ALMOST, BUT NOT QUITE

By Patrick Niland

The board decided to refinance your co-op's underlying mortgage – and even chose a lender. So, where's the money? Not so fast.

Refinancing an underlying mortgage is a difficult process that can take 60 to 120 days to complete, depending on the complexity of your building's situation. Gathering all of the necessary information, deciding on an amount and term, and then sorting through the various lenders and loan offers will consume at least half of that time. Contrary to popular belief, receiving an application is not cause for celebration. Rather, that's when much of the real work begins.

Virtually all lenders have a formal loan approval procedure that starts with an application package and passes through "underwriting" to a "commitment letter" and then to a closing. The first step in this procedure is the application itself, which usually includes a letter describing the important terms of the proposed new loan together with a host of forms to be completed, signed, and returned to the lender with a "good faith" deposit. None of the information required for the various forms is difficult to obtain: things like the address of the building, number of units, date of conversion, and so on. Every lender has its own set of forms, but the formats and information requested tend to be quite similar. The common requirement of all of these forms is that they must be signed by an officer of the co-op corporation, dated, and returned within a short period of time.

Most lenders' application packages include several verification forms. Each of these forms gives the new lender permission to verify the information supplied on the form. For example, a loan verification form asks for information regarding your co-op's existing loan (lender, address, loan number, contact person, phone number, etc.) and gives the new lender permission to contact your existing lender for a payment history. Deposit verification forms allow the new lender to confirm that the checking and savings account balances that the co-op reported are accurate.

Some lenders also include an environmental questionnaire to help them determine whether the co-op's property contains any environmental hazards. While board members and managing agents may not be able to answer every question on such a form, they should be as complete and honest as possible. While a follow-up inspection will uncover any hazards which may be present, the co-op's questionnaire sometimes provides enough information for the new lender to waive any further investigation (thus saving the co-op substantial time and expense).

If the board has not discussed its refinancing with the co-op's attorney before this point, they <u>must</u> do so now. Under no circumstances should a co-op return a loan application to a lender before reviewing it with their attorney. Every refinancing has myriad business and legal issues which must be handled carefully to avoid future problems for the co-op. The right time to address these issues is at application and the right person to address them is the co-op's legal advisor.

Another important reason to get the co-op's attorney involved early is the "good faith" deposit that must be submitted with every loan application. This deposit, usually equal to one percent (1.00%) of the new loan amount, shows the new lender that the co-op is serious (not "just shopping") and ready to proceed with the refinancing. However, such a large amount should not be sent without proper precautions. The co-op's attorney will make sure that this deposit will be returned should circumstances beyond the co-op's control prevent the new loan from closing.

Underwriting

The next step in the loan approval process is "underwriting." During this phase, the loan officer and other lender personnel evaluate all of the information the co-op supplied on the application and its various accompanying forms, as well as any other facts provided earlier. Additional supporting information will come from the credit report, appraisal, engineering inspection, and environmental assessment that the lender might order from third parties. The co-op's credit report is much like what would be requested for an individual; it gives payment records for all debts and lists any outstanding liens, judgments, or other obligations. As you might imagine, lenders want to be sure that potential borrowers pay all of their bills on time.

An appraisal (if required) will determine three hypothetical values for your co-op: its <u>replacement</u> value (the cost to rebuild the building today on the same or similar lot), its <u>sale</u> value (based on recent sales of "comparable" properties), and its <u>investment</u> value (based on the income stream your building would produce if it were a rental). Lenders consider all three values, but they give the most weight to your co-op's value as a <u>rental</u> because, if your co-op doesn't make its payments and the lender must foreclose, your co-op would revert to rental status.

Most lenders also hire a professional engineer to thoroughly inspect the co-op's property to make sure that no significant repairs are needed. Serious defects usually must be corrected before (or very soon after) closing; some lenders even escrow (hold back at closing) funds until such repairs are completed. Further, if the engineer indicates that major repairs may be needed in the new loan's later years, the lender may insist that the co-op establish a special "replacement reserve" for that purpose.

An environmental assessment (if required) will determine whether the property contains any hazardous substances (asbestos, lead paint, oil spills, etc.), if any such substances actually found pose a risk to co-op residents, and what steps may be required to remedy any problem(s).

Once the loan officer has evaluated all of these reports, he usually will summarize his findings in a short presentation for his institution's loan committee. Assuming that all of his conclusions meet the committee's standards, the co-op's application will be approved. Within a few days, the loan officer will send out a commitment.

The Commitment

Since the commitment (or commitment letter) is the document that everyone has been waiting for, there is reason for a small celebration. However, the refinancing still is far from being completed. True, every commitment is a contract between lender and borrower and contains all of the terms of the proposed transaction. However, most commitments contain one or more conditions which must be satisfied within a reasonable time period (30 to 60 days) before this contract is binding. If even one of these conditions is not met, your deal can fall through.

Most of the conditions in a commitment concern documents or other information which must be supplied by the co-op's attorney. For example, every loan requires a new title insurance policy to protect the lender's security interest. Most lenders want a report from the Secretary of State certifying the co-op's status as a legal corporation and an "opinion letter" testifying that your co-op was properly formed and continues to operate as a bona fide cooperative. Most lenders also need assurances that your property does not have any serious building code violations, mechanics liens, or other encumbrances. As soon as all of this information has been reviewed by the lender's attorney, a closing will be scheduled.

The Closing

This is the final step in most refinancings. The closing is a meeting at which the old loan (if any) is paid off and all of the documents describing the new loan are signed. It also is when all of the expenses of the refinancing are paid and the new loan proceeds are disbursed to the borrower.

The following individuals are invited to attend the closing, which usually is held in the office of the lender's attorney:

a) one or more officers of the co-op corporation, who are authorized by the board to sign all of the new loan documents;
b) the co-op's attorney, who makes sure that all documents are properly drawn, resolves any last minute problems, and answers any co-op questions during the closing;
c) the lender's attorney, who protects the lender's interests;
d) one or more representatives from the co-op's existing lender, who receive the remaining balance of the co-op's old loan in exchange for a "satisfaction" letter or an assignment of the old mortgage;
e) an agent from the title insurance company, who will review all documents, issue a final policy insuring the new loan, collect any mortgage tax that may be due along with the required recording fees, and then record all of the important documents at the county clerk's office;
f) the mortgage broker (if any), who arranged the transaction and who may help resolve any last minute problems.

A properly organized closing should take about two hours. However, if there are unresolved issues, a closing can last all day – or longer! Thorough preparation, and help from the co-op's experienced advisors, can make all the difference in the world. So get your professional team involved right from the start to assure that your refinancing gets done – right!