SIX STEPS TO SUCCESS

By Patrick Niland

KNOWING HOW TO DEAL WITH LENDERS CAN MAKE REFINANCING A LOT EASIER.

With interest rates at historically low levels, this should be the ideal time to refinance an underlying mortgage, right? Don't be so sure.

The market has become less receptive. Turmoil in the banking world – some of it caused by bad loans to sponsors – has removed many lenders from the market, while those who remain are cautious – and overworked. During the last 12 months, lower interest rates have elicited an avalanche of loan applications, but the number of supervising loan officers has dwindled.

In such an environment, neither borrowers nor lenders can afford to waste time. Even if your cooperative is fully sold, it may not hold the attention of a loan officer. Therefore, how co-ops present themselves to lenders will frequently determine what kind of loan they get – or even if they get one at all.

THE STEPS

1. *Know what you want.* Before shopping, consult with your accountant, engineer, and management company. Have a financial plan in place that considers your building's physical needs over the life of the new loan. Be sure to include adequate reserves for inflation, increases in real estate taxes, and future repairs. Then add a contingency factor for unforeseen items before settling on a total loan amount.

Negotiating for more money after a commitment has been issued wastes valuable time and irritates lenders. Even worse is having to borrow more money for some unforeseen major repair after your loan closes. Plan ahead. Then be ready to tell the loan officer exactly how much you want and why.

2. *Know the facts.* Nothing frustrates a loan officer more than borrowers who can't answer even the most fundamental questions. Before making that first call, assemble and review your records. Be familiar with and have on-hand several sets of the following:

- A basic fact sheet, containing the co-op's address, block and lot numbers, lot dimensions, number of units, number of floors, number and type of elevators, type of heating system and fuel, and other relevant information.
- The offering plan.
- All amendments to the offering plan, including the ones with your asbestos report and sponsor financial disclosure statements (if applicable).
- An up-to-date maintenance roll showing each apartment and its current monthly maintenance charge.

- A list of sponsor, investor, and sublet apartments showing the rents collected from each.
- At least two years' worth of audited financial statements.
- A list of all apartment resales during the last two years.
- Information and documents related to your current loan (lender, monthly payment, interest rate, due date, prepayment provisions, and so on).
- Any other important information about your cooperative.

You should also know when your building was converted and the percentage of the apartment corporation's shares owned by resident shareholders. All but a few lenders have minimum ownership requirements. Consequently, if yours is only 50 percent sold, you're going to have a tough time. For some lenders, even 80 percent resident ownership is not enough.

Sponsor information is crucial for buildings that are not fully sold. Does the sponsor collect more in rent from the unsold units than he pays in maintenance? If not, many lenders will end the conversation. Others will start talking about an escrow account to cover the negative cash-flow. If the shortfall is large, expect the escrow account to be larger – maybe two, three, or even five times the difference.

Another concern is whether the sponsor has used the unsold shares as collateral for other loans. If "yes," expect more rejection. (You may still be affected if the sponsor has pledged unsold shares from another conversion).

3. *Understand the market.* Read the "Credit Markets" columns in *The New York Times* (Section D) and *The Wall Street Journal* (Section C) for about a month before shopping. Develop a feel for what's happening in the financial markets. Note especially that interest rates change almost daily. As a result, the 9 ½ percent quoted last week may not be available today. Also, recognize that a quote is no more than an estimate. It is not binding, simply what the loan officer feels would be approved if you applied today.

Many lenders do not base their interest rates on an index like the prime rate or the rate on United States Treasury securities. And most do not adjust their mortgage rates to every market fluctuation. Nonetheless, use one of those indices as a proxy for the lender's pricing formula. This will help you to compare quotes from different lenders and judge whether an old quote may still be valid.

Two quotes of 9 ½ percent may not be equal (assuming, for the moment, that all other terms are identical). By calculating the difference (or "spread") between 9 ½ percent on the proposed loan and the average rate on treasury securities of the same maturity date, you might conclude that Lender A is more expensive than Lender B. Alternatively, you might expect a loan quote of 9 ½ percent, when treasury securities were trading at 7 ½ percent, to be adjusted upward by the lender if securities start trading at 8 ¼ percent.

Remember: lenders' policies can change, and that may alter pricing formulas and invalidate previous quotes. The only sure way to lock in an interest rate is to sign a commitment letter setting a specific rate.

4. *Know about loan officers.* They are busy and confined by loan committee criteria. They generally do not approve loans – they "recommend" them – and the approval committee does not always follow their recommendations.

Loan officers are also just like the rest of us. They appreciate a courteous manner, straightforward questions, honest answers, and all the facts. They will be happy to give you a loan if (a) it makes sense financially and (b) it meets their bank's criteria. In addition to the crucial ones – low owner occupancy, large negative cash-flow on the unsold shares, and/or sponsor borrowing collateralized by unsold shares – you may be rejected if you have too few units, no elevator, old windows, poor building condition, environmental contamination, or insufficient history as a cooperative.

If the amount you are requesting increases your maintenance charges by more than 15 percent, the loan officer may be forced to turn you down. Therefore, you might want to enact an increase several months beforehand to demonstrate that the co-op will be able to carry the higher payments.

The shortcoming that kills more loans that any other, though, is insufficient appraised value. Virtually every lender will require a professional appraisal of your building before closing. This will estimate the investment- or sale-value of your building as if it were a rental building subject to whatever rent controls may be applicable. While your co-op is clearly not a rental, it would likely become one if it failed to repay the proposed loan. Its value under those circumstances is what interests the lender. And no lender will advance you 100 percent of your appraised value, either. Each loan committee will set a maximum loan-to-value limit (or LTV ratio). Don't expect it to be more than 70 percent; you can probably rest easy if it is less than 50 percent.

Being demanding or rude to officers will get you nowhere. They want your business but they don't need it. Being responsive and reasonable, on the other hand, just might make your application stand out from the pile.

5. *Assign one person to the job.* Designate one board member to represent your co-op during the refinancing process. Involve as many people to help in the background as you like, but channel all communications through one. Mixed signals don't work in football or with loans. And give your designated hitter enough authority to make basic decisions. Going back to the full board for every question is a sure way to derail your application.

6. *Respond promptly.* If an officer requests additional information, a decision, or some action, don't delay. If necessary, call a special meeting, but don't leave the lender hanging. Remember, the financial markets can change faster than the weather – and so can the terms. Moreover, applications that start to collect dust have a nasty habit of creeping toward the circular filing cabinet. Keep the ball rolling.

Finally, remember that getting a commitment letter is not the end of the journey. Many activities must be coordinated and mounds of documents must be reviewed before a closing can take place. Wise board members will make a checklist of all such items and demand weekly status reports from their attorney, accountant, and other representatives. Keep the loan officer informed about your progress and request his or her help if needed. Staying focused on your objective – getting through the closing – during this final stage may be more important than any other task in the whole refinancing process. The time to relax and celebrate is after everything is signed, sealed, and delivered.

Good luck.