INTEREST ONLY LOANS

By Patrick Niland

“Interest only” loans are just what the words imply: loans on which the borrower pays only interest and no principal. That means that the outstanding balance at maturity is the same as the original loan amount.

Interest-only loans tend to increase the amount of debt on co-ops which, over time, can negatively affect their financial health and increase their future borrowing costs.

The alternative would be a loan with amortization, which is the repayment of a small portion of the original loan amount along with each month's interest payment. Even a minimal amount of amortization guarantees that a co-op will repay enough of its loan by the maturity date to cover the closing costs on their next loan.

There also is a philosophical "fairness" to amortization. Interest-only loans give current shareholders all of the benefits of the new funding, at a discount, but shift most of the cost to future shareholders.

A more equitable arrangement would be to include amortization as part of every new loan so that every shareholder pays back some of the cost.

In certain cases, it may be possible to structure a loan that combines interest-only payments during the early years with payments of interest and principal for the remainder of the term. This structure might allow a board to obtain the funds they need now at an affordable payment, and then gradually raise maintenance over several years to the level necessary to cover monthly amortization.