It’s Only Halftime!

By Patrick Niland

A loan application may tell you the score but, remember, it ain’t over ‘til it’s over!

Refinancing an underlying mortgage takes about 90 days, depending on your co-op’s particular situation. Assembling all of the necessary information, choosing an amount and term, and then sorting through the various lenders and loan offers can eat up at least half of that time. Even after choosing a lender, you still must complete their application process, negotiate a commitment, and close before you get your money.

The Process

Virtually all lenders have a formal loan approval procedure that starts with a written application, passes through “underwriting” to a “commitment letter”, and then ends with a closing. The first step, the application itself, usually includes a long letter describing the important terms of the proposed new loan, a host of forms to be filled out, and a list requesting additional documentation (things like general building statistics, the offering plan, recent financial statements, a current maintenance roll, etc.). Every lender has its own set of forms, but they all tend to be quite similar. The common requirement of *all* applications is that they must be signed by an officer of the apartment corporation, dated, and returned with a “good faith” deposit. This deposit, usually equal to one percent (1.00%) of the new loan, shows the lender that the co-op is serious (not “just shopping”) and is truly ready to proceed with the refinancing.

Forms, Forms, and More Forms

Most application packages also include several verification forms. These forms give the new lender permission to verify information supplied on each form. For example, a loan verification form requests information about your co-op’s existing loan (lender, address, loan number, contact person, phone number, etc.) and gives the new lender permission to contact your existing lender for a payment history. A deposit verification form allows the new lender to confirm checking and savings account balances that your co-op reported.

Some lenders include an environmental questionnaire to help them determine whether the co-op’s property contains any environmental hazards. Board members and managing agents often can’t answer every question on this form, but they should be as complete and honest as possible. These questionnaires sometime provide enough information for a new lender to waive any further environmental investigations.

Good Counsel

Your co-op *never* should return a loan application to a lender before reviewing it with your attorney. Every co-op has myriad business and legal issues which must be handled carefully to avoid future problems. The right time to address such issues is at application and the right person to address them is your co-op’s legal advisor. Moreover, your attorney will make sure that your good faith deposit will be returned should circumstances beyond the co-op’s control prevent the new loan from closing.

Underwriting

The next step in the loan approval process is "underwriting" – when the loan officer and others evaluate all of the information on the application, its various accompanying forms, and any other data provided by the co-op. They also review supporting information from a credit report, appraisal, engineering inspection, and environmental assessment. A co-op credit report is much like one for an individual; it shows payment records for all debts and lists any outstanding liens, judgments, or other obligations. All lenders want to be sure that potential borrowers pay their bills on time.

Third Party Reports

If an appraisal is required, it will determine three hypothetical values for your co-op: a *replacement* value (the cost to rebuild your building today on the same or similar lot), a *sale* value (based on recent sales of "comparable" properties), and an *investment* value (based on the income stream your building would produce if it were a rental). Lenders consider all three values, but they give most weight to your co-op's value as a *rental* because, if your co-op doesn't make its payments and the lender must foreclose, your co-op would revert to rental status.

Most lenders also hire a professional engineer to thoroughly inspect your building to make sure that no significant repairs are needed. Some lenders insist that serious defects be corrected *before* closing, while others escrow the necessary funds and require such repairs to be completed soon after closing. Further, if the engineer indicates that major repairs may be needed later, some lenders may ask the co-op to open a special "replacement reserve" to save up for those future expenditures.

An environmental assessment (if required) will determine whether the property contains any hazardous substances (asbestos, lead paint, oil spills, etc.) and whether they pose a risk to co-op residents. If hazards are uncovered, the report will recommend remedial steps and estimate their cost.

The Commitment Letter

Once the loan officer has evaluated all of this documentation, he will present your application to his loan committee. If his presentation is convincing, the co-op's application will be approved and a commitment issued.

While getting a commitment does warrant a small celebration, your refinancing still is far from done. True, a commitment is a contract between lender and borrower. However, most commitments contain one or more conditions which must be satisfied before that contract is binding. If you fail to meet even one of these conditions within the 30 to 60 days allowed in your commitment, your deal could fall through. So, stay focused!

The Home Stretch

The co-op's attorney usually supplies most of the documents and other information needed to satisfy commitment conditions. For example, every loan requires a new title insurance policy to protect the lender's security interest. Most lenders also want a report from the Secretary of State certifying the co-op's status as a legal corporation and an "opinion letter" testifying that your co-op was properly formed and continues to operate as a *bona fide* cooperative. In addition, lenders usually demand assurances that your property does not have any serious building code violations, mechanics liens, or other encumbrances. All of this information must be reviewed by the lender's attorney before a closing can be scheduled.

The Closing

This is the final step in most refinancings. At the closing, the old loan (if any) is paid off, all of the new loan documents are signed, all of the refinancing expenses are paid, and the new loan is funded.

A typical closing is held in the office of the lender's attorney and includes the following individuals:

a) An officer of the co-op corporation;
b) the co-op's attorney;
c) the lender's attorney;
d) a representative from the co-op's existing lender, who receives the old loan "pay-off" in exchange for a "satisfaction" or an assignment of the old mortgage;
e) an agent from the title insurance company, who reviews all documents, issues a final policy insuring the new loan, collects any mortgage tax and recording fees that may be due, and then records all of the important documents in the public records;
f) the mortgage broker (if any), who arranged the transaction and may help resolve any last-minute problems.

A properly organized closing should take no more than two hours. Unfortunately, unresolved issues can stretch a closing all day – or longer! To avoid that nightmare, prepare thoroughly and get help from the co-op's experienced advisors. Involving the right attorney, as well as a skilled mortgage broker, from the very beginning can make all the difference in the world. So make sure your whole team is on the field from kick-off to touch-down!

One Last Thing

There actually is an 8th step to every successful refinancing. It's called a post-closing *party*!

Letters to the Editor

Just read your article and thought it was very good. However, I think you left out a couple of things:

1. The client should speak to their accountant to see if there are any financial or tax issues they should be concerned about, such as the impact of mortgage amortization on the 80/20 rule and the fact that self-amortizing loans are usually not right for co-ops.

2. It's not over with the closing, or even with the post-closing party. There needs to be prepared a closing statement and closing binder and copies should be sent to the management company, the building's on-site office, and the accountant. We frequently have to struggle to get our copy and we cannot prepare the tax deduction information or complete our audit without it.

Again, a very good article.

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<u>Editor's response</u>

Thanks, Mark, for your comments. They underscore the importance of having the co-op's accountant involved in the entire refinancing process, from the very beginning to the very end.