

Q&A

Questions and Answers on Private Secondary Financing

What do primary and secondary financing mean for our co-op?

Your co-operative's primary financing is the financing that brought it into being—your first financing, in fact. Primary financing paid for your co-op's hard and soft development costs, which were rolled together into your mortgage. Hard costs included such things as

- purchase or lease of the property
- construction or renovation of a building or buildings
- landscaping.

Soft costs included

- design of the building
- marketing to fill the new units
- initial education for residents
- set-up of management systems and
- sector-support contribution.

Private secondary financing is non-government money lent to your co-op at a later time to meet later needs. It could take the form of a second mortgage, bearing in mind that a mortgage is just a kind of loan. Some co-op boards who read this may be looking at a second round of secondary financing.

Why would we want secondary financing?

Borrowing more money is your only option if your property needs more work than your co-op can pay for. This loan would be secondary financing.

How would we decide if we need to borrow?

Your starting point is to find out how much work your property actually needs. The best way to do this is through a building-condition assessment (BCA), which is normally done by an engineer. A BCA will tell you what work your property needs, how soon it should be done and what the hard costs are likely to be. Estimates are often conservative, which means that they are set high to avoid ugly surprises down the road. Soft costs are not usually included, so, for a large job, you should expect to pay for project management.

You may be able to finance much of the work through your capital replacement reserve and housing-charge increases. Your co-op will benefit from self-financing as much as possible, because any loan will have to be repaid with interest.

Your relationship manager can explain how to analyze your current cash flow and project it into the future. You should look at several different options, based on different yearly housing-charge increases. For example, your BCA may say that some of the work should not be delayed, but your cash-flow statement shows that it cannot be paid for from your capital reserve. In this case, it would be reasonable to apply for a loan.

Where can we borrow the money, now that we know what we need?

If CMHC approves, co-ops can borrow from a NHA-approved secondary lender. This is a commercial lender, such as a credit union or

bank. Direct loans from CMHC are not available.

How would a lender decide if our co-op qualifies for a loan?

A lender has three questions, and the answer to all of them must be “yes.” The first question is “Do you have an asset you can put up as security for our money?” The lender will want to know that you are looking to borrow quite a bit less than the value of the property, so that, if need be, they can sell it to recover all their money and also get paid for their trouble.

The second question is “If we lend you money, can you pay it back?” Before your co-op considers secondary financing, the board of your co-operative needs to make sure your answer is “Yes, we can.” If you have a record of deficits in recent years, you will not be a good candidate for a loan until you raise your housing charges to market.

The third question is “If we lend you money, will you pay it back?” This speaks to the character of your co-op and whether your past actions show that you can be depended on to keep your word and honourably pay your bills on time. A lender and CMHC may also look into your history to determine whether your members have consistently approved annual housing-charge increases. Your co-op may have to increase your housing charges before the loan is allowed to go forward.

What if we're not sure how we would answer?

In that case, the directors first need to ask themselves some questions.

1. Do we increase our housing charges every year by enough to keep up with our costs, including our capital-reserve contributions, and leave something over?
2. If we have paid member parking, is the monthly charge close to the standard for the neighbourhood?
3. Are we keeping all of our units occupied?

4. At year end, were we short more than three months' housing charges for arrears and bad debts?
5. Do we use a collection agency or take other action if someone moves out owing money?
6. For Section 95 co-ops, is no more than 10 per cent of our total subsidy money coming from operations every month as an internal subsidy?

If your answer to any of these questions is “no,” it's time to make a change in your co-op's practices. Your relationship manager can help with this. Otherwise, you may not be able to find anyone who will lend money to your co-op at an interest rate you can afford.

If you are doing everything right, and you still can't pay for all the work your property needs, you may be a candidate for secondary financing.

Once we've done our homework, what happens next?

The short answer is as follows:

1. Ask your relationship manager to point you to one or more approved lenders in your community—ones that make loans to housing co-operatives—and advise you on how to approach them.
2. Ask the lender about a loan.
3. Work with the Agency on an application for CMHC approval for the loan.

Of course it's never that simple.

How long will it take?

This is a hard question to answer. Much depends on how quickly the co-op provides all required documentation. Every day counts. Check your by-laws to confirm what the board can approve and what must go before a members' meeting. It will be important to call meetings as soon as possible when a decision is required. Ensuring that reports and other documentation are delivered without loss of time to the office of

the co-op lawyer or lender is important too. The process can take a year or as little as six months. It is never wise to discount the element of luck, but do not trust to it.

What information does our co-op need to give a lender?

Different financial institutions have different requirements, policies and procedures. The Agency can give your co-op a list of some of them. For example, an environmental study may be required in some cases.

What is the Agency's role in the approval process?

The Agency acts on behalf of CMHC. We review the required documentation, let your co-op know if we believe it needs changes and, when the paperwork is ready, make the recommendation to CMHC for approval to put another mortgage on your property.

What is approval based on?

CMHC and the lender will look at your co-op's finances and credit history. They will evaluate the loan request based on whether you have been making the required payments on your first mortgage and where your housing charges are in relation to market. These speak to your co-op's ability to pay back secondary financing.

Can't we simplify the process?

Not really. The process is complicated, at best. Because its permission must be secured, CMHC leads the lender, especially if it is also insuring your new loan. Yet co-ops cannot deal directly with CMHC. The Agency's job is to act as the go-between and also to be your co-operative's tough-minded, straight-talking friend who helps you do what is necessary to get your loan approved.

Can't we save the cost, time and bother of arranging for a BCA and borrow just enough to fix one building component, such as our windows?

A lender does not usually have enough confidence in a borrower to make this kind of loan. Lenders need to manage their risk of losing money.

Because the loan is paid back over time, lenders always wonder if the co-op will need another loan to keep its units liveable—and bringing in revenue to service their loan. They want assurance that other major repairs to the property will not be required. The fear is that a co-op will discover serious new building problems while work is taking place, or that other problems will arise after the work is complete, but the loan has years of payments left.

Your board should try to get the full picture as to what repairs your property needs and what they will likely cost. A capital replacement study, based on a BCA, is the surest source of this information.

Can we just go to a lender and borrow money?

Most co-operatives already owe money to CMHC, or CMHC has insured their mortgage. This is why your co-op's operating agreement requires you to get CMHC approval before borrowing, since a second loan could affect a co-op's ability to pay off the mortgage it already has.

The Agency will help your co-op consult several lenders about their requirements and the co-op's options. Once your board has decided on what is best for your co-op, the Agency will work with you to get CMHC approval for the loan.

Can we get CMHC mortgage insurance on the loan?

Possibly, and insurance will give your lender confidence, allowing your co-op to borrow at a better interest rate. Bear in mind, though, that you will have to pay a per-unit application fee, even if CMHC decides not to insure your mortgage. You will also pay CMHC a percentage of your mortgage premium if the loan goes ahead, so make sure you ask for an opinion on whether insurance is worthwhile for your co-op.

Are there any government grants to help our co-op get the work done?

Grants are not available now from either CMHC or the Agency for work on a co-op's property. The money some co-operatives received from

the Social Housing Renovation and Retrofit Initiative was intended to stimulate the economy. Such a program is not likely to be made available in the foreseeable future.

The Homeowner Protection Office (HPO), which helped B.C. co-ops with catastrophic building envelope failure (leaky co-ops), is not making new commitments.

An Additional Financial Contribution (AFC) was once available to co-ops and non-profits facing a decline in subsidy funds on mortgage rollover. It has been dropped now that a change in a co-operative's annual mortgage payment is

precisely balanced by an increase in the amount of rent-geared-to-income subsidy received from government.

A co-op can still apply for a grant to make certain changes to a unit for a person with a disability. However, governments may get many more applications than there is money available. Your co-op may have to reapply at the start of government's new fiscal year.

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