To Borrow or Not to Borrow?

By Patrick Niland

At the end of May, I wrote about "virgin co-ops" ... those which have operated just fine for many years without an underlying mortgage. Many of these buildings now confront urgent repairs and/or recommended capital improvements. Having crossed the bridge over the abyss of "doing nothing," they find themselves between a rock (large shareholder assessments) and a hard place (underlying mortgage debt). The relative "hardness" of these two funding solutions differs for each board and reflects the economic circumstances of their respective shareholder bodies. However, the issues to be considered in making their choices are pretty much the same for all of them.

Some shareholders see no reason to veer from their building's established "pay as you go" method of operating just because the current bill will be bigger. They view debt as "funny money" that will lure future boards down a slippery slope to financial ruin. They also think that the presence of debt on the co-op's balance sheet will diminish the market value of their apartments. The counter argument that assessments often deter would-be buyers and offer no tax benefit until a shareholder sells their apartment (the amount of an assessment is added to the basis of the shares assigned to an apartment) barely registers with these folks. They also discount the difficulty (or outright inability) of some of their fellow shareholders to come up with substantial lump-sum assessments as fiscal flaws of character that should be ignored for the physical and financial well-being of their cooperative.

Other shareholders ... whether they be full-fledged fans of the credit society, cash poor, planning to sell their apartment in the near future, or just accepting of debt as a part of life ... have a less-jaundiced view of underlying mortgage financing. To them, using "other people's money" to complete the needed work makes the most sense. Getting an ongoing tax deduction from their pro-rata share of the new loan's interest is just an added benefit.

Then, there are the "yes, but..." shareholders who accept underlying mortgage financing as a solution ***as long as*** it's self-liquidating. Most of these folks would prefer an assessment but acknowledge the economic hardship that such a solution would present to some of their fellow shareholders. Therefore, they accept debt as the lesser of two evils … but ***only*** if everyone agrees to purge the evil from their cooperative's balance sheet as soon as possible.

Lastly, there are shareholders who lament not having taken on debt years ago. In their view, past boards ignored or postponed important repairs and improvements in misguided efforts to keep shareholder maintenance low. As a result, the current situation is critical and the required expenditure much greater than it could have been. Further, they don't understand why debt is such a "big deal" ... after all, don't most co-ops have an underlying mortgage?

These shareholders also usually oppose the "self-liquidating" argument. They feel that former shareholders got off without paying their fair share of the true costs of operating and maintaining their building. So, they see injustice in making current shareholders shoulder the entire burden of today's necessary expenditures. Moreover, since these investments will add years of life to their property, they think that current ***and*** future shareholders should share the repayment burden. I

suppose that, if they could, they'd also go after those former shareholders!
Only you know into which camp your fellow shareholders fall. However, with proper professional guidance, every board can design a solution that is financially sound and equitable for all. I wish you good luck in that endeavor!