

Housing Co-operatives in USA

History

The first housing co-operative was set up in New York City in the late 1800s. Historically, the development of housing co-operatives in the US followed two paths: limited equity and market rate. Major co-op housing development happened after World War I in New York, San Francisco, and Chicago, mainly involving people with higher incomes. However, many housing co-operatives did not survive the Great Depression of the 1930s. Affordable housing co-operative development grew a great deal during the 1950s with an unsubsidized federal government mortgage insurance program, and into the 1960s and 1970s with federal government subsidy programs. State agencies also spurred development of affordable housing, the most notable being the Mitchell-Lama Housing Program in New York, considered as one of the most successful programs for developing affordable housing. The Nixon administration ended the federal subsidy programs, and co-op development for low- and moderate-income families in any appreciable numbers stopped in the 1970s. At the same time, the US co-op housing movement failed to understand the power of the condominium concept and failed to respond to social changes of the 70s and 80s. Today, well over half of the US co-ops are in metropolitan New York City and most of those are market rate.

Context

To more effectively compete with condos, the co-operative housing movement must publicize the benefits co-ops have over the condos, such as reduced financing and property tax costs as well as lower transfer costs at the time of sale. Moreover, housing co-operatives have a greater ability to accept social investment and can provide partial outside or internal subsidy. Because of all these advantages, housing co-operatives have the potential to meet the increasing needs of low- and moderate-income people. The co-op housing movement believes that it can meet the homeownership needs of people at 80-120% of median income without ongoing subsidy. On the other hand, the co-op housing movement must convince politicians, at both a local and federal level, of the potential of co-op housing, as co-op housing is often overlooked and left out of federal and state legislation for single-family homeowners. Furthermore, they are sometimes inappropriately included in legislation and regulation for rental property owners.

The Co-operative Housing Movement

Incorporated in 1960, the National Association of Housing Co-operatives (NAHC) is the national co-operative housing organization in the United States. It is a non-profit federation whose mission is to represent, inform, perpetuate, serve and inspire the nation's housing co-operatives. Its membership includes housing co-operatives, mutual housing associations, co-op housing associations, and other resident-owned or controlled housing, professionals, organizations, and individuals interested in promoting the interests of co-operative housing communities.

There are also several organisations developing, representing and serving housing co-operatives in the different states as well as organisations representing specific interest housing co-ops.

For more information, go to www.coophousing.org

Statistics

The National Co-operative Business Association indicates that there are currently 6,400 housing co-operatives. In January 2003, the limited or zero equity housing co-operatives represented 425,000 units and the market rate housing co-operatives 765,000 units, totalling close to 1.2 million housing co-operative units. Housing co-operatives account for about 6% of common interest ownership housing and about 1% of all housing units. The housing co-operatives have developed under several financing mechanisms. There are housing co-operatives for families with low-, moderate- and high incomes. Half of all the co-ops in the US are in New York City. Many of the others are found in the Midwest and in major urban areas like Atlanta, Miami, Kansas City, Washington, and San Francisco. The following table gives the units distribution by programs and/or financial mechanisms.

<u>Limited Equity Housing Co-operatives</u>		<u>Market Rate Housing Co-operatives</u>	
HUD – Insured and assisted	148,000	HUD – Insured	109,000
Lanham Act	35,000	Conventional, new construction	100,000
Former Public Housing	20,000	Conventional, conversions of rental	550,000
Farmers Home	5,000	Membership sponsored	6,000
Mitchell-Lama (NY)	60,000		
State Housing Finance Agencies	45,000		
United Housing Foundation (NY)	40,000		
Tenant Self-converted / UHAB	50,000		
CDBG/LIH Tax Credit	7,000		
Mutual Housing	15,000		
Total	425,000	Total	765,000

Description

As indicated there are two major types of housing co-op development in the US. About half of the housing co-operatives are mid-rise or high-rise multi-family buildings and the other half are townhouses or garden style (3-4 story walk-ups). Three other smaller scale types have been also developed.

There are two sets of terms used in housing co-operatives. In New York, where half the housing co-operatives in the USA are, the terms tenant-shareholder, stock and proprietary lease are used whereas elsewhere, the terms used are member or co-operator, membership certificate and occupancy agreement.

Market rent and limited-equity housing co-operatives share the following characteristics:

- The housing co-operative owns (or sometimes leases) the property and the members, also called tenant-shareholders, jointly own the corporation.
- The co-op holds the mortgage (blanket mortgage).
- The member buys stock in the co-operative. The stock is also called shares (for co-ops located in Washington and New York incorporated under the Business Corporation Law) or membership certificates. Members often must obtain a loan to purchase the shares (share loan). The shares and the proprietary lease guarantee the loan.
- The member signs a perpetual lease, called a proprietary lease or occupancy agreement. This gives him a legal and exclusive right to occupy a unit as long as the member fulfills its obligations to the co-operative.
- The co-operative is responsible, as the owner of the property, for all legal and financial obligations. The member pays a single monthly fee, also called a carrying charge or maintenance charges, to the co-operative that is based upon the number of shares or size of unit.
- The member's total carrying costs include the monthly fee and the individual share loan repayment.
- Most co-ops restrict the rights of members to sell or lease their apartments, protecting the right of the co-op to approve any new member/resident.
- Members are both tenants, as determined by the occupancy agreement, and owners because of the shares held in the co-operative.
- The co-operative property taxes are assessed against the building as a whole (like a rental building) rather than the sum of the units like a condo. There is no reassessment when the shares are sold.

1. Market rate housing co-operatives

- Sponsored by for-profit real estate developers. Most new market rate co-ops are conversions of existing rental buildings in New York.
- Directed to households with middle to high income.
- Found more in largest and expensive cities where individual ownership is very difficult (blanket mortgage, lower property taxes assessment, the ability to approve of one's neighbors and no reassessment of taxes upon sale are net advantages for the members.)
- Shares are sold at full market value.
- Sale of shares is considered a sale of personal property instead of real estate, which means lower transfer costs. Transaction fees are around 2-3% of the cost as compared to 7-10% for a condo.
- Most market rate housing co-operatives have a voting formula based on the number of shares held.
- Co-operative housing unit ownership is also open to revocable living trusts (used by wealthy persons to avoid estate taxes and probate). The property value increases and the aging population make these alternate ownership possibilities attractive to shareholders. Several mechanisms can be put in place to protect the co-operative overall control.
- In New York co-operative conversions, only a minimal percentage of units must be sold to create a co-operative housing project and a majority of units can remain in the hands of the

developer. This can create some difficulty for the development of a viable co-operative community.

- Unsold shares could be an issue in some co-operative housing developments (New York conversion projects). Investors can buy shares and they have privileges similar to a developer such as :
 - Sale or sublet of the units done without board approval
 - Able to keep units in perpetuity

2. Limited equity housing co-operative

- Sponsored at first by labour unions and ethnic immigrant societies, they are now usually sponsored by a non-profit organization or a tenants group with a few using the Scandinavian type mother-daughter mutual.
- Purpose: prevent speculation, encourage long-term residency and preserve affordability
- Targeted to low- and moderate-income
- Government financial assistance can be used to maintain affordability of shares. Not all limited-equity housing co-operatives receive financial assistance. Assistance is in two forms.
 - Assistance may in the form of a lower interest rate offered by two financing programs (Section 221d3-Below Market Interest Rate and 236.) Both programs have been discontinued, but many co-ops financed with those programs are still benefiting from a 40 year mortgage with a low interest rate (state or city bond financing like Mitchell-Lama also provides a lower interest rate).
 - The other form of assistance is Section 8, rental assistance to individual owners based on income. The government pays this assistance to the co-operative.
- Shares are sold according to a predetermined formula established in the co-operative's bylaws that limits the rate of return. (Original cost of the shares plus a modest profit usually based on inflation, depreciated value of improvements and return of principal).
- Shares are typically much less than down payments on comparable condominiums.

3. Leasing housing co-operative

- Property is leased by the housing co-operative on a long-term basis from the owner, sometimes with an option to buy. The residents manage the building as a co-operative.
- This is used by syndicates of investors to take advantage of federal income tax credits. The co-op is a co-general partner in the syndicate.
- Share prices are the same as a rental deposit. There is no equity accumulation because there is no ownership of the building.
- At the end of the 15 year tax credit period, the co-op can buy the building from the investors.

4. Mobile Home Parks or Manufactured Housing Communities

- Co-operative owns the land and any common amenity.
- Members own their manufactured home and have complete control over the management of the home.
- Members jointly manage the park.

5. Cohousing

- Communal type of setting – common house and recreation areas.
- Designed and managed by residents – each one owns their own house.
- Few cohousing developments are organized as co-operatives – the majority are condominiums or homeowner associations of fee simple houses.

6. Special interest housing co-operatives

a. Senior Housing Co-operatives

- Incorporate design and service features appropriate to a senior residency and each co-operative decides whether or not to offer extensive personal or home-care services.
- Most co-operatives limit all units to 55 and older (minimum of one 55 year old member per household is required by law in order to meet an exception to the federal requirement that landlords may not discriminate against families with children under 18).
- There is one kind of senior co-op, called a deep equity co-op, where most members were homeowners and upon becoming members use the equity in their house to pay the co-op's share. The co-operative may still need a blanket mortgage for around 30% to 40% of the value.
- Senior housing co-operatives have been also developed in rural areas. (Retirement oriented communities using the co-operative form of ownership are popular in the upper Midwest, but not commercially successful for the developers and lenders. There are some large scale market rate retirement co-ops in Florida and the Southwest and Western States.)
- Zero equity senior housing (www.csi.coop) has been successful with a federal loan/grant program (Section 202) to reach very low-income seniors using the Scandinavian approach (mother-daughter approach). All the residents are members of their building co-op and also the mother co-op, which provides development and management services.

b. Artist Housing Co-operatives

- Organized as leasehold or limited-equity co-operatives.
- Specifically designated to artists.
- Combine housing and workspace needs.
- Goal: permanent affordability.

c. Student Housing Co-operatives

- Housing for students on university campuses.
- Could be dormitory, house or apartment building.
- Minimal membership fee is charged (typically \$50).
- Canada and US Student Housing Co-operatives work together through NASCO.
- 2 corporations have been set up to assist in the development and the management of student housing co-operatives: NASCO Properties, a property-holding non-profit organisation that

buys and leases buildings to housing co-operatives and that pools co-op housing member resources such maintenance reserves, and the Kagawa Fund which provides technical and financial assistance in the form of loans.

Financing:

Co-operatives for low-and moderate-income are now financed by local government (see New York City, for example), private sponsors and fiscal incentives. The federal government has mortgage insurance programs to protect private lenders from losses.

HUD – U.S. Department of Housing and Urban Development

- Section 213 – mortgage insurance program
 - Provides full-faith-and-credit guarantees of 40-year, fully amortizing, fixed-rate, non-recourse construction and permanent loans.
 - Insurance for the construction and permanent loan (Insured Advances) or the permanent loan only (Insurance Upon Completion).
 - Loan to value ratio of 98%.
 - A Co-operative Management Insurance Fund is set up: reserves to meet any possible default on the Section 213 mortgages – mortgage insurance premium of ½ of 1% of the total mortgage / Section 213 co-ops have been so successful that patronage refunds from excess reserves are paid back to the co-operatives. 50 year total loan losses of less than 0.1% (.001) per year.
- Section 221d3 and Section 236- 100% loan-to-value loans for moderate-income co-operatives.
- Section 223f - a refinancing program for older buildings that did not have HUD mortgage insurance before.
- Section 8 - tenant assistance based on income.
- Section 202 – grant for low income seniors.

National Co-operative Bank / Together We Can Program

- Goal: preserve and develop affordable co-operative housing using technical assistance, training, advocacy and predevelopment capital for experienced non-profit developers.
- Housing co-operatives in existence for more than 2 years are eligible. First and second mortgages and lines of credit are available.

Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac)

- National loan market for co-operatives housing / both buy co-operative blanket loans and share loans. Both can buy uninsured mortgages. Provides liquidity for lenders. Guidelines for purchasing mortgages become a tacit set of regulations.

Federal disposition program - HUD gives priority to tenants who want to buy their building when the landlord defaults.

New York City programs - Conversion of city-owned, federally subsidized and distressed buildings.

- Tenant Interim Lease program (TIL). When application is selected, tenants of city-owned buildings go through an interim period managing their building while they receive training and support. The City does major capital improvements before transferring the building to the co-operative. Tenants buy their apartments for a minimal amount (\$250) each.
- Third Party Transfer is a property disposition program of the Housing Preservation and Development (HPD) of New York City. This program gives the city the capacity to foreclose on distressed tax-delinquent properties and transfer them directly to a responsible owner such as a housing co-operative. Tenants of these buildings have an option to work with an organization (UHAB) that will take ownership temporarily while helping tenants create an HDFC (Housing Development Fund Corporation) co-op.

Strict rules and a strict process regulate the conversion of a building into a co-op. Some tenants (handicapped, senior, rent-stabilized) are protected and may be able to stay in the building as tenants. Non-protected tenants may have up to 3 years to vacate before the units can be sold. The developer and the co-op afterwards must ensure that the units of those individuals are well maintained.

Fiscal incentives:

- Section 216 of the Internal Revenue Code allows shareholders to take a personal income tax deduction for mortgage interest and real property tax payments made by the co-operative housing corporation. The deduction is prorated to their shares.
- Interest of the individual loan to purchase the shares is deductible from personal income tax.

Reverse Mortgages – an investment tool for senior housing co-operatives

- Goal: convert part of the unit's equity to provide for an income stream.
- Member must be a least 62 years old.
- Member can borrow against the equity held in the co-op from a bank.
- Paid in lump sum payment or monthly payments / No payment of interest and principal until the apartment is sold, the member moves out permanently or the last apartment's tenant dies. Interest accrues and is added to the loan.
- Loan amount is based on the age of the member (as an example, an 80 year old member would be able to borrow about 42% of the unit's value). Location, unit value and interest rates are also considered.
- Loan is a non-recourse loan meaning that the owner can never owe more than the value of the apartment, regardless of the loan balance.
- If the co-operative consents to such a loan, it signs a Bank Recognition Agreement limiting the risks for the lender in reselling. (Recognition Agreements are also required for share loans.)

Kagawa Fund – an investment tool for student housing co-operatives

- Pool of risk capital to eligible campus co-operative development projects.
- Financed by individuals' and organizations' investments, donations and grants that support the student co-operative housing movement.
- Traditional lending criteria as well as social criteria are assessed before making a loan.

Funds from private foundations, states and local governments

At least 33 states have set up housing trust funds. But only a few include co-ops as mostly are for rental housing.

Legal Framework

Co-operatives existed in the US before any federal or state government program. They are creatures of a combination of state corporate law and landlord-tenant law. Some states, such as New York, California, Maryland, DC, and Florida regulate the sale of co-op shares through disclosure and consumer protection requirements. California and Florida impose a state regulatory scheme on co-op operations, similar to the regulation of condominium operations in those states.

At the Federal level, “regulation” of co-ops not insured by HUD consists of:

- Tax law. For shareholders to get the same personal income tax deductions for mortgage interest and real estate taxes that are enjoyed by single family owners, the co-op must get at least 80% of its income from residential shareholders. This presents a hardship for some NY co-ops with ground floor commercial space or parking garages, but is not a problem in the rest of the country.
- Secondary mortgage market. Fannie Mae and Freddie Mac, government sponsored enterprises with publicly traded shares on the stock exchange, adopt standards for loans that they buy from private lenders. Those legal and underwriting standards become ad hoc regulation.

Some affordable co-ops without a HUD-insured mortgage may accept Section 8 rental assistance from HUD on behalf of needy families. HUD regulation of these co-ops is limited to property inspections and a review of management processes to ensure accurate financial records.

There is private regulation by lenders holding blanket mortgages. Such regulation tends to restrict the co-op from changing bylaws or managers without the lender's consent, requires the co-op to maintain insurance and reserves, and requires annual audited financial reports.