"Shop 'Til You Drop"

By Patrick Niland

To get a great underlying mortgage you need to know who's got what.

Need a mortgage? Call a bank, right?

Not so fast. When it comes to underlying mortgages, there are almost as many choices as there are pigeons in Central Park.

At any given time, various lending institutions offer a wide array of options for co-ops that need to refinance an underlying mortgage.

But who are these lenders and what are the advantages and disadvantages of each? And how can a board be sure it has researched the market thoroughly and uncovered all the possibilities? That's the tough part.

When shopping for a new underlying mortgage, it helps to have a feel for the financial markets, to understand some of the jargon, and to know a few of the "players".

Commercial Banks – Commercial banks are among the oldest and most visible of all lending institutions. There's one on almost every corner – with names we all know well. Commercial banks offer checking and other deposit accounts and, historically, made loans only to businesses. But over the last 10 to 15 years, commercial banks have become quite active in consumer loans and home mortgages, but their rates and terms vary widely. And, unfortunately, few of those provide credit lines or second mortgages.

Savings Banks – To a layperson, savings banks are indistinguishable from commercial banks because they provide many of the same services. But there are some subtle differences.

Originally, most savings institutions were created as small, local "thrift" associations whose dual purpose was to provide a safe place for people's savings and affordable mortgage loans to help their depositors buy homes. Over the past 20 years, savings banks acquired new financial powers and now offer checking accounts, money market funds, life insurance, business loans, home equity loans, student loans, credit cards, and other consumer credit.

In the 1980's, the savings and loan crisis bankrupted hundreds of savings banks and forced many others to merge. The byproduct of this debacle is a much smaller universe of savings institutions staffed by very conservative loan officers. Today, however, some of the caution is wearing off and savings banks are again a good source for certain types of underlying mortgages. Most savings banks offer renewable 5- and 10-year loans; only a very few offer any sort of credit line or second mortgage.

Fannie Mae and Freddie Mac – Both Fannie Mae ("FNMA" or the Federal National Mortgage Authority) and Freddie Mac ("FHLMC" or the Federal Home Loan Mortgage Corporation) were federally-chartered institutions that are now publicly-traded corporations. However, each still has a quasi-governmental aura that probably facilitates their activities. Though they share similar charters, congressional mandates, and regulatory structures, Fannie and Freddie differ in the strategies they use to meet their operational goals.

Both organizations purchase loans from a network of lenders across the country, thereby creating a "secondary market". They then package these loans into "pools" which are then used as collateral for bonds known as mortgage-backed securities (MBS). These bonds are sold to large institutional investors such as insurance companies and pension funds.

Because government regulations limit the lending activity of banks to the deposits they actually hold, mortgage loans could become scarce if banks were forced to keep every loan "in portfolio". Fannie and Freddie help solve this problem by buying loans from banks while still paying them fees to "service" each loan (i.e., collect payments and handle any problems). This process strengthens lenders by freeing up their capital for more business and by giving them a steady stream of servicing income.

Although Fannie and Freddie were originally created to support the single-family residential mortgage market, they both now purchase large multi-family loans, including underlying mortgage loans for co-ops.

The rapid growth of the secondary market can be attributed largely to the use of uniform underwriting standards and investment rating agency supervision. Since virtually all of Fannie's and Freddie's volumes are "sold" to the secondary market, neither will purchase loans not underwritten to those uniform standards.

For this reason, a lender who plans to sell your loan to Fannie or Freddie will probably be less flexible than a lender who plans to hold your new loan in portfolio. Before choosing a lender, you might want to weigh the importance of such flexibility.

Insurance Companies and Pension Funds – These institutions often are referred to as "premium" lenders because they lend only to co-ops with the best profiles (excellent location, high owner-occupancy, very low loan-to-value). With rare exception, insurance companies and pension funds target their lending to larger co-ops ($2 to $5 million minimums).

If your co-op satisfies such criteria, these institutions can be excellent sources for a new underlying mortgage on <u>very</u> competitive terms. Unfortunately, most of these institutions do not lend directly to co-ops; instead, they channel their funds through "correspondents" who process, close, and service loans on their behalf.

Conduits – Conduits are a relatively new player in the co-op underlying mortgage game. Most conduits were formed as subsidiaries of Wall Street investment firms to repackage and sell off troubled property left over from the savings and loan crisis. Given the risk involved, conduit interest rates and terms were not very attractive.

However, familiarity with the market and growing competition is forcing most conduits to cut spreads, loosen terms, and streamline processing. Nonetheless, they still are most effective on larger transactions with unusual or difficult components. Most co-ops will find better deals from more traditional sources.

Private Lenders – Private lenders use their own money (or the money of other investors) to make mortgage loans. Because these lenders are not subject to federal or state banking regulations, they have much more. However, this flexibility usually comes with a higher price tag. Nevertheless, co-ops with tough financial problems, sponsor defaults or high owner arrears, low occupancy rates, or serious maintenance problems might find a private lender to be the perfect solution.

The most important thing to remember about private sources is that they often are the “lender of last resort” and, therefore, can be quite expensive. So make sure that all other options have been exhausted and that all of the co-op’s professional advisors concur with the decision. Professional guidance is important for any refinancing, but it’s crucial when dealing with private lenders.

As you can see, a co-op’s options for obtaining a new underlying mortgage are varied and sometimes tricky. It’s impossible to categorize any of the above loan options as “right” or “wrong” – any one of them could be the proper choice depending on each co-op’s unique situation. That’s why the involvement of the co-op’s professional advisors is so important.

So, when it’s time to refinance your underlying mortgage, take time to prepare well and then fully research the market with your full team of advisors. That’s the <u>only</u> way to find the “best” loan from the “right” lender.