

# HABITAT

## The Entrance Standard

To accept or reject – guidelines from other co-ops you can employ when considering a new buyer.

From student loans to building size, a board must weigh a number of factors when deciding whether to accept or reject a new buyer. Habitat discusses what you need to know when making your decision.

You are serving on your board's admissions committee for the first time, facing an applicant for an apartment in your co-op. She doesn't quite meet all your building's financial criteria, but she has impeccable credit. The committee is thinking of rejecting her, when the cooperative's attorney, Theresa Racht, a partner in Racht & Taffae, offers an argument in her favor: "It isn't that she doesn't have debt. She has it, and she manages it well. But this is a woman who pays her bills and lives within her means. She doesn't keep high balances on her credit cards."

The committee – and then the full board itself – decides to look past the ratio of income versus maintenance and mortgage payments and judge the whole picture. "I think you're going to get a stellar shareholder in here, you know, probably better than the guy who left," offers Racht. Your board approves her – and never regrets it.

To many board members, the admissions process is a cut-and-dried affair: you look at the financials, you check out the references, you meet the person, and then you put it all together and make a decision. Many don't think twice about it. Pam

Laudenslager, president of a 65-unit co-op at East 66th Street in Manhattan, for instance, is typical: "We review the financials and the references, and require 50 percent down. We don't have a formula like you have to have X amount of wealth over the value of your apartment or something like that. So we don't really have any set formula at all. Our treasurer is very capable in terms of analyzing the financials and just making sure that they have all the components that we're looking for."

But what does making such a decision actually mean? What does "analyzing the financials" entail? Is there a magic formula you can apply to make sense of it all?

**Adam Leitman Bailey, an attorney in private practice.**

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**Listen to What the Bank Said?**

In the simpler old days, bank approval was considered a sufficient barometer as to whether the applicant was financially solid. Many a board member would say, "If his financials are good enough for the bank to approve him, then that's good enough for me."

No longer. According to some, many banks are making questionable loans. "We have seen some fairly aggressive mortgage brokers out there," says Jerry Fingerhut, board president and former treasurer at the 580-unit Castle Village co-op in Manhattan. "You begin to wonder what factors are being considered when some of these loans are being proposed to the board. Some of these loans make us very uncomfortable. They're loans that are not really supported by any collateral. We've seen loan applications where, basically, if you did the math, you'd have 90 percent of the monthly income going to maintenance. And you say, 'Well, how

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could the bank possibly approve this?’ So, there are banks doing strange things out there that we don’t think are in the potential shareholders’ best interests.”

Therefore, it’s up to the co-op board to do its homework. That means reviewing key elements of the financials on a case-by-case basis. As a starting point for evaluation, you should apply a standard formula used by brokers and some lenders: the debt-to-income ratio. It considers debt and income when weighing whether a buyer can afford to pay for his or her home on a long-term basis.

“Boards usually want to see the buyer fitting in somewhere between a 25 to 30 percent debt-to-income ratio. Thirty percent’s kind of a benchmark with a bank,” notes Miriam Sirota, senior vice president at the Corcoran Group, a real estate brokerage. “A bank can (and does) approve well into the 40s nowadays, maybe even close to 50 [percent]. But most co-op boards do not want to see 40 or 50 percent of the buyer’s income going to their housing.”

That brings another question to the forefront: how do you define income? “People list all their assets – cars, furniture, antiques, jewelry – all of which is nice when you have big numbers on those lines but all of which is virtually meaningless for a board to consider,” says Don Levy, a vice president at the management division of Brown Harris Stevens. The assets that are most important to boards are the ones that are liquid. Liquidity is key because if a person has a lot of money tied up in, say, a retirement account when he or she is not at or near retirement age, it doesn’t mean a thing until he or she retires. If there’s a problem in paying the maintenance, you don’t want to wait for a shareholder to go out and liquidate his or her personal assets.

The tax return is the most obvious way to judge income, but even that must be done with a discriminating eye. “People who are self-employed take a lot of deductions,” says Sirota. “They take as many as possible, and so their gross income versus their adjusted gross income is very dramatic sometimes. Some boards are very understanding of that and will look at the gross income. Others only look at the bottom line, the adjusted gross income.”

You must decide how flexible you want to be in this area. “To some boards, the tax return is the thing,” notes Sirota. “If your tax return says you made \$50,000 last year even if you have an employment letter that says you have a \$150,000-a-year job that you’ve been in for six months, they won’t accept that.”

Figure out how many years of tax returns you want to see. For many, one year is sufficient. Others insist on three years because they want to see where the income has been going over that time. Is it going up? Has it been stable? Has it gone down?

When analyzing the financials, the board must also look beyond the applicant’s housing debt and consider the other debts he or she is carrying. Does he or she have student loans? Does he or she have a car loan? Does he or she own another property and possibly another mortgage?

“This backdoor ratio, as we call it, is really a combination of all of their debts, plus the new mortgage they’d be taking on, and asks, where does that put them?” says Sirota. “I’m very much a watchdog with this. Some brokers don’t even concern themselves with this ratio. I don’t even present an offer to a seller before I find out the buyer’s income, their assets and their liabilities, and [see] that they have a mortgage prequalification letter from a lending institution or

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from a mortgage broker.”

Finally, you should examine the types of loans they are carrying. Accountant Mark Shernicoff, a partner at Zucker & Shernicoff, recalls that at his own Upper West Side Manhattan co-op the board has a policy forbidding interest-only loans. “They put people in a hole,” he explains. “We want people to be reducing their obligation, not increasing it. If you borrow money today at six [percent] and you pay interest-only for 10 years, where will interest rates be in ten years?”

## Other Factors

Applying this analysis will only get you so far, however. To complete the weigh-in, you must consider some other more intangible factors:

**Location.** Where you are may determine who you are and what you should expect from your potential owners. In other words, the location of your building may make a difference in how you evaluate a potential buyer’s financial needs. “The location determines value and the value and price determine financial requirements,” observes Shernicoff. A middle-income building in Brooklyn or Queens, for example, is less likely to look at “deep pockets” (i.e. assets) and permit financing for much of the deal while a Park Avenue building in Manhattan is more likely to require significant net worth, as well as requiring cash or sales.

“A lot of the buildings on Park and Fifth Avenues create a level of differentiation because many of the ones at the very top end don’t permit any mortgage financing,” says Levy. “If someone is going to come in and buy a \$4 million apartment and must be able to pay for it all-cash at the closing and can’t take out a mortgage, that certainly further narrows down the scope of people who are able to apply for these apartments and hope to be approved.”

**Building size.** Size matters, especially when you consider possible arrears down the road. “If you have a 200-unit building and you’re getting stiffed by two people, that’s not that big of an impact,” observes Tom Sahagian, a former board member at two Manhattan co-ops on the Upper West Side. “But if you’re a 20-unit building and you’re getting stiffed by two people, that’s a huge impact.”

“I would say the smaller, very, very clubby types of buildings, along Park Avenue and Fifth Avenue, are a little bit more stringent because the risk factor is spread among fewer people,” agrees Jan Feld, a former board president at a Park Avenue co-op. “They are more concerned about the financial condition. The larger buildings could maybe afford to absorb some kind of a problem. Extra-large buildings, with a hundred to two hundred apartments – it’s a small amount that they are missing.”

**Applicant’s earning potential.** Look at the applicant’s future potential, as well as his or her past performance. Sometimes, there are extenuating circumstances – a buyer has the potential to earn more income, for instance – but you still want to require some sort of cushion. In that case, you can put a fixed amount of money in escrow as a guarantee.

“If their income was less than the guideline or their assets were too thin or some combination of both, but you thought that they had potential because they were young and upcoming or they’d had a recent setback and the past two years may not be typical of their earning capacity, you say, ‘Okay put a year’s maintenance in escrow,’” says Shernicoff.

(You can go too far in such requirements, of course. “When I was applying to the building that I used to live in, they put us through the meat grinder,” recalls Sahagian. “Because they were

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really uptight that we were somehow not going to pay our maintenance, and at the time, I had a mortgage for my existing apartment with my mother. And they actually made me sign a letter that said that, if push came to shove, I would stiff my mother before I stiffed the building. So, since it was the difference between getting the apartment and not getting the apartment, I signed it, but I had absolutely no intention of honoring it.”)

Sahagian recalls a couple that applied for an apartment in his co-op. The woman of the pair had a job with a variable income. The board asked itself: what if the person with the irregular salary lost some of her customers and then couldn't pay the maintenance? The amount of income was important, but another key factor was the steadiness of it. “In other words, if you were, say, an actor, and one year you made 100 grand and the next year you made 10 grand, that would be different from somebody who made, you know, fifty-five grand a year steadily,” explains Sahagian. “That would certainly be a red flag.”

## Can You See Clearly Now?

Some say you should make your formula clear to potential buyers so no one wastes his or her time filling out applications for an apartment he or she is unqualified for. “We have ours in writing that went with every application package,” says Shernicoff. “If it went to the seller who gets the application package, they understand what the buyer's going to have to come up with. They need to understand what the building's rules are in evaluating the ability of a purchaser to be approved.”

Others say that even such a revelation is too much. “There is no building other than in their own private conversations that has a specific formula that indicates what a minimum financial requirement is to be able to buy an apartment,”

counters Levy. “And the reason for that is simple: you don't want to put people into a position of having a reason to come back and bring some sort of a claim. Because if they meet that criterion and something else comes up along the way so the board chooses not to accept them, then you've lost the ability to create a defense, should there ever be a claim, that they were rejected for financial reasons.”

In doing all this, the underlying reason is simple: you must protect yourself and the co-op. You cannot discriminate, but you must be discriminating. There's a difference. You are supposed to choose people who are the right fit, financially and otherwise, for your property. You just can't violate the law in doing that. What that means is you can't turn someone down because of his race, creed, color, religion, or sexual orientation.

Sometimes, what you can't ask or act on is surprising. For instance, children are protected under the fair housing laws. “It is illegal to deny housing to a party because they have children,” observes Sirota. “It would seem obvious to any of us that denying housing on the basis of gender or race is just bigotry and wrong. And yet [the] children [prohibition] is something that people might not be aware of. Someone might say, ‘Oh children, you know, we have such a quiet building, do we want children here?’ That's not a question you can even ask or answer.”

Even though you are not required to give reasons for rejection, in a lawsuit, you can be forced to, so it is important that you be on solid ground. Check with your lawyer and/or manager on what those are. And both will tell you that the most solid and objective yardstick you can use is the buyer's financial condition.

“I don't want my clients to meet with the candidate unless they are already okay with the financials,”

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says [Adam Leitman Bailey](#), an attorney in private practice. “If the financials aren’t acceptable to you, do not meet with the candidate, because I don’t want any discrimination claims. I don’t want a lawsuit. If you don’t know what color they are and you reject them, you’re really protected in the decision you’re making. In other words, financials are the entrance fee.”

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