Three Refi Scenarios

By Lisa Prevost

All co-ops need cash from time to time, and most boards refinance their underlying mortgages to get it. But a co-op refi is not a generic, one-size-fits-all product. It's more like a bespoke suit, with the interest rate just one of the many variables that distinguish one deal from another. Each deal needs to be tailored to fit each building's unique needs, based on its size, physical condition, and financial means.

While the most common structure is a 10-year, fixed-rate loan with a 30-year amortization, refi loans can actually be structured in a multitude of creative ways. That's why boards should be explicit about their building's needs when discussing refinancing options with a broker or lender. "If you've got a problem, talk to the lender about your problem," says Patrick B. Niland, the president of First Funding of New York, a mortgage brokerage. Do it, he advises, with a clear understanding of what your co-op needs and how much it's going to cost.

"The whole refinancing process really should start with a meeting between the board, accountant, managing agent, legal counsel, and possibly a mortgage broker, if the board so chooses," Niland says.

David Lipson, director of the mortgage division of Century Management, says he would discourage a co-op board from moving forward on a refi unless it has done a detailed capital plan, looking ahead at least five years. Lipson doesn't want the board to end up in a situation where it has borrowed too little – and winds up having to seek another refi in just a few years, potentially facing prepayment penalties and another round of closing costs.

Once the board knows what it needs and wants, it can compare offers among lenders – or hire a broker to do that. "We deal with 30 or 40 lenders," says Niland. "We know who's hungry for money and who's not."

Here are some examples of variations on the typical refi, as tailored for co-ops in three fairly common scenarios:

SCENARIO 1: A co-op has done its due diligence and has a 10-year capital plan in place. The board knows how much money it will need to cover those costs over time but would rather not borrow it all up front.

One way to avoid borrowing all the money at once, which can be more expensive, is to work with a lender that will allow supplementary financing, says Niland. The building could, for example, initially borrow enough to cover the building's needs for the first five years and then return to the same lender later to borrow the rest.

"There are lenders that allow supplemental financing at any time after the first year, up to the loan-to-value limits on your building," he says. "You're underwritten in the same risk profile. And it's at a fixed rate of interest with the same end date as the first mortgage."

Niland prefers that approach to simply putting a line of credit in place to cover the later-year improvements. Credit lines have variable interest rates – "not a good way to finance long-term capital costs," he says – and some lenders have begun imposing "non-use" fees on credit lines when co-ops don't tap them.

SCENARIO 2: A co-op needs to borrow a substantial sum for immediate capital needs. But some shareholders are already struggling, and the board is wary of sticking shareholders with a sharp increase in maintenance.

One way to handle this scenario is to structure the loan so that the first three years are interest-only, says Lipson of Century Management. That will give the board time to phase in the maintenance increases gradually, putting the extra money in the reserve fund until the interest-only period ends. The loan then turns into a 30-year amortization over the remaining seven years.

But boards shouldn't avoid borrowing what the co-op needs out of concern for the finances of individual shareholders. "Co-ops are not social-service agencies," Niland says. "Boards have to live up to their fiduciary responsibility to all the other shareholders. And refinancing is the most important decision they will make, as it affects the value of every single shareholder's apartment."

SCENARIO 3: The building needs a new roof, but the board is wary of looking too far beyond that because it wants to borrow a minimal amount. It's hoping to get another 10 years out of the boiler, but that could go either way.

Boards often debate "ad nauseam" how much to borrow, says Lipson. Some want to borrow just enough to cover their closing costs on a refi, and then cover future capital costs by using reserves and assessments. That may work just fine for high-end buildings with lots of resources. But in reality, Lipson says, "these buildings are so under-leveraged that borrowing more money is not really a concern."

Alternatively, says Niland, boards might get a credit line when they refinance, but with a lender that also allows supplemental financing. That way, "if the boiler does blow in the middle of February, they can use the credit line to immediately get another one in," he says. "But then they can go back to the lender to get secondary financing to pay off the credit line, replacing it with fixed-rate debt."