Closing in on Closing Costs

By Patrick Niland

As interest rates have plummeted, your board probably has been thinking more seriously about refinancing your building's underlying mortgage. Since refinancing is such a complex and time-consuming process, everyone's first question is, "how much will it cost?" The answer to this question depends on the unique circumstances of your co-op. However, closing costs – the actual out-of-pocket expense of finding, processing, and closing a new underlying mortgage – often play the largest role in determining whether a co-op enters the market before its existing loan comes due. Some refinancing expenses depend on the size of your new loan and some do not; some are fixed, while others are negotiable. Therefore, before you begin, it pays to know what's involved.

Refinancing costs fall into three main categories: "get ready" costs, "up front" expenses, and "actual" closing costs. "Get ready" expenses include fees paid to your attorney, accountant, and managing agent for gathering and analyzing all of your co-op's records in preparation for the refinancing effort. Never skimp on these activities. Being well prepared <u>before</u> contacting lenders will pay big dividends later on.

"Up front" expenses include any amounts which lenders collect in advance as part of the application and underwriting process. For example,

- **Application Fees** ($250 to $2,500) – Few lenders collect pure "application" fees. However, if collected, they are rarely negotiable and never refundable.

- **Good Faith Deposits** (1% to 2% of the new loan amount) – Paid to lenders at time of formal application to show serious intent. Rarely negotiable, sometimes refundable.

- **Appraisals** ($1,500 to $6,000) – Required by most lenders, except in extremely low loan-to-value situations. Usually performed by an outside firm with a MAI (Member of the Appraisal Institute) designation. Rarely negotiable, never refundable.

- **Engineering Inspections** ($500 to $4,000) – Not always required. Somewhat negotiable.

- **Environmental Reports** ($500 to $3,500) – Almost always required. Be prepared to pay for removal or remediation of any hazardous substances identified in the survey. Somewhat negotiable.

- **Credit Reports** ($250 to $1,000) – All lenders will check the co-op's credit record. Not negotiable, not refundable.

Once your loan application has been approved, a commitment letter will be issued. Most commitment letters include a list of documents and other information that must be supplied prior to closing. Virtually all of this documentation will be assembled or prepared by the co-op's attorney. Once all of that legal work has been completed, a closing will be scheduled. At the closing, the new lender will pay off the outstanding balance of any existing loan, as well as the following expenses:

- **Origination or Commitment Fees** (0% to 2% of the new loan amount) – This amount is somewhat negotiable and usually will be reduced by the amount of any good faith deposits submitted earlier.

- **Title Insurance** (roughly $3 per $1,000 of new loan) – Every lender requires a new title insurance policy covering the amount of the new loan. Since the fee comes from a standard schedule, it is not negotiable. However, it often is possible to save some money by updating the policy from your old loan.

- **Prepayment Penalties** – If you are refinancing an existing loan before its maturity, you may owe a prepayment penalty.

- **Pay-Off Letter** – The old lender will send a representative to your closing to pick up a check for the outstanding balance on your old loan (unless those funds are wired) and deliver a "satisfaction letter." They also will send a bill for $200 to $800 for this service.

- **Mortgage Recording Tax** – In New York State, all mortgages that are recorded in the county clerk's office are subject to a tax. This tax ranges from 1% in outlying areas to 2.75% on larger loans in the five boroughs of New York City. However, there is a provision in the law that allows an existing lender to assign the old mortgage to the new lender. Assignment transfers a credit for any taxes already paid on the old loan to the new lender. Therefore, the new lender will collect mortgage recording tax only on the "new money" advanced. No lender is required to assign or accept assignment. Most, however, will do both.

- **Survey** – Most lenders will require a new survey of the property being used as collateral for the new mortgage. Depending on the work involved, this might cost $300 to $3,000. You can save some money by updating and recertifying your old survey.

- **Legal Fees** – Your co-op will be represented by an attorney and so will the lender. As borrower, you get to pay for both. Each side's legal fees are somewhat negotiable between a minimum of $2,500 (for loans up to $500,000) to $20,000 (for loans over $10 million).

- **Searches and Recordings** – Before closing your new loan, both attorneys will search the public records for anything that could effect the integrity of the new loan, e.g., unsatisfied mortgages, mechanic's liens, unpaid taxes, building violations, easements, etc. Further, the new lender will insist that all important documents be recorded in the public records at the county clerk's office. For these two activities, expect to pay a total of $500 to $1,000.

- **Brokerage Commissions** – If your co-op retained the services of a mortgage broker to arrange your new loan, you also will pay that commission at closing. Brokerage fees typically equal 1% of the new loan amount but often are negotiable.

Lastly, most lenders will require that your co-op's property insurance be paid for a year in advance. They also will collect $1/12^{th}$ of the annual total of your co-op's real estate taxes and water and sewer charges for every month that has elapsed since these items were last paid. They do this to establish an escrow account that will enable them to pay all of these items directly when they next come due.

As you can see, refinancing an underlying mortgage is a very expensive process. Therefore, it should not be undertaken lightly nor without extensive preparation and involvement by all the co-op's professional advisors. Nevertheless, a refinancing can produce significant long-term savings for a co-op if the process is completed properly.

Since closing costs add up quickly, it pays to get a detailed estimate before applying to any lender. A co-op's professional advisors (attorney, accountant, managing agent, and mortgage broker) can provide these estimates as well as other important information that will help the board make an educated decision about whether and when to refinance.