MAKING ENDS MEET

By Patrick Niland

This is the time of year when many boards are engaged in the budget and planning process. Unfortunately, this process sometimes results in the unhappy realization that the cooperative does not have enough "sources" to cover all of its projected "uses". What's a harried board member to do? Find the money, of course. But too often the board's knee-jerk reaction is to refinance the building's underlying mortgage. Just because the co-op is a little short of cash does not automatically mean that the building needs a new loan. In fact, in more cases than not, a refinancing is *not* the best solution.

A better first step would be to determine whether this budgetary imbalance is due to a permanent shift in the co-op's finances or just a temporary change or one-time occurrence. Since the origin of a problem often involves its timing, a solution sometimes can be found there as well. For example, quick cash could be generated by offering a discount to shareholders who prepay several month's maintenance. Certain capital projects might be deferred, and others might be staged over a longer period of time. Obviously, each of these measures could affect future operations or cash flows. Therefore, none of them should not be enacted without consulting the co-op's managing agent, accountant, and other professional advisors.

Origins of Imbalance

Unfortunately, most budget problems are the result of a permanent or irreversible change in the co-op's cash flow. In this case, the solution is usually more complicated; but it still will be achieved through an increase in cash "sources" or a reduction in cash "uses" -- or both. Many board members understand this and move quickly to close the gap by levying a special assessment or increasing maintenance. While such moves may be part of the ultimate solution, neither should be imposed without careful consideration of their long-term ramifications. A history of assessments often implies that a co-op is poorly run, and excessive maintenance can impede resales. Again, consult your team of professionals.

Creative Income Ideas

In most co-ops, there are several *other* ways to boost income. Flip taxes, sublet surcharges, pet premiums, move-in/move-out fees, late payment penalties, and fines for house rule violations each can contribute small but meaningful amounts to a co-op's coffers. More aggressive buildings have renegotiated their laundry room contracts, increased parking fees, and installed vending machines in the basement or mail room. Still others have converted idle cellar space into cash-generating storage rooms with bins of various sizes and prices. Why not rent a corner of that big lobby to the local dry cleaner as a satellite location that is a time-saver for the co-op's shareholders and a money-maker for everyone? Got the picture? Get creative!

Don't overlook the co-op's banking relationships, either. Determine the average balance in each of the co-op's accounts. The bank is using these balances to make more money for *it*. What benefits does the *co-op* get in return? If a board member were to ask that question in the right way, the bank might waive or reduce some of its charges. Alternatively, it might provide additional services at no charge. Also, the board should evaluate the performance of the co-op's reserve fund on a regular basis. A reserve fund of $100,000 generates an extra $100 per year for every tenth of a percent increase in yield. Now a hundred dollars may not seem like much. But, to paraphrase a famous congressman, a hundred here and a hundred there and pretty soon you have real money.

Cost-Cutting Strategies

Every business can cut costs and co-ops are no exception. Start with taxes and other municipal charges. Ask a tax attorney to review the building's assessment (both past and present) and, if necessary, begin a certiorari proceeding. And don't forget to file for J-51 benefits on any qualifying capital improvements. Then check the water bills. Are they correct? Would metering save money?

In short, board members should take a hard -- and regular -- look at every planned expenditure. Is it still necessary? Can it be deferred or reduced? Can we get it cheaper elsewhere? Why not work out an arrangement with the super or managing agent -- or even big suppliers -- to share cost savings. After all of the bad press about kickbacks, here's one everyone can be *proud* of!

Sometimes the best way to cover a planned expenditure *is* to just borrow the necessary funds. But, before calling your friendly banker or mortgage broker, you might want to explore other (and, perhaps, cheaper) sources. For example, some of the co-op's shareholders, who have their money sitting in a passbook savings account earning just 2% or 3%, might gladly lend it to their co-op at 5% or 6%. A big supplier might be willing to extend payment terms for a reasonable finance charge. And, given the current market for construction, virtually every contractor is hungry enough to at least *consider* some form of financing for bigger projects -- or help the co-op arrange it with *their* bank.

Bank Financing

Of course, the most obvious source for money is, as Willy Sutton noted, the banks. But they, too, can provide money in many different ways. For example, if the co-op's managing agent or a shareholder has a strong relationship with a particular bank, the board might be able to negotiate a short-term loan on very favorable terms. Alternatively, the board (or even a group of shareholders) might agree to move checking accounts and/or investment balances to a different bank in exchange for a credit line there. Or, the board could apply for a second mortgage from any of the smaller institutions which make such loans.

However, the best solution to the budget dilemma often *is* a refinancing of the cooperative's underlying mortgage. In those cases, it is *absolutely essential* that the board consult all of the cooperative's professional advisors *from the beginning*. No board should attempt a refinancing on its own. Refinancing is a serious endeavor that will affect not only the budget itself but also the market value of every shareholder's apartment. A good refinancing will pay dividends for years to come. A bad one can drag a co-op down.

Seven Steps

There are seven key steps to a successful refinancing. First, the board should create a file which contains all of the important facts about the cooperative and its operations. This includes an offering plan with all of its amendments, a current maintenance roll, financial statements and resale information for the most recent three years, a list of sublets and arrears, and a budget for the coming year.

Second, the board must decide how much money it needs and how it will be spent. This calculation includes the outstanding balance of the cooperative's existing underlying mortgage, prepayment penalties (if any), amounts for planned capital improvements and a replenished reserve fund, and the closing costs of the new loan. Input from the cooperative's accountant will be invaluable in determining these amounts.

Third, the board needs to familiarize itself with the money markets. Reading the third section of both the *New York Times* and *Wall Street Journal*, as well as watching any of the myriad financial programs on television, will go a long way toward this goal.

Fourth, the board should appoint a "designated hitter" -- the one person (I repeat, *one*) through whom all (I repeat, *all*) communication with the lending or brokerage community is conducted. This will prevent erroneous or misleading information from leaking into the market and disrupting the co-op's negotiations with lenders.

Fifth, the board must remember that loan officers are *very* busy people -- just like the rest of us. They therefore appreciate (and deserve) the same courtesy and respect that each of us would like to receive. Being rude or demanding will enhance neither the terms nor timing of your new loan.

Sixth, the board should be prepared throughout the refinancing process to respond to lender questions and requests as soon as possible. This may mean special board meetings, called with little notice, to make the decisions which a lender may need to continue processing the new loan. Do *whatever* it takes to keep the ball rolling.

Seventh, use the cooperative's professional advisors to the max. If ever there was a time to have their "meters" running, a refinancing is one of them. Don't be penny wise and (thousands of) dollars foolish. Years later, you still will be glad that you had the right advice when it *really* mattered.

Lastly, if none of the above suggestions strikes your fancy, you can always buy a lottery ticket. As the ad says: *You never know!*