FINANCING ALTERNATIVES 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 situation has just two solutions: the politically unpopular special assessment, or a costly and time-consuming refinancing of the building's underlying mortgage. Indeed, each of these options should be considered - but only after a thorough review of all alternatives.

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 simple while others require a bit of creative thinking.

The first place to look for money is in 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 similar actions can all contribute savings toward your goal. Downsizing 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 defer it, increase shareholder maintenance by a small percentage, and then 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 caused by 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. And don't forget to apply for any tax or utility abatements for which you might qualify.

A board can often "borrow" the needed money from its contractor through extended payments. 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-tax. This 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 flip-taxes will help.

Most co-ops allow 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 co-op's ability to refinance its underlying mortgage. Therefore, at the very least, sublets should be restricted. One way to do that is through surcharges.

Surcharges provide an economic incentive for shareholders to accept current market values. They also encourage owner-occupancy and provide interest-free capital. One Manhattan building has been especially creative at generating income from its sublets. In addition to a graduated surcharge (10 percent of maintenance the first year, 20 percent during the second, and 30 percent during the third and last 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 basements. 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 will depend on your particular circumstances. But one thing is certain: you'll be happy you made the effort.