that he didn't want to "start the lawyer's meter running just yet".

Direct your accountant to analyze your expense history and recommend a prudent level for your reserve fund. Two to four months of operating expenses is the generally-accepted target, but your accountant may feel that more or less is warranted in your situation.

Check with your managing agent for expected increases in real estate taxes, labor costs, fuel prices, and other operating expenses. Get his or her input on needed major repairs and capital improvements. Now is especially the time to rely on their experience. Remember, that's why you hired them in the first place.

It always has been a good idea to hire an engineer to assess the repair and maintenance needs of your building over the five, ten, or more years covered by your planned new loan. But now, in light of the new AICPA/CIRA reporting guidelines, it is foolish not to.

Refinancing is a time-consuming and expensive process. But, if handled successfully, it can dramatically improve the long-term financial health of your building.

Have the Answers

The key to doing it right, says Sheldon Gartenstein, regional manager of the National Cooperative Bank, is to plan ahead. "Those who don't," he continues, "are stuck!"

It continues to surprise me that at least one in four board members who call my mortgage hot-line can't answer even the most basic questions about their co-op. Yet they persist in asking, "What's your rate?" They fully expect to get a detailed loan proposal without revealing any of the essential information about their building.

For such people, I have a stock answer: "From five percent to ten percent." Thankfully, some then realize that no one can possibly answer their question without more specific information. The rest continue to drive loan officers and mortgage brokers "bananas."

If you are hoping that the lender won't ask certain questions or, worse, you actually plan to withhold material information, fuggedaboutit! Know everything about your building and be ready with simple, honest answers. Have all of the key facts (address, number of units, percent sold, etc.) at your fingertips and the rest in an organized file for easy access. Don't try to hide anything: you can't. Skeletons in the closet have a nasty habit of appearing just before the closing. No building is perfect, so be up-front with the loan officer.

It surprises many board members to find that all lenders are keenly interested in their sponsor. You should be prepared to give comprehensive information about your sponsor (and any other holder of unsold shares), including a list of all units owned, the rents collected, lease terms, and whether the sponsor has used the unsold shares as collateral for other loans. If the sponsor won't cooperate by providing this information, don't expect much from the lender.

If you don't care or try enough to get this information for the lender, don't expect the lender to care or try enough to give you a new loan.

How Much to Borrow

Borrow what you need—nothing more, nothing less. Remember, money without a stated purpose always finds one. Don't be tempted to borrow more just to round out the total or to "put a little something in the bank." That "little something" won't earn much at today's money market rates but will cost you additional interest at whatever (higher) rate you're paying on your new loan.

Be sure to borrow enough. Nothing can be more costly than being forced to refinance at the wrong time because the board failed to plan well enough ahead.

Since closing costs can add up to two to three percent of your new loan amount (up to ten percent for very small loans), you'll want to get as much mileage from each refinancing as possible.

Therefore, do your homework. Know how much it will take to keep your cooperative financially sound over the life of your new loan, including the effects of inflation, legislative changes, and unforeseen events.

Don't borrow extra money to avoid raising maintenance fees. Balance your budget each and every year. Set maintenance levels to cover your expected operating expenses on an on-going basis, plus allow for unforeseen items and inflation. Board members who believe that a refinancing can repair the damage of deficit spending need only look at the Federal government to see what awaits them in a few years.

If you think you can duck the political heat of a maintenance increase by depleting your reserves instead, then you don't belong in the kitchen. Using your reserve fund to subsidize maintenance charges is like spending your retirement savings at the grocery. You can eat steak for a while but, sooner or later, you end up in the soup.

Weigh All the Options

Don't assume that the lender with the lowest interest rate will give you the best loan. Compare offers from various sources to get a feel for the overall market. But don't become obsessed with the rate alone. Interest rate is just one of the many factors that make up a good loan. Other terms, if overlooked, can cost you many times the few basis points which you might save on the rate. I am now representing a co-op in Queens that needs money for a new roof and major elevator repairs. Unfortunately, their existing loan does not allow any secondary financing or prepayment. The "great rate" they have (which, in today's markets, is not all that great) is small consolation to the shareholders on the top floor. And the price tag on the solution to their problem is about twice what it would have been if they had included provisions for secondary financing and/or prepayment as part of their refinancing. Don't be penny-wise and dollar-foolish. Look at all the terms being offered by each lender.

Consider the services of a mortgage broker to help your board navigate these stormy markets. A good mortgage broker can save you much more than his fee. But hiring more than one broker can ruin your chances of getting a good deal.

Get recommendations from other buildings, your managing agent, or your attorney. You might want to interview several brokers. Be sure to check their references. But hire *only one.* Having more than one broker represent you will get you less than one loan. Hiring the right broker will get you a better loan than you could have arranged on your own. There is nothing more annoying to bankers than receiving three or four phone calls from different brokers requesting financing for the same building. This can give such a bad impression that, in some cases, the loan officer will stop taking all calls related to that building.

Refinancing an underlying mortgage is serious business. You, as a board member, have a fiduciary obligation to give it your serious attention. But don't be intimidated by the process. By enlisting the aid of professionals whom you trust, you will get a good loan and secure the financial future of your cooperative. Your shareholders will thank you.