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Board Talking Points: Refinancing

Your organization may be thinking of ways to reduce expenses. If your organization has an obligation to pay back an existing loan, it may be able to reduce these obligations by refinancing. Contact Lawyers Alliance for assistance in considering these possibilities.

Below are some questions a Board might have about the steps to take to refinance an existing loan and some issues to consider.

1. What is a refinancing?
2. Where should the board look first to determine whether a refinancing would help the organization?
3. Does the organization have to stay with the same lender?
4. How should the organization evaluate the terms and costs of the refinancing?
5. Who might the organization need consent from?

<u>Answers</u>

1. What is a refinancing?

A refinancing usually takes one of two forms: (1) an agreement between a borrower (your organization) and its lender to modify the terms of an existing loan or line of credit, or (2) the use of an entirely new credit facility to replace an existing one.

Refinancing may enable the borrower to lower their monthly payment by either lowering the interest rate, or extending the maturity date for repayment. As part of a voluntary workout of a loan, the lender might forgive some portion of the indebtedness. In a secured loan, collateral can be released through a refinancing thus freeing up the property for sale to generate cash or for use to support additional borrowing.

2. Where should the Board look first to determine whether a refinancing would help the organization?

A Board should review the organization's financial information to determine the details of the organization's (1) current and anticipated financial resources, i.e., its ability to (re)pay, and (2) its current credit arrangements. Then, the Board should review the current credit market situation to determine whether or not there may be an opportunity to refinance, e.g., have interests rates declined below the rates being paid by the organization under the current arrangements. After the Board has this information, the Board can “shop” its requirements to different lenders (including its existing lender) to see whether they can get a more favorable loan.

3. Does the organization have to stay with the same lender?

Probably not, but there may be advantages to cultivating existing relationships, including lowering transaction costs. Any new lender will pay off the existing lender. As discussed in more detail in 4 below, the organization should watch for prepayment penalties (or other termination costs) associated with the existing arrangements. There may also be “lockout periods” during which the lender will not allow prepayment of the loan. You will need to factor in these costs to see to what extent these transaction costs outweigh any savings.

4. What terms and costs of the new loan should the organization consider?

The Board should review the terms of any potential new loan very carefully, and, in the context of reducing expenses, pay particular attention to:

(1) interest rate (and how it may change);
(2) maturity date (and default provisions);
(3) restrictive covenants (including lockout periods and collateral requirements); and
(4) set-up costs.

“Set-up” costs are out-of-pocket expenses of the lender that the borrower may have to pay for and may include the following: (1) appraisal; (2) processing and administrative costs of the lender, e.g., application, commitment and closing fees; (3) loan document preparation fees; (4) lender’s attorneys fees and disbursements; (5) title costs; and (6) borrower’s attorneys’ fees and disbursements. “Set up” costs vary from lender to lender so the organization should ask each potential lender for a specific breakdown of these expenses and whether they can be paid from the loan proceeds.

Example: Do Right currently has a mortgage loan from Big Bank in the loan amount of $15,000,000 at an interest rate of 7% for a 15-year term. Do Right pays a “carrying cost” of $89,166.70 to Big Bank every month. Do Right has approached a few other lenders and thinks it might be able to qualify for a loan in the same amount of $15,000,000 but at an interest rate of 5% for the same 15-year term. This lower interest rate would result in a monthly “carrying cost” of $87,500 and lower the organization’s monthly “carrying cost” by $1,666.70. In order to refinance the existing loan, Do Right has to pay “set up” fees that total about $12,000 at closing. Since Do Right will likely pay these “set up” fees out of pocket, it must consider that it will take about six months for Do Right to recoup the $12,000 before it begins to save $1,666.70 per month from the refinancing (not allowing for the time value of money).

5. Who might the organization need consent from?

At a minimum, the organization will need the consent of existing lenders and the Board. Under the New York Not-for-Profit Corporation Law, a nonprofit corporation cannot mortgage real property unless authorized by a vote of two-thirds of the entire board, provided that if there are twenty-one or more directors, the vote of a majority of the entire board is sufficient. It will be necessary to review any existing agreements to determine every entity or individual whose consent is needed, the required manner of consent under the agreement and any notice periods. If the collateral is in the form of government contracts or receivables, the lender might require consent from the government entity, as the obligor under the contract. An organization should also check with any insurance company that it maintains liability or other insurance with in the event that the new lender requires different or additional insurance covenants.

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This alert is meant to provide general information only, not legal advice. If you have questions as you try to determine whether to refinance or if you are unsure about what your existing loan documents permit or need an attorney to represent your organization in the refinancing, contact Lawyers Alliance at (212) 219-1800 for assistance.