Pandemic's Impact on Co-op City's Budget and the Need to Refinance our Mortgage

Management Report

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The pandemic-related supply chain disruptions and inflationary price increases of the goods and services we purchase is having a serious impact on our finances.

We are now into the 21st month of managing Co-op City during the pandemic. During 2020, we adapted those procedures and schedules that we could control with the aim to protect the staff and residents from getting infected to our maximum ability while continuing work on our vital capital projects, maintaining the facilities and providing services. Our carrying charge collections remained strong, while our expenses actually went down. It enabled us to delay the implementation of the second stage carrying charge increase authorized in the prior budget from September 1, 2020 to January 1, 2021.

In April 2021, the Board approved a new two-year budget as required by our state regulatory agency, HCR, that we believed was in balance after implementing increases to the equity price paid by new shareholders, garage and storage room fees and a 2% carrying charge increase effective next month (January 2022). Since implementation of the budget, as the country has tried to restart the economy, supply chain disruptions and price increases have had a significant impact on the budget.

We reforecast the current fiscal year budget using six-month actuals (through September) and presented it to the Board last month. Where the initial budget projected a $4M surplus that would have been rolled over into the second year of the budget, we now project a $1.3M deficit or a negative financial change of $5.3M.

The biggest but not sole reason for this is a dramatic increase in natural gas prices. The Power Plant uses natural gas to produce our electricity, heat and hot water. Last year, we purchased $9.7M of natural gas. Prices had begun to rise when we drafted the current budget and we projected our cost this year would be $13.4M. However, prices took off over the summer and into the fall. We now project our cost for this year will be $21.1M. We have purchased fuel hedges for 75% of our expected usage at prices that are currently below the spot market price in an attempt to reduce our exposure to future increases.

We have also seen significant increases in prices for goods we use such as flooring, lumber and hardware. Deliveries have become more difficult, and we have experienced shortages of supplies from time to time. It seems every week we get a report of something else we need being in short supply or unavailable.

We have implemented steps to help alleviate the deficit such as a partial hiring freeze. Only those positions that are critical and necessary will be filled. We are also looking at other areas such as reduction of overtime. However, any steps we take will have an impact on service delivery.

Another area that may need to be considered is the delay in commencement of new capital projects. This would not affect ongoing projects.

We currently are nearing completion of the residential elevator modernization project. We have completed 121 of 160 elevators and expect this will be completed next summer.

Mandated Local Law 11 work will continue into 2023. Section 5 should be completed soon. Buildings 9-14 are done. Buildings 20-25 will be completed early next year and Buildings 1-8 and 15-19 will start next year. We cannot avoid or delay this work without incurring significant fines from the City.

The installation of new building entrances to comply with the Americans with Disabilities Act (ADA) will be completed next year as well as remedial work to repair deterioration in Garage 2.

New capital projects we are planning to commence next year include façade repair work to the townhouse clusters, improvements in the building pump rooms to increase energy efficiency and the reliability of hot and cold water delivery. We also need to accelerate the modernization of the garage elevators that we did not expect to begin until 2023.

The changes in our budget require us to delay commencement of these projects. This is not desired or advisable. All of these projects are necessary to maintain the community's aging infrastructure. Delay will only allow conditions to worsen and probably increase the final cost of repairs.

We also have to ultimately deal with the condition of our convector system and what will be an expensive, lengthy and disruptive project to repair or replace components of that system. We have engaged an engineering firm to begin a feasibility study to review the current condition of the system and recommend the path forward.

To avoid sharply higher carrying charges or other fees and to allow for the continuation of our capital projects, we have recommended, and the Board has approved, that we proceed with a refinancing of the corporation's mortgage.

The current mortgage was taken out in 2012 for $621.5M. The interest rate is 2.4% and insured by HUD, the City and the State. That refinancing provided the funds that will allow us to complete the capital projects in progress and those we have already completed in the last five years. We have paid down our mortgage to a point where the current balance is approximately $500M. The HUD program we are in allows us to borrow back up to the original loan amount at a minimal cost in closing fees. The new interest rate is projected to be very close to the current rate. It is expected that rates will soon rise as the Federal Reserve has indicated this week in testimony before Congress. We need to complete a refinancing sooner rather than later. By completing the refinancing now, the cost of our debt service should be close to what we are paying now and what is already included in our budget.

A mortgage refinancing will provide us with $14.5M for capital projects next year that will help to relieve pressure on our current budget and avoid an emergency carrying charge increase. It will also provide us with $109M placed in a restricted reserve fund that could only be used for future capital project expenses, including those in our current five-year capital plan. The terms of our existing mortgage require that every ten years we have a capital needs assessment completed by an independent firm approved by our lender, Wells Fargo. This was recently completed. It requires that even in the absence of a refinancing, we would need to fund $44M in capital reserves beginning in 2023. If we don't obtain those funds through a refinancing now, we will have to increase carrying charges significantly, decrease expenditures that will only cause service reductions and deteriorating infrastructure, or ultimately, refinance at a later time when interest rates will be higher.

At right, is a Q & A that I hope will answer all the questions relating to our current budget situation and the proposed mortgage refinancing.

These are difficult times but we have managed our budgets in the last five years so that we have been able to limit the increase in carrying charge fees while completing over $150M in capital improvements that had been deferred or avoided for years. I have said to the Board that the proverbial can always seemed to have been kicked down the road in Co-op City by past management. Well, the can is at my feet now and I do not intend to pass the problem to my successors. The Board has been deliberative and supportive of our initiatives. I hope the community also supports our plan as the best path forward to improve the infrastructure and limit your cost.

Proposed Mortgage Refinancing Q & A

1. What does the Wells Fargo proposed refinancing package offer Riverbay?

The HUD-insured mortgage program that we are currently using allows us to borrow back up to the original 2012 loan balance of $621.5M. Depending on when the new mortgage would close, it will provide Riverbay with approximately $120-$123M in proceeds because we have paid down that amount over the last ten years. The loan proceeds can only be used for future capital projects as outlined in a recently completed Capital Needs Assessment ("CNA") that we are required to perform every 10 years under the terms of our existing mortgage.

2. How will it impact our budget?

The immediate impact is to make $14.5M of the loan proceeds available in FY 2022-23 for current capital projects. This will provide relief for the operating budget which we now project has a $5.3M negative financial change due to primarily higher natural gas prices.

Refinancing will also allow Riverbay to fund its reserve accounts.

If we do not refinance, we will have to fund approximately $44,000,000 in reserves starting in year 2023, per the CNA. Absent a refinance, the source of those funds would be a combination of maintenance increases and decreases in our operating budget, primarily by a reduction in staff and services.

With rising prices for fuel, supplies and materials that we use, together with ongoing supply chain problems, Riverbay's cost of doing business will continue to increase. As such, a reforecast of future budgets will be necessary as we may need to adjust costs based on the changing circumstances. With the funds from the refinancing allotted to the capital budget, Management will have more latitude when reforecasting FY 2021/2022 and a cushion for any possible deficit that may arise.

3. Why must we refinance the mortgage now?

Management is proposing the refinancing now because interest rates are low. Nearly all economists are projecting an increase in rates starting in mid-2022, in part because of inflation. Lenders have also forecast increased interest rates in 2022. Further, the Federal Reserve has started to reduce its purchases of bonds, which has contributed to low interest, signaling to investors and the stock market that an increase of interest rates to deal with inflation will occur as early as the 1st or 2nd quarter of next year.

While the final loan rate cannot be known until our application is reviewed and approved by HUD, Wells Fargo is currently projecting the rate at 2.45%. This is only 0.05% higher than the existing rate. Also, with the loan proceeds to be deposited into a reserve account, the corporation will have the funding in place for all of the projects in the current five-year capital plan and beyond.

Management has forecasted a negative $5.3M change in our operating expenses for the remainder of financial year 2021/2022 and this trend most likely will continue given the current economic situation. We went from a projected $4M surplus to a $1.3M deficit. Therefore, we need to secure funding now while the situation is still favorable to the corporation.

4. What will be the consequences if we don't complete the refinancing?

With the projected shortfall in the current operating budget, we will have to delay the commencement of new capital projects such as the townhouse façade renovation, garage elevator modernization and pump room renovation. All of these projects are necessary and must be undertaken sooner than later. If we delay projects, the conditions will worsen, the cost of completion will increase and place further strain on our limited resources.

Further, as mentioned above, Riverbay's existing loan agreement requires that every 10 years an outside property inspection company, approved by Wells Fargo, must be hired to review our infrastructure and project our capital needs for the next 10 years. We are then required to maintain adequate funds in a reserve account to pay for those expected capital repairs and improvements. The recently completed Capital Needs Assessment indicates that Riverbay will need to fund approximately $44M in capital reserves beginning in 2023. If Riverbay does not obtain those funds by a refinancing now, it will need to either refinance in 2023 – when interest rates may be higher – or increase carrying charges dramatically (every 1% increase in carrying charges equals $1.8 million) and decrease expenditures.

5. Will the new 2% carrying charge increase generate sufficient revenue to meet Riverbay's obligations?

No. When the budget was approved, this increase was sufficient to allow us to meet all of our obligations. However, prices have increased higher than anticipated during the year. The budget reforecast recently provided to the Board includes the projected revenue from the increase. We have a negative $5.3M change to our financial position in the current fiscal year. With the current rate of inflation, the additional revenue from carrying charges will not cover the cost of our operations given rising prices.

6. If the increase is not sufficient, what steps have we taken?

We have imposed a partial hiring freeze and will only hire for critical vacant positions. We have also curtailed/reduced some departmental expenses as evidenced in the reforecast budget and continue to put strategies in place to reduce expenses such as overtime. If this in insufficient, we will consider delayed new capital projects as discussed above.

7. Will the refinancing relieve our shortfalls?

Unsure, but it will dramatically contribute to alleviating any shortfall. It provides $14.5M in capital project funding for next year, the second year of our current operating budget. Funds from the refinancing are earmarked specifically for capital projects and not operating expenses. Therefore, Management will be able to fully utilize an equal amount of revenue from carrying charges for operations. The refinancing is projected to provide an additional $109M for future capital projects, starting in 2023.