REFINANCING UNDERLYING MORTGAGES

By Patrick Niland

With interest rates at historically low levels -- again -- now may be the right time to refinance your co-op's underlying mortgage.

Refinancing an underlying mortgage is the most important decision that a co-op board will make. It will affect not only the monthly maintenance but also the market value of every shareholder's apartment. It also is a long and complex process that will require the complete attention of every board member. This article will guide you through the seven essential steps to a new mortgage.

<u>**The Seven Steps**</u>

1. **Know the facts about your co-op.**

   It is a surprising but all too common fact that many board members don't know the fundamental facts about their building. No board should enter the market until it has assembled a file of basic information about their co-op. This file should be divided into three main sections; physical description, financial history, and co-op profile.

   The physical description should include the number of apartments (total and by type, e.g., number of studios, one bedrooms, two bedrooms, etc.), the number of floors, the property's exact address, nearest cross streets, and commuting or driving directions. A brief outline of the property's construction and mechanical systems is important as well. Most of this information can be found in the "building description" section of your co-op's offering plan.

   The financial history should include complete financial statements and corporate tax returns for the most recent three years, a budget for the current year, the property's current assessed value for real estate tax purposes, a description of any tax abatements or exemptions, plus an explanation of any assessments or unusual financial events during the recent past.

   The co-op profile should include the conversion date as well as a short background on the sponsor. In addition, every lender will want a detailed breakdown of apartment and share ownership. The board should be able to identify which units are owner-occupied, sublet by former resident shareholders, owned by the co-op itself, investor owned, or still held by the sponsor. Lenders also will want a listing of rents in all units which are not owner-occupied. It may be difficult to gather some of this information, but it is absolutely essential.

2. Know what you want and why.

Determining the amount of your new loan may not be as easy as you might think. Clearly it must include the outstanding balance of your existing loan. But what about prepayment penalties on your old loan and closing costs (3% - 4% of the new loan amount, in most cases) or additions to your reserve fund (most accountants recommend an average balance equal to 2-4 months of maintenance)? And what about the amount needed for capital improvements during the life of your new loan? No loan officer will make a loan without knowing how the money will be spent. Likewise, no board should seek a new loan before knowing the amount it really needs.

3. Get a feel for interest rates.

Every board member should begin reading the Wall Street Journal and the business section of the New York Times about three months prior to starting the refinancing process. These two sources, as well as financial news programs on the radio and TV, will give everyone a flavor of the financial markets and at least some idea of where rates may be headed. Without this background, board members may find it difficult to evaluate the various loan offers they may receive from different lenders.

4. Get to know the mortgage market.

The mortgage market is composed of many lenders, each offering a different type of loan. Some of the more active "players" are savings and loans, commercial banks, insurance companies, pension funds, and governmental programs like HUD or FNMA ("Fannie Mae").

Loan types include "5 and 5's" (5-year loans at a fixed interest rate with 5-year renewal options), 10-year fixed-rate loans, and 30-year self-liquidating mortgages. While one format may be more appropriate for your co-op than another, the board should consider all options before making a final selection.

You also will do well to remember that loan officers are ordinary people just like the rest of us. They appreciate courtesy, expect honest information, and like straight answers to their questions. And, more often than not, the loan officer will not make the final lending decision. He/she will evaluate your request and then recommend it for approval by their institution's loan committee. Most loan committees will be happy to approve your new loan if (a) your request makes financial sense and (b) it meets their lending criteria. No amount of screaming or pleading will change this fact. All lenders want your business but no lender needs it.

5. Have a "Designated Hitter".

Choose one person to represent your co-op to the outside world throughout the entire refinancing process. Involve as many board members and other shareholders as possible -- especially those with specific financial or banking experience -- but channel all communications to and from the lending community through that one person. This will avoid unauthorized lender contacts, leaks of incorrect or misleading information and most misunderstandings regarding the terms of your new loan.

6. Respond Promptly.

Whenever a loan officer requests information, it means that he/she is working on your application. The faster you respond, the faster the loan officer can move forward on your new loan. So don't delay. Call a special board meeting, do a phone poll of board members, hire a messenger to deliver documents, or do whatever else is necessary to keep your ball rolling.

7. Hire Professional Help.

Refinancing is not a do-it-yourself project. It is a complex and time-consuming process. Therefore, every board should use its team of professional advisors to the max. If ever there was a time for "meters" to be running, a refinancing is it. Get your attorney, accountant, and managing agent involved from the start. Their expertise can save you hundreds of headaches and thousands of dollars. In addition, most boards should hire an engineer to help estimate both the cost and priority of future capital improvements. Finally, unless board members have both the time and the specific mortgage market skills, they should retain the professional services of a good mortgage broker. Like each of the other professionals involved, a skilled mortgage broker will save the co-op much more than their fee. So, don't be penny-wise and dollar-foolish. A solid professional team can spell the difference between a successful refinancing or a very costly mistake.