REFI PRIME TIME

LOW RATES COME WITH CLOSER SCRUTINY

BY LISA PREVOST

Prior to the pandemic shutdown last March, Donald Einsidler, the president of Einsidler Management, was busy helping five different co-op boards navigate the process of refinancing their underlying mortgages at interest rates just above 3%. Then came the stay-at-home order, and suddenly pricing went haywire. "Rates spiked up to points where it wouldn't have made sense to go through with the loans," Einsidler says.

Fortunately, because he had secured lender commitments on four out of the five loans, Einsidler felt no urgency, and he advised his boards to "just hang out" and hope that over time the rates would come down. And that's exactly what happened. Refinancing rates once again dipped to tantalizing lows, Einsidler says, and all of the loans eventually closed at rates low enough to allow the co-ops to maintain their same monthly payment even after taking out some cash. With the nation's economy in tatters from the pandemic, this is one sector that is enjoying robust health. But as with everything these days, there are complications that never existed before.

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Brisk Business, Red Flags

Though the economic uncertainty is causing lenders to take some extra precautions on refis – above and beyond traditional prepayment penalties – terms are still attractive enough that boards are lining up to take advantage. "You'd think that with the world falling apart, this market would not be moving right along," says Harley Seligman, a senior vice president at National Cooperative Bank (NCB). "But this is one of the worst years we've had in the seven years I've been here."

In fact, the business is so brisk that more lenders are jockeying to get in on what has long been one of the safest bets in New York City mortgage lending. "There are banks coming out of the woodwork that want to do these co-op loans that have never even been in the space before," says Nicoletta Pagnotta, a senior vice president at Meridian Capital Group.

But boards should not assume that the pace of business means that loans are sailing through the underwriting process. To the contrary, brokers say, co-ops should be fully prepared to undergo closer financial scrutiny than was common before the pandemic hit.

"A prime building in a prime location, the building is in good shape, you want a new roof and want to borrow an extra million – you're not going to have any problem," says Patrick Niland, the president of First Funding of New York, a mortgage brokerage. "If you have any borderline issues, you're going to get a lot more scrutiny."

At NCB, interest rates ranged from around 2.7% to 5% in mid-August, depending on the loan amount and type of building, Seligman says. Most of the buildings that were refinancing had one to four years left on their existing 10-year loans – because the prepayment penalty shrinks as the loan matures, making refinancing more attractive late in the term. Seligman says NCB's underwriting standards have remained largely unchanged in the wake of the pandemic, but there is one major red flag for the bank: the co-op's commercial income. Co-ops that own retail space and/or rely on a commercial tenant for a significant portion of their maintenance will find it harder to get approval.

"It's a huge kind of bag of issues that are popping up," Seligman says. "It could be that the unit is vacant, it could be that we don't have confidence that it won't be vacant in six months, or the tenant has stopped paying their rent. Take a Soho co-op with a high-end designer's store on the ground floor paying a huge rent. Will that even exist in a year?"

Niland says that the lenders he works with are being similarly cautious about commercial space, looking closely at who the tenants are and how stable they are likely to be. "It's all about cash flow," he says, adding that some lenders won't go near those loans at all. "I had a building that had a Dunkin' Donuts, a Starbucks, a drugstore and a local grocer on the ground floor. All of them were operating; they never shut down. A couple lenders just said no – it was retail space, and they were not interested."

A board dealing with lost commercial income might try to improve its odds of qualifying for a loan by increasing everyone's maintenance or imposing an assessment to cover the shortfall, says Marc Schneider, a managing partner at the law firm Schneider Buchel. A lender would want to see that the shareholders have been able to cover the shortfall for some period of time, he says, and that delinquencies aren't rising.

Niland reports that some lenders are also being more conservative about the percentage of arrearages on shareholders' monthly maintenance they will allow, fearing what the future might hold if unemployment continues to rise. Whereas before the pandemic, "a few wandering ducks" didn't really hurt a co-op's chances of

securing a loan, now all those ducks need to be in line.

"I just did a loan on a building in Woodside, Queens, that has two units that have been in arrears for a long time," Niland says. "They've taken the people to court and won a judgment and are now moving to collect, like, $50,000. The lender looked at that and said, 'This has gone on for a long time.' Now the lender is holding an escrow until those situations are resolved."

Some lenders are requiring co-ops to put up what they call a "COVID-19 debt service reserve," which is typically three to six months of mortgage payments, according to Pagnotta. "They just want to keep an eye on what's going on," she says. "If nothing happens over a certain period, that money would be released back to the co-op." But the co-op has to come up with the money – one more sign of banks' unease about the current climate.

A Cloudy Future

Toward the end of summer, Pagnotta also began to see signs that Manhattan's troubled real estate market was affecting co-op appraisals. This was in buildings in which the appraiser based unit values on comparable rentals. With rental vacancies soaring due to the pandemic and rents on their way down, the valuations for some co-ops are coming in a little bit lower. "Now, these loans are usually very low loan-to-value," she says, "so the slightly lower appraisal doesn't necessarily hurt, but it's something we're making our clients aware of."

When it comes to condominium associations, interest rates are also attractive on Common Interest Realty Association, or CIRA, loans. A mechanism that enables condos to pay for major capital needs over time, CIRA loans are secured not by real estate but by a security interest in the condo association's common charges. However, lenders who do these niche loans are raising the minimum number of units they require in an association, says Barry Korn, the managing director of Barrett Capital. The minimum now tends to be around 20 to 25. With a building any smaller than that, it gets tougher, he says, given the uncertain job market and the risk that some unit-owners will stop paying their monthly common charges. "I even had a bank ask for a list of what each of the unit-owners do for work in a 14-unit association," Korn says.

With economic forecasts ranging from uncertain to gloomy, boards considering a refi or CIRA loan would be well advised to act sooner rather than later, says Schneider, the attorney. "I don't know that we've seen the economic fallout yet," he says. "People have had unemployment and stimulus money to fall back on. Once some of that stuff runs out and more people wind up unemployed, they may stop paying their maintenance or common charges in a timely way. Then it's going to become harder to get a loan." ■