“CREATIVE FINANCING” FOR CAPITAL IMPROVEMENTS

By Patrick Niland

The funding of major capital improvements presents many co-ops with a major problem. Unfortunately, some boards wrongly assume that this problem has just two solutions: the politically-unpopular special assessment or the costly and time-consuming refinancing of their building’s underlying mortgage. Indeed, each of these options should be considered – but only after a thorough review of all of the other alternatives. (Note: A refinancing is usually a better choice than an assessment, due to its more favorable tax treatment.)

Many board members are so focused on the total cost of their planned improvements that they overlook a host of smaller measures which, together, can put a big dent in the problem. Some of these measures are quite simple while others require a bit sleuthing and creative thinking.

The first place to look for money is your expenses. Changing the frequency or level of building services can often free up a lot of cash. Making do with one porter instead of two, mopping floors and washing windows less frequently, exterminating only when needed, imposing controls on supplies, and other such actions can all contribute savings toward your goal. Down-sizing and tightening up should be your new mantras.

The “income” side of the equation holds even more potential. If the capital improvement is not urgent, the board might increase shareholder maintenance by a small percentage and accumulate the needed funds over one or more years. This is by far the cheapest way to raise money, but it requires a bit of patience.

If the capital improvement will produce operating savings (e.g., lower heating bills due to gas conversion, an entirely new boiler, or new thermopane windows), the board might offer its shareholders graduated discounts for prepayment of one or more months of maintenance charges. The accelerated cash flow will help pay for the improvement now while the reduced operating costs in future months will help offset the maintenance shortfall until full maintenance payments are resumed.

As mentioned earlier in this article, a board can often “borrow” the needed money from its contractor through extended payment terms. Alternatively, a board might arrange an improvement loan from the contractor’s bank, using the contractor as a guarantor. Some contractors might charge a fee for this help and the contractor’s bank probably charges a higher interest rate than a mortgage lender. However, the total cost of this type of funding will be much less than the total expense of refinancing an underlying mortgage.

If the co-op’s apartments enjoy a healthy turnover rate, the board might consider a flip fax. Flip taxes can be structured as a flat fee on every sale, a percentage of the total sales price, or a portion of the seller’s profit. In some cooperatives, flip tax revenue is high enough to cover all capital improvements. That might not be the case for your co-op, but it will help.

Most co-ops have at least a few sublets, but not many impose surcharges for that privilege. Having too many sublets can alter the character of a building and hinder the board's ability to refinance the underlying mortgage. Therefore, at the very least, sublets should be restricted. One way to do that is through sublet surcharges.

Surcharges provide an economic incentive for shareholders to accept current market values. Surcharges also encourage owner-occupancy and have the added benefit of raising money for the co-op. A Manhattan building has been especially creative at generating income from its sublets. In addition to a graduated surcharge (10% of maintenance the first year, 20% during the second, and 30% during the third and <u>last</u> year), it collects a $250 review/processing fee, a move-in fee of $500, and a move-out inspection fee of $500.

In today's materialistic world, people seem to acquire ever more "stuff". Most buildings have unused space in their cellars. Why not exploit this situation by creating storage bins and renting them out to the highest bidders? And what about fines for shareholders who don't pay their maintenance on time, break house rules, waste energy, or make unauthorized alterations to their apartments?

Garden and roof rights can be created and sold to shareholders who want some private outdoor space. Or they can be rented to companies like the communications firm that is negotiating with an Upper East Side cooperative for the right to place a rebroadcast station on its roof. And if the roof isn't big enough, try the lobby. An enterprising Queens cooperative rented out a portion of its large lobby as a branch outlet for the local dry cleaner. Another board set up a coffee, muffin, and newsstand operation in a corner of its lobby. Each of these co-ops had decided that it was less important to impress guests than it was to provide income and service to shareholders. What do you think?

Every building can squeeze more money out of its operations. Whether these savings will be enough to pay for the capital improvements you need to make will depend on your particular circumstances. But one thing is for sure: You'll be happy you made the effort.