

DIAL “M” FOR MORTGAGE

By Patrick Niland

MAKE SURE THAT YOUR GUNS ARE LOADED BEFORE TAKING AIM ON A NEW UNDERLYING MORTGAGE.

With interest rates heading lower once again, now may be the ideal time to start hunting for a new underlying mortgage. But don't go off half-cocked. Board members who prepare well before entering the mortgage jungle always bag the best deal.

Unfortunately, as some boards have discovered, there are no short-cuts or alternate routes. There are seven essential steps to any refinancing which, if followed, will guarantee success for every co-op.

Step One: Get the Facts

Be an expert on your building. Have enough information at your fingertips to capture and *keep* the attention of every loan officer. Before making any calls, assemble and review all of your important records. Then create several sets of the following for distribution to interested lenders:

- A basic fact sheet with the co-op's address, legal description, and number of units, plus a breakdown of units by type (studios, one bedrooms, two bedrooms, etc.).
- A description of your co-op's physical plant, i.e., heating system and fuel used, number of floors and elevators, condition of roof and windows, and any other relevant data.
- A complete offering plan.
- All amendments, especially those containing your asbestos report and sponsor disclosures (if applicable).
- A current maintenance roll showing each apartment, its monthly maintenance charge, and any arrears.
- A list of sponsor, investor, and sublet apartments with rents and lease expiration dates.
- A description of your co-op's sublet policy.
- Audited financial statements for the most recent three years.
- A list of all apartment sales during the most recent three years.
- Recent statements for all bank accounts and investments.
- Information about your current loan (lender, monthly payment, interest rate, due date, prepayment provisions, and so on).
- An explanation of any tax issues like J-51 benefits or pending certiorari reductions.
- Any other important information about your cooperative.

Ownership information is crucial to all lenders and most have minimum criteria which your building must meet. If a sponsor or investor still owns any units, most lenders will have two main concerns. The first is whether rent exceeds maintenance for those units. A positive

relationship will enhance your chances while a negative one might cause problems. But even if sponsor cash flow is negative, you are not doomed. A few lenders are not frightened by such situations.

The second concern is whether the sponsor has used (or “pledged”) the unsold shares as collateral for other loans. If the answer is “yes”, your options will decrease. However, you still might find a sympathetic lender if everything else about your profile is acceptable.

Step Two: Pick a Target

Before going shopping, you need to know what you want. Ask your managing agent, accountant, and engineer to help you assess your co-op’s financial and physical needs over the next five or ten years. Then develop a comprehensive financial plan to meet those needs. Be sure to account for inflation, increases in real estate taxes, and future repairs. Then add a contingency factor for unforeseen items. This contingency should be at least 10% of your total needs and perhaps as much as 15% - 20% if you are looking for a longer-term loan. Some co-ops neglect this important step and wind up pleading for more money at the last minute. Don’t be shortsighted. Plan ahead.

Step Three: Wise Up

When it comes to money and banking, most people are poor shots. But you can improve your aim with a little research. All major newspapers have a daily “business” section featuring articles on interest rates and general trends in the financial markets. Two of the best are the “Credit Markets” column in Section C (Money & Investing) of *The Wall Street Journal* and a column of the same name in Section D (Business Day) of *The New York Times*. In addition, *Business Week*, *Forbes*, *Fortune*, *Money*, and other similar publications are all excellent choices to learn more about the market.

Every board member should read several of these publications regularly for about three months before you plan to enter the market. This exercise will give everyone a fair sense of the market, help you appear more professional to the lending community, and provide a sound basis for making important decisions all through the refinancing process.

While doing your research, take special note of the fact that interest rates change every day. As a result, the 9% rate you read about today may not (and probably won’t) be available tomorrow. Also, recognize that anything you read is just a *summary* of the facts and, therefore, may not apply fully in your case.

Now armed with a folder full of facts, a specific goal in mind, and a good grasp of market conditions, you are almost ready for the hunt. All that you lack is a little product knowledge. I will provide that now.

Underlying mortgage loans come in several flavors from a variety of sources. Even today, the most common form of underlying loan is still what lenders call a “five-and-five”. This is a

relatively short-term loan of five years, followed by one or more optional renewal periods. Such loans are usually found at savings banks.

A few commercial banks are active in this market as well. Their products are similar, though sometimes offered in 7-, and 10-year versions. Some of these banks give renewal options and some do not.

Certain insurance companies and pension funds also make underlying mortgage loans. However, these institutions are very conservative and very selective. Unless your building has a prime address, is almost fully sold, and is largely owner-occupied, you needn't apply.

Another source of money is the secondary market. This is the home of the FNMA ("Fannie Mae"), the FHLMC ("Freddie Mac"), and HUD. You cannot borrow directly from any of these lenders, but you can get a loan through any one of their authorized agents. Though somewhat more complicated and expensive, these loans have fixed rates and terms from 10 to 35 years. Many of them are self-liquidating, to boot, which saves you the hassle and cost of future refinancings.

Finally, there are a number of other lenders which, for lack of a better term, I call "hybrids". These entities are difficult to classify because their lending operations mix practices of the other more conventional institutions. Their products are equally difficult to define because they often are tailor-made to meet the specific needs of each borrower. So, if your co-op has a peculiar situation, these might be the choice for you.

Step Four: Team Up

As you've probably gathered by now, refinancing an underlying mortgage is a very complex, expensive, and time-consuming process. Do not expect (or allow) the co-op's Treasurer to handle this job alone. It is the single most important decision that a board will ever confront. It will affect not only the co-op's budget but also the market value of every shareholder's apartment. Therefore, you should assign several board members to the task or perhaps appoint a special refinancing committee.

And don't forget your co-op's professional team. Get them all involved *from the start*. Ask your managing agent to forecast operating expenditures and pending repairs. Have your accountant evaluate your tax picture and possible loan structures. Tell your attorney to review your title and building violation record, as well as your existing loan documents for prepayment provisions, notice requirements, and other restrictions. Hire your engineer to perform a complete building inspection and advise you regarding its condition and possible future capital items. Don't be afraid to run the meter. If ever there was a time to use your professionals, *now* is the time.

Step Five: Follow the Leader

Regardless of how many people are involved in the refinancing effort, only one person should contact the outside world. Nothing disturbs a loan officer more than to receive conflicting information about the same co-op from two or more sources. Likewise, nothing causes more

confusion and misunderstanding at board meetings than several versions of the same issue. To avoid such problems, appoint one person as your “designated hitter” for the entire refinancing process. Funnel all information to and from the market through this one individual. This practice will not get you the right deal, but it will ensure that you get the deal right.

Step Six: Be Nice

Loan officers are very busy people – just like the rest of us! So, a little courtesy will be appreciated. And so will straightforward questions, honest answers, and all the facts. Never try to conceal anything from a loan officer. When the truth eventually comes out (it always does), your credibility will be trashed – and so will your application.

It may surprise you to know that, in most cases, the loan officer does not approve your loan. They will collect all of the necessary information, evaluate your situation, make a proposal, and then present your application to a committee of senior executives. This committee may approve the loan, approve it with modifications which you may or may not like, or reject it. So, the next time you call a loan officer, be nice. It *will* make a difference.

Step Seven: Talk Back

Keep an open and active channel of communication between you and the loan officer. If the loan officer asks a question or requests additional documentation, respond as quickly as possible. Since a loan officer’s desk is usually piled high with paper, your application can get buried quite easily. Do whatever it takes to respond to every request within one or, at most, two days. This will keep your application on track toward a commitment.

Unfortunately, as wonderful as a commitment may be, and as excited as you might be to have received it, you are not done. Every commitment must be closed. This is not as simple as you might think. Neither is it something that you can hand off to your attorney and forget. Your attorney will be very involved at this stage of the process, but you also have much to do. So, stay focused. You can relax and/or celebrate after the closing. Good luck!

The 8 Most Costly Mistakes to Avoid

1. Starting too early
2. Waiting too long
3. Borrowing too much
4. Not borrowing enough
5. Interest rate myopia
6. Ignoring amortization
7. Not providing secondary financing
8. Too many cooks in the kitchen