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The Legal Aspects Pitfalls of Cooperative Refinancing

By Randall A. Pentiuik and Joseph G. Couvreur

A large number of cooperatives are contemplating refinancing their existing mortgages. Several reasons exist for this. First, interest rates are at an uncommonly low level which makes it rather advantageous to take out a loan. While the existing mortgages are typically low, the rates now are extremely attractive and may not last much longer. Thus, there is a window open now to get great interest rates. Second, many cooperatives have experienced HUD being more burdensome in its demands than in the past. They seek to either eliminate or reduce HUD oversight by eliminating the mortgage which HUD insured or subsidized. A third and most common reason is the need to amass a sufficient sum of money to undertake repairs, renovations and enhancements of the property. Many cooperatives would prefer to complete these tasks in the near future to properly maintain the property rather than make improvements over an extended number of years.

The Players

Boards ask us what steps are involved. The initial step is to assemble a team to do the “due diligence,” research the options, and to handle the mechanics of taking the project through the steps outlined below, culminating in the closing. The Board, of course, must be involved as the ultimate decision-maker at all stages. Management and a Cooperative Attorney with expertise in dealing with the intricacies of this type of transaction and dealing with HUD are essential players who provide guidance and perform the task of carrying out the mechanics of putting the deal together must be involved. There may also be a need to consult with the Cooperative Auditor for financial projections and related services.

It is important that this team work closely together at every step of the journey. Typically, the Management Agent serves as the coordinator while the Attorney does the lion share of the detailed work of negotiating and preparing the detailed paperwork for the new loan and paying off the existing loan.

Early on, we must determine where the authority lies to borrow money. Most bylaws give that authority to the board. However, we do not recommend that the membership be excluded from the process. HUD will request proof of membership notification. Information ought to be shared so the members know and understand what is being done and why. The most common question is what impact will this have on carrying charges, and you should have an answer. Many cooperatives have refinanced with no increase in carrying charges because of the low interest rates and the amount borrowed. Again, typical bylaws allow the board to decide such matters.

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