PolicyLink

Equitable Development Toolkit

Limited Equity Housing Cooperatives

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Lifting Up What Works®

What Is It?

Limited Equity Housing Cooperatives (LEHCs) are business corporations in which residents share ownership of a building. Co-op members work together to reach mutual goals based on democratic control and decision-making. Cooperative residents are typically guided in practices of living together in mutual ownership by the "Rochdale Principles," developed by the International Cooperative Alliance.

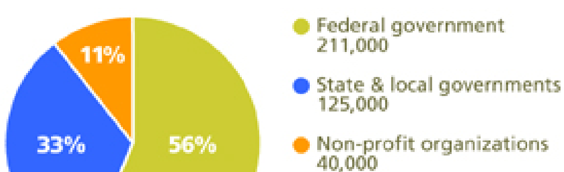
LEHCs offer ownership opportunities to lower income households while limiting the return from resale that they can receive from the housing. It contrasts with market rate cooperatives, where memberships can be transferred at market value.

A LEHC is one approach to resident-controlled housing. Others include limited equity condominiums, mutual housing associations, co-housing and community land trusts (CLT). Some of these tools may be combined, such as the LEHC and the community land trust.

Limited Equity Housing Cooperatives:

- Build member participation in the corporation
- Operate as nonprofits
- Combine business and social goals
- Rely on democratic participation
  Create voluntary membership
- In the United States, there are more than 400,000 units of limited equity housing.

Distribution of LEHCs Units by Sponsors, 1995



Source: National Association of Housing Cooperatives

Note: Of the 125,000 units of LEHCs sponsored by state and local governments, 80,000 are in the state of New York and 45,000 are in all other states.

Some of the best examples of LEHCs occur when apartment building tenants join together to purchase their buildings and share in permanently affordable and democratically controlled home ownership. Renters in a class action lawsuit over the uninhabitable conditions of their Columbia Heights apartments in Washington D.C. reached a settlement to acquire ownership of one building for one dollar. They are forming a limited equity cooperative to formalize resident ownership and make longed-for improvements on the building.

Why Use it?

LEHCs make housing affordable to low-income people by taking property off the speculative real estate market. Cooperative properties allow lower income people who might be forced out by rent increases or sales to remain in their apartments. The construction of new cooperative units can offer displaced low-income residents the opportunity to remain in their neighborhood.

LEHCs can improve the quality of life for its members by giving them control over their housing, by creating a process for members to work with other people and institutions in improving the neighborhood, and by formulating political influence that can slow gentrification and increase local control over their neighborhoods.

A Note of Caution: Developing a LEHC *can* add to gentrification pressures by removing rental housing from the housing stock. While this can be averted by new co-op construction or by the conversion of vacant buildings, the very act of improving housing creates pressures by increasing the neighborhood's desirability to outsiders. By creating a coordinated approach to neighborhood planning, LEHCs can benefit current neighborhood renters while advocating development of new affordable rental housing.

Protect Renters

Properties converted to co-op or vacant properties used to build a new co-op allow low-income people to remain in their units who might otherwise be forced out as rents climb.

Advantages of Cooperative Housing

Cooperatives create economic and social benefits:

- **Security of tenure.** By removing the owner or landlord, the residents control their own living environment and gain homeownership opportunity.
- **Lower housing costs.** Eliminating landlords' rental profits and lowering operating costs through members' contributions to management activities, maintenance and bookkeeping can significantly reduce monthly housing costs.
- **Ability to accrue savings.** While equity in the housing is limited, the differential between lower monthly charges and market rents allows residents savings that can build other forms of assets.
- **Mortgage deductions.** Coop members may deduct mortgage interest and property taxes from income taxes like other homeowners.
- **Rent subsidies.** Cooperative members can qualify for Section 8 rental subsidy to support their monthly housing costs.
- **Membership.** Cooperative members can build inclusive communities through the process that guides selection of new membership.
- **Quality of housing.** Cooperative members can initiate property upgrades that would not be possible in private rental housing.

- **Long-term affordability.** Cooperative members can ensure that their property will remain affordable over time to other low-income people.
- **Surrounding neighborhood conditions.** Cooperative members can develop, participate in, and allocate funds to local neighborhood improvement projects.

How To Use it

Types of Co-ops

LEHCs can provide almost all types of housing, including multifamily apartments, town-houses, single-family homes, and mobile home parks. LEHCs may be concentrated in an area, or interspersed among privately owned housing. Legally, cooperatives may be either nonprofit or for profit.

There are many methods of forming LEHCs.

- **New housing cooperatives** from vacant buildings or through new construction.
- **Conversion of tenant-occupied buildings**. These conversions commonly occur in government subsidized buildings experiencing a phasing out of their public subsidies, in buildings with federal insurance and rent subsidies, or in public housing. Conversions can transform privately owned housing if the owner is willing to work through the process with the tenants. In some cases, legal action against landlords of substandard rental housing can result in cooperative conversion.
- **Sweat equity cooperatives** utilize members' labor as an investment in new construction or rehabilitation. Licensed contractors are hired to install or upgrade electrical, plumbing, and heating systems, as required by health and safety regulations. A construction manager supervises and trains the co-op members in other labor.
- **Leasing cooperatives** lease a building from the owner. One variation of leasing cooperatives syndicates the property to private investors to raise capital and qualify for financing through tax credit programs. The co-op can be the general partner of a limited partnership that owns the property and leases it to the co-op. After 15 years, the cooperative members can purchase the property from the partnership investors.

Ownership Models

There are many different ways that residents can exercise ownership or control over their development. The most important thing to remember is that if you can define what the structure should look like, a lawyer can probably make it happen.

In a **co-op**, residents own all the stock of a corporation that owns the development. Residents do not own their own unit, but they do completely control their development. Co-ops work best in large buildings where residents are familiar with the cooperative concept.

Resident-controlled rentals are almost exactly the same as co-ops, except that the development is owned by a non-profit controlled by the residents. Unlike a co-op, residents hold no equity in this model.

Mutual Housing Associations are also non-profits, but they typically have a board that includes residents, future residents, and representatives of the public and private sectors. They have a mission of continuing to expand to include more and more housing, and they often manage their own developments. They are useful for owning scattered sites. MHAs lease their housing to their residents.

Owners of **condominiums** do own their own units, and a share of all common facilities as well. **Limited Equity Condominiums** limit the sale price to keep the units affordable.

There are many variations on all these models including combinations with land trusts, a wide variety of partnerships, and structures in which residents have input, but not control.

Model	Advantages	Disadvantages
Limited Equity Co-ops	Strong Track Record Pick Your Neighbors Easy to Finance Improvements Easy In Easy Out	Model unknown in many places You do not own your unit Requires significant participation Difficult in small developments
Limited Equity Condos	Own your unit Less participation required Can work in small developments Easier for developer to finance Easier to self-manage Model is well known	Owners must obtain a mortgage Not available to low-income Can lose affordability on foreclosure High transaction costs Hard to finance improvements Hard to pick new residents
Resident-Controlled Rentals	Similar advantages to co-op As "rental", easy to understand	Similar disadvantages to co-op No equity (ownership) for residents
Mutual Housing Associations	Similar to RC Rental Subsidies available from Neighborhood Reinvestment Expands to fill need of more people	Term not well-defined Similar disadvantages to RC Rental
General Partnerships	Cash available from developers Expertise of developers	Must share power with developers
Overlay: Cohousing	Community-related advantages such as sharing childcare and meals	More participation required
Overlay: Land Trusts	Strong tool to guarantee long term affordability Expertise of land trust	Dependent on existence of third party

Chart courtesy of Richard Schulze: (Rschultz@gis.net), weown.net

Structure and Controls

Legally, cooperatives may be stock- or membership-based nonprofit or for profit corporations. A LEHC is usually a nonprofit corporation, incorporated under state laws. State enabling legislation describes the types of cooperatives that are allowable. These laws cover resale controls and authorization to certain state financing vehicles, programs and agencies (e.g. bonds, insurance).

Typically, LEHCs are not tax exempt, 501(c)(3) corporations and must pay all applicable taxes. The corporation owns the property and issues a lease, or Occupancy Agreement, to its members, giving each the right to occupy a specific unit in the building. Articles of Incorporation describe the purposes of the corporation and the Bylaws determine how the corporation is operated, including the resale guidelines that are used to maintain long-term affordability of the co-op units.

The corporation obtains a **blanket mortgage** for the initial costs of the property. Members can obtain **share loans** for financing their particular units. When a member moves out, the new purchaser may need to obtain a share loan in order to finance the increased value of the selling member's unit.

Methods of Resale Controls or Restrictions

Maximum sale price of member shares is controlled to assure that the share value remains affordable to the low-income earners. This is accomplished by (1) granting the cooperative the right of first refusal to repurchase the share of any member who decides to leave, and (2) establishing the maximum price at which member shares can be resold.

The maximum resale price or resale control is usually determined by a formula that is specified in the Bylaws or Articles of Incorporation. Many different resale formulas can be used, ranging from original value plus one dollar to those that incorporate inflation and improvements.

Preserving Affordability

LEHCs, in contrast, remove the property from the speculative market and keep the units affordable to low-income people over time.

Equity returns can be applied to the down payment amount or to the original value of the unit. If applied to the down payment, a modest equity gain generally is realized. If applied to the original value, the unit may deliver windfalls to the selling member and quickly become unaffordable to low-income households. Sometimes, all controls are removed at the end of the mortgage term or at a specific date, having a similar affect on affordability.

The cooperative may generate significant equity in the building in a strong real estate market. A cooperative can extract equity accumulation by refinancing or selling, taking the equity and splitting the proceeds among its members. Specific provisions in the Articles, Bylaws or financing agreements can eliminate these cost-escalating possibilities.

Provisions could allow refinancing, for example, for only specified purposes (requiring approval by a super majority of the members). These purposes can include benefiting the co-op, expanding the co-op, and benefiting the surrounding neighborhood- but would not to allow members to split up the growth in equity. Provisions can require distribution of excess proceeds from the sale of the property to another nonprofit or foundation which will be required to use the funds for a public purpose. (See Resources)

Policy Implications of Limiting Equity

Resale controls can curb gentrification pressures by removing property from the speculative market and keeping the units affordable to low-income people over time. LEHCs, instead of focusing on equity accrual to individual households, create community benefits. Most public policy around homeownership and asset accrual is heading in the individual direction, however.

Today, extensive discussion and programmatic development is devoted to increasing homeownership as a means of building equity for low-income people. U.S. Department of Housing and Urban Development, HOME, Community Development Block Grant, and extensive foundation dollars provide homeownership subsidies that accrue to the individual. LEHC policy, on the other hand, channels these extensive public subsidies to housing both current and future low-income households.

Individual Development Accounts (IDA), an emerging mechanism that provides incentives for low-income families to save, can work well with LEHCs. Living in a co-op with reduced housing costs allows families to accrue assets through savings. In this way, cooperative policy gives equal importance to community and individual assets.

Balancing long-term affordability with growth of individual assets should be addressed in the creation of each new co-op.

When Members Sell

Ultimately, the use of resale controls must seek balance among potentially conflicting needs:

- **Control resale prices** so that the units remain affordable to future low-income residents and the property does not add to the neighborhood's real estate market pressures.
- **Provide adequate incentives** to maintain the interest, support and participation of its members.
- **Create a structure** that outside parties - lenders, public agencies, etc. - can support.

Administration

The LEHC Board

A board of directors makes decisions for the cooperative. Each member has one vote in the election of the board. The board plays a major role in creating policy and managing the cooperative. Board committees, which include both board and non-board members, accomplish the tasks needed to operate the property.

The board of the cooperative has major responsibility for:

- **Oversight.** The board oversees property management, either through "self-managing" members or a hired management agent.
- **Budget.** Board oversight of the budget maintains reasonable living costs by keeping monthly maintenance costs as low as is prudent.
- **Finances.** The board is responsible for all financial aspects, including, purchasing, record keeping, bookkeeping, setting reserve amounts and uses, auditing and reporting, financing or refinancing decisions.

- **Resales.** The board manages the resale process, including interviewing and approving new members and purchasing and reselling members' shares. It also regulates improvements and valuation of improvements to individual units.
- **Evictions.** The board determines the need for any evictions (within the constraints of local just cause eviction regulations).
- **Committees.** The members join various committees that support the work of the board. Committees are central to the co-op's operations and depend on the participation of a reasonable percentage of the membership.

Participation, Organizing, and Training

> *"A surprisingly large number of people who join housing cooperatives are only vaguely aware that joining a coop is much different from renting an apartment."*
> *SOURCE: Cooperative Housing a Handbook for Effective Operations. Midwest Association of Housing Cooperatives, Organization for Applied Science in Society. Ann Arbor 1977. page 7.*

Participation is the lifeblood of a cooperative. Cooperatives and the requirements of cooperative living are unfamiliar territory to most residents. Real estate development and operation is a demanding process that requires constant attention. To be successful, a co-op needs a core of very committed people willing to contribute a great deal of time. and a second tier of supportive members who are willing to work. Insufficient participation can result in anger and resentment and ultimately undermine a co-op.

Co-op members have to be clear about the type of contribution they seek from applicants. Co-ops can require a minimum participation of members to address this issue; sweat equity co-ops require this during the construction phase.

An experienced organizer is key. Successful recruitment of members depends on the capacity to provide a clear understanding of the roles and skills needed to create and maintain a co-op.

Special skills are needed. Co-op management involves preparing budgets, reading financial statements, supervising personnel, hiring and firing, negotiating contracts, understanding property management and maintenance, and group process skills. The resources spent training on these skills will result in much greater long-term savings.

The organizing process is not merely marketing a product. It is the creation of a community. It provides potential members with information about what their options are, what the costs will be and what their personal and corporate responsibilities are. Then they have the need for information and skills to learn how to run the co-op.

Organizing a Co-op is similar to community organizing. Someone helps to bring people together to meet a common goal. This activity is needed at several different points in time in the life of a co-op:

- **very early in the process,** organizing encourages people to come together to create the co-op. The initiative may come from someone interested in starting and living in a co-op or from an organization interested in sponsoring co-ops for others. Either case requires finding other people to join the co-op; these people may

Organizing costs money

These funds must be considered as important to start and operate properly. It should be considered as pre-development costs.

know little about responsibilities and requirements of a co-op.

- **at the conversion of an existing residential rental building** into a cooperative, this process is critical. Residents will know little about co-ops; the idea may come from residents or from an outside organization concerned with the future of the building and its residents. Organizing assures that everyone involved builds a clear understanding.

Organizing also plays an important role on an ongoing basis after the co-op is formed, continuing to build participation for the original members. It eases the transition for new co-op members and makes it easier for them to take part in the co-op's life.

Both organizing and training cost money. Once the co-op is running, there should be a line item cost in the budget each year for these items, which may also include other costs (e.g. conferences) as the co-op solidifies over time.

Developing LEHCs

Selecting the Developer

A developer typically is needed to manage the complexities of creating a LEHC. While tenants, however, can perform this role by hiring consultants to undertake technical work, usually a nonprofit developer is involved. Tenants or a developer can initiate the development process. There needs to be trust and good communication since the interests of each party are different. The sponsors must be clear about who makes decisions and how they are made. The developer must be committed to the additional time of working through resident participation and decision making.

Many low-income housing developments run into opposition from other residents in the neighborhood. Because cooperatives are a form of home ownership, they may be more acceptable to neighbors than rental housing.

Knowing When to Purchase

A key to developing a strong LEHC is a sound purchase. In gentrifying neighborhoods, the market is moving quickly. There are ready buyers, usually with higher incomes than the people presently living there and with the capacity to buy quickly. Nonprofit and cooperative developers of low-income housing usually do not have the capacity to compete financially or move as quickly with these other buyers. The best time to buy is <u>before</u> gentrification pressures begin. For communities that develop plans to increase resident ownership through increasing LEHCs, it is important to recognize the real estate cycles and act when the time and opportunity is most appropriate.

Other Considerations in the Development Process

A key issue in the development of a co-op is the size, usually measured by the number of units. For any type of resident-controlled housing, the minimum size is generally 12 to 20 units. The need for participation from a large number of households is difficult to meet in smaller buildings. Some organizations prefer a minimum size of 50 units, because this is the threshold at which Fannie Mae will purchase share loans.

Another development issue is the geography of the co-op. If the co-op is in one large building, there is generally not much of an issue. However, if the co-op is scattered among several buildings and interspersed with other housing, the tasks of development and management become more difficult.

Key Players

Creating a limited equity cooperative is both a technical and political process. It requires the cooperation and assistance of many different people.

- **Neighborhood Residents.** People in the neighborhood need to be accepting of the co-op. They may be advocates for the co-op, recommending the creation of LEHCs and helping with the planning and control of gentrification. They may be potential members of the co-op. They may also oppose LEHCs for a variety of reasons. NIMBY participants may oppose any type of low-income housing developments.
- **Sellers.** When real estate markets are weak, sellers may be willing to offer longer escrow periods-very useful in creating the necessary time to pull together the financing. A seller may offer to finance part or all of the sale. Sellers may also be willing to enter into a donated sale or partially donated sale, which lowers the cost to the buyer. When real estate markets are stronger, sellers are less likely to agree to these terms. Developers should explore these possibilities; the seller may be sympathetic to their goals and offer excellent terms even in a hot market.
- **Public Agencies.** Agencies at all levels of government can be helpful or obstructionist in creating LEHCs. They are influential in obtaining financing. They can be central to the process of obtaining zoning changes or needed variances. When neighborhood opposition arises, agencies can play an important role with their recommendations to decision-making bodies.
- **Co-op Members.** Members need to be willing to cooperate, to participate in the governing and managing of the co-op, and willing to accept limitations on their equity accumulation.
- **Developer.** The developer must be willing to work with a large group, accept input, and seek solutions. This work adds time to the process and increases the costs as well. When sweat equity is involved, the developer must be willing to work with the residents and to help train them.
- **Trainer and Organizer.** These functions may be handled by the same person or by different ones. Both functions require great skill and are crucial to the functioning of the cooperative.

Challenges

There are several considerations in the development of a LEHC that can better prepare communities utilizing this strategy to enjoy success in dealing with gentrification.

Ensuring Community Benefit. The very act of improving existing housing or building new housing can create gentrification pressures by increasing the neighborhood's desirability to outsiders. A single development approach will likely prove inadequate. Negative side effects can be mitigated through a coordinated approach to the neighborhood-wide issue of gentrification. Coordinated neighborhood planning can create a LEHC that makes membership available to current renters in the neighborhood while developing new construction of affordable rental housing.

Building Understanding of the Cooperative Process. To be successful, a co-op needs dedicated people willing to put a great deal of time into the development and operation of a co-op. Insufficient participation can undermine a co-op.

Purchase Strategies. A key to developing a strong LEHC is a sound purchase. In gentrifying neighborhoods, markets move quickly. Buyers, usually with higher incomes than the people presently living there, often have the capacity to move quickly. It's important to work with the best nonprofit housing developers to begin the financing and development process so that no opportunity is lost.

Development Considerations. The minimum size is generally thought to be 12 to 15 units; many organizations prefer a minimum size of 50 units, because this is the threshold at which Fannie Mae will purchase share loans. Size decisions should be made in cooperation with the development team.

Fulfilling Financial and Subsidy Needs. The ***blanket mortgage*** has some similarities to a regular first mortgage for a rental property. As with any low-income housing development, the developer must first determine the feasibility of carrying the first mortgage. Appraising a co-op in an area where appraisers are unfamiliar with co-ops can present problems. Moreover, cooperatives can generate lower appraised values than a condominium. If the co-op needs a relatively high-appraised value in order to obtain a higher loan amount (due to lack of available subsidy, for example), the cooperative form of ownership may result in an inadequate value needed to sustain the desired loan amount. ***Obtaining subsidy*** also represents significant hurdles. Just as with any low-income housing development, LEHCs require subsidy. Many of the same sources are available to co-ops. Many of the local, state and federal programs that provide subsidy and security enhancement for other types of low-income housing developments are also available for cooperatives. Tax increment financing is available for those states with this financing approach. A local or state government could also use general revenues for this purpose. Foundations and religious institutions are other possible sources.

Neighborhood Support. Creating a limited equity cooperative is both a technical and political process. It requires the cooperation and assistance of many different people. If the neighbors do not want to see low-income housing built or developed in the neighborhood, especially new residents or business people who want to see the area change, developing the co-op will certainly be more difficult. It will also make the relations with neighbors more difficult after it is built and make other efforts to ease the problems of gentrification more problematic. However, LEHCs are often considered more appropriate than rental apartments and are sometimes more acceptable to opponents as a form of homeownership.

Intangibles. More than anything, cooperatives are comprised of people. As such, care must be taken to establish an atmosphere that promotes cooperation, mutual support, and commitment to the collective. Individuals that counter this approach hamper the effectiveness of the LEHC strategy. Experts on LEHC development say the type of challenges in this regard to beware of parallel those to be faced in many community institutions - abuse of power, money, racism, sexist attitudes. Cooperative participants need to feel enough support so that they are confident that the venture can succeed, but not so much that they rely on others to accomplish their goals. Organization, training, and a community building approach to realize this balance are **pivotal**.

Success Factors

Key Ingredients

Many elements are needed to successfully develop a LEHC in the context of gentrification pressures.

- **Member Commitment.** Members need a clear understanding what they are getting into. Members must be motivated to participate in the co-op's life and willing to accept the equity limits.
- **Community Support.** Community acceptance is key to successful development. In order to garner support, developers must devote sufficient time to educating neighbors, key public supporters, and local community organizations. .
- **Local Government Support.** Local politicians and staff of key public agencies play crucial roles. They can hold the key to reasonable access to financing and zoning approvals.
- **Adequate Financing.** There are many types of financing needed with a LEHC. See Financing.
- **Workable Limited Equity Formula.** A balance needs to be found in creating the formula that controls the amount of equity that a member may take out of the unit and long term affordability to other low-income families. The formula needs to provide an adequate incentive to encourage members to maintain the property and the individual units and to participate in the co-op's life.
- **Technical Development and Management Capacity.**
- **Comprehensive Neighborhood Plan.** The co-op is best created as part of a plan to address gentrification issues. The plan may call for development of many co-ops as well as other types of housing to accommodate older and newer residents. The plan will help assure that the community as a whole supports the co-op and wants it to succeed.
- **Ongoing Training.** Ongoing training of co-op members is also crucial in order to keep building the skills of the residents to meet changing conditions.
- **Reasonable Progress.** Sometimes people lose confidence that a co-op can ever become a reality as the development process can take several years.

Financing

Blanket Loans and Share Loans

There are two primary types of financing needed by cooperative members: **blanket mortgages** and **share loans.**

- **The blanket mortgage is the loan obtained to cover the primary costs of developing the property.** It is the responsibility of the cooperative corporation and is repaid as part of the members' monthly charge. A blanket mortgage can be refinanced at a later date to obtain a lower rate if rates fall, or to obtain additional funds for major rehabilitation, or for any other purpose allowed by the Articles of Incorporation. Blanket mortgages are usually secured against the property and are typically first mortgages.
- **Share loans are obtained by the individual members.** These are not usually required by the first members if the amount needed to purchase a share to join the co-op is relatively low. An amount roughly equivalent to the first and last months' rent plus a deposit for renting an apartment in the same neighborhood is the affordable entry goal of many LEHC developers. However, if the resale formula allows for reasonable increase of property value, the later generations of households that buy the rights to a unit may need financial assistance for the purchase. The share loan is the member's individual financial responsibility. The loan is considered personal property and is secured by the Occupancy Agreement.

Determining Financial and Subsidy Needs

The blanket mortgage has similarities to a regular first mortgage for a rental property. As with any low-income housing development, the developer must determine the feasibility of carrying the first mortgage. This process is accomplished by working backwards.

- 1**Determine the carrying charges that are affordable to the target population.**
- 2**Project the vacancy rate and potential losses from nonpayment of member charges.**
- 3**Establish the actual operating expenses and the necessary reserves.**
- 4**Deduct vacancy, losses, operating expenses and reserves from the potential income** .
- 5**Subtract the debt service coverage that lenders require. The remaining amount is available to pay debt service on the blanket mortgage.**
- 6**Negotiate the best loan available from a lender, based on rate and term with any possible modifications to debt service coverage, vacancy rate, operating expenses, and the other costs.**
- 7**Ensure loan repayments are reasonable for the members.**
- 8**Calculate subsidy needed. The difference between the affordable loan amount and the total costs of developing the property (including acquisition, construction, architect, etc.) is the**

amount needed in subsidy. In situations where members can only pay operating expenses, the property development and debt service must be paid for with some form of subsidy or equity.

- 9**Generate subsidies throughmembers' down payments, grants, investments, and deferred loans.** [Sample sources and uses, operating budget.]

Obtaining Financing

Co-op developers face two financial needs: a loan and a subsidy. The blanket loans are available from conventional lenders and from specialized lenders such as the National Cooperative Bank (and its subsidiary, the National Cooperative Bank Development Corporation), which focuses on community development. Lenders (and lender consortia) vary in their familiarity with the cooperative legal structures and lending requirements. Nevertheless, cooperative housing loans have been made in many parts of the country, although extra security enhancement (e.g., local government guarantee, insurance) is sometimes necessary.

Obtaining a blanket loan requires clearing several hurdles:

- Lenders can be reluctant to lend on property with recorded covenants that restrict the value for several reasons:
    - they worry that the restrictions do not offer adequate incentives for co-op members to concern themselves with the property.
    - if the co-op defaults and the lender needs to foreclose, the lender, as well as any new buyer, could have to maintain the affordability requirements and restrictions. These restrictions will limit the value of the property compared to a similar property without restrictions, constraining the resale possibilities (as well as the value as shown in the appraisal).
- Appraisals of a co-op by an appraiser unfamiliar with co-ops can generate under valuations. If the co-op lacks subsidy sources, it will need a relatively high appraisal value to obtain a high loan amount. Lenders who are comfortable making loans to cooperatives can act as a resource to less familiar lenders.

Borrowing can be used to lower the costs for residents. Lower cost credit exists from loan funds and religious institutions. They can provide short-term loans at lower rates that could lower the total costs of development. They may also be able to offer the primary loan if the amount and term fall within their lending capabilities.

Obtaining Subsidy

As with any low-income housing development, LEHCs require subsidy. Many of the local, state, and federal programs that provide subsidy and security enhancement for other types of low-income housing developments are also available to cooperatives. Tax increment financing is available in states that utilize this

Need Money?

Potential subsidies include widely used programs such as Community Development Block Grants, local housing trust funds, the Federal Home Loan Bank's Affordable Housing Program, Section 8 and Hope VI.

financing approach. A local or state government can allocate general revenues for this purpose. Foundations and religious institutions are also good sources.

There are three different kinds of subsidies and all are frequently employed:

Interest subsidies reduce the cost of financing.

Rental subsidies, such as Section 8, reduce the monthly payments for individual

households.

Capital subsidies, usually grants, are made to the co-op at the beginning of development to reduce the need for financing.

The final financial and subsidy package is usually a patchwork of programs and sources that form the financial base of a successful housing development. Please see the resources for further ideas about lenders and possible subsidy sources.

Policy

Policy Priorities:

- 1**Make multi-family co-ops eligible for all types of "deep" subsidies.**
- 2**Create equitable access for all co-op ownership programs to Fannie Mae and Freddie Mac and to state and local housing financing**

Policy Opportunities:

Use Temporary Assistance to Needy Family (TANF) funds for housing. Regulations published in 2000 (expiring in 2002), make TANF funds available for co-op purchase. TANF can provide both a down payment and a modest subsidy to low-income families. States can also use TANF money for housing preservation, including assistance to troubled LEHCs. The Philadelphia Housing Authority is proposing to spend surplus TANF money on rehabs, with an emphasis on LEHCs. TANF money can also be used to create loan funds for co-ops [or for individual cooperators].

Advocate co-op eligibility for Low-income Housing Tax Credit (LIHTC). The main finance mechanism for affordable housing development currently is the Low-Income Housing Tax Credit. This program does not permit tenant ownership, rather it requires outside investor partnerships, with the general partner being the nonprofit housing developer, and the limited partners consisting of investors who reap tax advantages over the course of 15 years. Buildings are owned by the partnership and then leased to the co-op association, sometimes with an option to buy after the 15 years are up.

Creating and maintaining a LIHTC requires a high level of technical expertise. However, it does not permit true ownership. The partners are often hesitant to yield control to co-op lessors and this can create a significant barrier to good co-op development.

Require conversion to co-ops of rental buildings financed through the LIHTC. LIHTC tax credits only last for 15 years, and have limited long-term effect on the stock of affordable housing. A better approach might be to condition the tax credits on the eventual conversion of developments to limited equity co-ops at the conclusion of the program. Such a policy would produce less displacement at the expiration of the tax credit, and residents could gain valuable experience in self-governance years before the conversion takes place. In too many cases, limited agreements are less than effective, or even ignored.

Urge HUD to vigorously implement the 203n program. Legislation for the 203n FHA co-op share loan-financing program has long been on the books, but HUD has failed to implement the program in any meaningful way. Market acceptance of cooperative ownership would be greatly increased by an active 203n program for unsubsidized co-ops.

Advocate greater funding for Section 8 Project-Based Rental Assistance. These subsidies could be used to create lower buy-in costs to LEHCs.

Restore project-based access to Section 8 homeownership funds. In the past, Section 8 funding was available to projects and to individuals. Today, only individuals can take advantage to these substantial subsidies. Because Section 8 certificates are portable, when a family moves, the home price goes up to market rate unless another family qualifying for Section 8 is found. Having to find immediately another qualifying family complicates the waiting list process and is counter productive. More problematic, this type of structure does not really permit a neighborhood stabilization strategy. Before about 10 years ago, there was more project-based Section 8. Now that it is virtually all portable, it ends up helping the families but not the homes and neighborhoods in which they live, in the long run.

Urge states to provide mortgage credit certificates. State funds can be used for LIHTC or for mortgage credit certificates, allowing homeowners, a credit on their federal income taxes without itemization. Some states have given tax breaks to developers. They should be encouraged to also support lower-income families and individuals.

Urge the White House and Congress to make grants available for closing costs for first-time co-op buyers. Current proposals call for $1,500 grants for closing costs on new single-family houses. These grants would be most helpful to co-op purchasers, and should be made available for down payments as well.

Homeownership Tax Credit. The Bush Administration is proposing a tax incentive program for construction of new homes for low-income families. The initial language includes co-op development. Throughout the legislative process, advocates must work to protect the co-op inclusive language.

Property tax exemption or deduction for limited equity co-ops. New Jersey has a statewide real estate tax reduction for limited equity co-ops. While cities could enact similar measures, state programs could produce greater benefits. State intervention is preferable.

Additional Opportunities

Increase per unit mortgage limits under Section 213 of the National Housing Act. The last across-the-board increase in FHA multifamily programs was 1992. The National Association of Housing Cooperatives, the Mortgage Bankers Association, and the Cooperative Housing Coalition propose a 23% increase in the Section 213 per unit mortgage limits. It is important to note that 213 requires no congressional appropriation and no credit subsidy because of its unique status as a separate mutual fund.

Authorize VA guaranteed co-op share loans. The Department of Veterans Affairs lacks statutory authority to guarantee "no money down" VA loans for veterans wanting to buy a share in a co-op. Veterans deserve access to such a program. Although past attempts have failed to correct this, advocates should continue to pressure Congress for this change.

Secure the use of housing counseling funds for co-ops . Legislation (HR.1776 and S.1452) passed in the House in 2000 to explicitly permit housing counseling funds to be used to assist co-op purchasers, and because of the special role of co-ops in home maintenance, to allow use of counseling funds for training co-op boards of directors.

Urge Appropriation of funds for training FHA and VA staff. Underwriting co-op loans and appraising co-op buildings involve specialized knowledge that can be easily transferred with training.

Promote Homestead exemptions for co-ops. A certain portion of the property you own is exempt from taxation and from bankruptcy. This is usually the first $15,000 worth of value.

More Financing Strategies

Encourage banks to provide secondary mortgages for LEHCs . These "Soft seconds." are designed in such a way that if the co-op member sells shares on the market prior to a certain time, you then have to pay the city back. The loan (principal and interest) is forgiven if the co-op member remains.

Develop community land trusts to go beneath LEHCs. A land trust approach brings down the cost of new affordable housing developments and provides more long-term benefits than government financing allows.

Encourage credit unions to provide more loans to co-ops.

Other Funding Initiatives

Currently, foundations and housing groups look to homeownership as an important solution to wealth-building in low-income families. Research shows that nearly 100% of family wealth is home equity. A range of initiatives exists to promote homeownership, led by several key national foundations. Not all of these foundations consider LEHCs a form of homeownership, viewing the limited equity aspect as preventing asset accumulation. In reality, LEHC owners do get some equity; they also get extra cash each month due to savings; and they would not have other opportunities for homeownership based on their income. UHAB and other nonprofit groups around the country are leading educational efforts with national philanthropy.

The Co-op Housing Coalition, NAHC and NCBA all have subcommittees set up to try to get a Federal program that explicitly promotes co-ops.

Local Policy Opportunities

The enormous diversity of local land use and finance law is beyond the scope of this website. However, there are several universal policy principles that should be considered in regard to limited equity housing cooperatives.. State enabling legislation, where it exists, is key to encouraging additional limited equity housing cooperatives. Local laws should be structured to complement this legislation. Care must be taken to prevent local legislation that runs counter to the fundamental tenets of LEHCs. One example of a detrimental local policy would be a provision that allows co-ops to sell vacant units on the market to families with up to 165% of the median area income.

At the local level, community organizations can play a key role in by combing cooperative housing with other strategies, such as community land trusts. The ability to combine strategies depends both on the prevailing local conditions as well as the capacity of the organizations involved to maintain multiple strategies.

State Policy Opportunities

Policy opportunities will vary by state. Various types of legislation, highlighted elsewhere in the tool, can create conditions that encourage the development of cooperative housing. There are additional regulatory and financing policy options that can improve these conditions.

In New York, there is intensive regulation on co-ops of all kinds because there are so many of them. Regulations require disclosure since they sell stock. This is an important consumer protection: it also challenges the co-op development process. Various types of tenant-sponsored co-ops have been able to exempt themselves from this disclosure through a "no-action letter." Legal services groups have continuously negotiated with the Attorney General to get different types of LEHCs exempt. Such disclosure requirements actually can make or break the efforts to become a co-op. Up to 800 pages of documentation is required and legal and financial experts are necessary. One building was asked for two years of financial statements as part of the process. The tenants had purchased the building recently, and did not have any financial history (the building was owned by the city) and that means they would need to wait 2 years before becoming a co-op if they cannot get an exemption.

Financing

Some states, including California, Hawaii and Nevada, have laws that are favorable to co-op mortgages. And while there are no specific programs in New York State that promote co-ops, the housing trust fund and other housing finance tools all allow co-ops. Elsewhere, limited familiarity with the co-op model often inhibits finance opportunities. Thus, advocates must undertake vigorous public education campaigns. Other states, including California, Hawaii and Nevada have co-op laws that provide encouraging conditions for co-op finance.

Case Studies

History of Limited Equity Housing Co-ops in New York

New York City faced serious housing problems in the late 1960s. The Mitchell-Lama Housing Program was created in 1955 to build affordable housing for middle-income residents, but the city's affordable housing stock for low-income residents was deteriorating rapidly due to a vanishing tax base, corporate disinvestment, and increasing social problems. A wave of abandonment by landlords of their deteriorating buildings ensued. They neglected their maintenance responsibilities and refused to pay tax assessments and other fees to the city. By 1992, the city acquired through default 45,000 residential units, most of which were in low-income, minority neighborhoods.

To some, the city did not make a much better landlord than the landlords it had replaced. Once a building came into receivership, it sometimes took months for the city to begin collecting rent and managing the building. Stories were reported of people freezing to death in city-owned buildings. Efforts to form co-ops were initiated by tenants of these buildings out of frustration with the city. In Harlem, where the tenant population was dominated by the African American community, tenants perceived their neglect by city agencies to be driven by racial prejudice and pushed tenant ownership as a direct solution.

In the 25 years since, tenants and advocacy groups like The Urban Homesteading Assistance Board have taken control of more than 1,300 buildings. Two of the most noted programs grown from their efforts include the Community Management Program (CMP) which sold buildings to nonprofit organizations, and the Tenant Interim Lease program (TIL) which sold buildings to tenant associations.

TIL, through which most limited equity co-ops in New York were developed, started in 1978. Through it, tenants lease their building from the city for a period during which they demonstrate their ability to manage and improve the building and obtain financing and insurance. While some buildings have failed to move from TIL to ownership due to financial or leadership problems, the majority of tenant associations in TIL have succeeded in purchasing their buildings to become a LEHC. Recently, the city has transitioned TIL into a "third party transfer" program through which distressed buildings are first transferred to a nonprofit holding group during foreclosure and then to another nonprofit for rehabilitation and co-op conversion.

After 20 years of operation, the New York City Council celebrated its re-commitment to the TIL Program as the most effective long-range solution to properties that were foreclosed. Its $75 million annual investment has helped clean up buildings and neighborhoods, and cultivated civic pride in residents.

Currently, there are more than 1,300 LEHCs in New York City, comprising tens of thousands of units. The generation of co-ops that emerged in the late 1970s and 1980s played a key role in preventing affordable housing stock from disappearing in the current inflated housing market.

Pride of Ownership for the Price of Rent in Harlem

The broader trend in New York City has also been felt in Harlem. The earliest co-op in Harlem dates back to the Harlem Renaissance. Black leaders like A. Philip Randolph and Adam Clayton Powell acknowledged the racism that prevented blacks from obtaining mortgages. They advocated group ownership. The more than

300 LEHCs in Harlem today reflects the strong tradition in housing advocacy from the 1920s and make limited equity housing cooperatives an effective model for community stability. Today, the cooperative movement in New York secures a significant portion of the affordable market. While the recent economic expansion challenges the affordability of all types of housing in New York, LEHCs remain an anchor for low-income housing in Harlem.

Resources

Technical Assistance Providers

1. National Housing Survey 2000 Census Data
phone: (301) 457-3199
email: ahsm@census.gov

2. Ann Henderson & Andy Reicher
Urban Homesteading Assistance Board (UHAB)
phone: (212) 479-3300
email: reicher@uhab.org

3. U.S. Department of Housing & Urban Development (HUD)
Information Center
phone: (202) 523-4400

4. National Association of Housing Cooperatives
1614 King Street
Alexandria, VA 22314
phone: (703) 549-5201
Terry Lankford - Director of Marketing and Membership
(202) 383-5478 email: terri@coophousing.org

5. Herb Cooper Levy, Executive Director
Robert Pierre Johnson Housing Development Corporation
2666 Military Road
Arlington, VA 22207
Phone: (703) 528-5606x13
Fax: (703) 351-9754
email: Herbcl2@aol.com

6. The Center for Cooperative Housing
1614 King Street
Alexandria, VA 22314
Phone: 703-684-3185
Fax: 703-549-5204

7. Cooperative Housing Coalition
1401 Eye Street, NW
Suite 700
Washington, DC 20005
(202) 336-7750
email: tlewis@coophousingcoalition.org

8. We Own.Net
by Association for Resident Control of Housing -
781-777-1119
email: ta@weown.net

9. CUNY Center for Human Environments
Susan Saegert
212-817-1886
email: susan saegert@aol.com; ssaegert@gc.cuny.edu

note: National Cooperative Bank is the umbrella organization for the NCB Development Corporation and the National Cooperative Business Association

10. National Cooperative Bank
1725 eye Street, NW, Suite 600
Washington, DC 20006
Phone: (800) 955-9622
(202) 336-7700
www.ncb.com

11. National Cooperative Business Association
1401 New York Avenue, NW, Suite 1100
Washington, DC 20005
Phone: (202) 638-6222
Fax: (202) 638-1374
www.ncba.coop

12. National Cooperative Bank Development Corporation
1725 Eye Street, NW, Suite 600
Washington, DC 20006
Phone: (202) 336-7680
Fax: (202) 336-7804

Additional Reading Materials

Heskin, Allan *The Struggle for Community*
Available through **National Cooperative Business Association**
Item #: 88T
Price: $24.95
Multi-ethnic, working class tenants in Los Angeles successfully fought displacement by a proposed freeway and wound up creating a housing co-op. How are tenants empowered? What are the roles of class, ethnicity and gender in community struggles? (195 pages; softbound; Westview Press)

Heskin and Leavitt, *The Hidden History of Housing Co-ops*

Contains background info/partial case studies on Brooklyn (Utica Ave), p.165, and Harlem, p.169; general info on city program, TIL, and history of Harlem co-ops

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Lategola, A.R. *Paradise For Sale*
Available through **National Cooperative Business Association**
Item #: R32
Price: $10.00
Tenant organizing and attempted cooperative conversion at Paradise Manor Apartments, a low-income housing complex in a neighborhood notorious for crime and drug problems. Puts a human face on the struggle of inner city residents to take control of a deplorable housing situation, and shows how federal housing policies and housing development professionals can help or hinder the efforts of low-income people to improve their housing, their neighborhoods, and their lives. (1996; 47 pages; spiral back; Center for Cooperatives, University of California)

Mushrush, Paula, Mark A. Larson, and Jerry D. Kraus *Social Benefits of Cooperative Housing*
Available through **National Cooperative Business Association**
Item #: R35
Price: $10.00
By comparing the lives of residents in three models of Section 8 affordable housing, a cooperative complex, a traditional rental complex, and dispersed rental "voucher" housing units, the authors make a compelling case for cooperative housing. This study should inform the work of both affordable housing developers and policy-makers as they look for new and better ways to support low-income families. (1997; 25 pages; spiral back; Center for Cooperatives, University of California)

Tucker, Thomas D., *Converting Mobile Home Parks into Cooperatives*
Available through **National Cooperative Business Association**
Item #: 82N
Price: $6.00
Case studies of the conversion of rental mobile home parks into cooperatives which offers a way to control costs and operations for residents, financial opportunities for owners and developers, and affordable housing for the community. (1983; 67 pages; softbound; National Cooperative Bank)

National Association of Housing Cooperative publications
DeGraphenreed, John W. *The Conversions of Public Housing Units into a Limited Equity Housing Cooperative in Nashville, Tennessee, Under the Homeownership Demonstration Program*

Thompson, David J., ***Renters Fight Back and Find Their Freedom: A Senior Mobile Home Park Goes Co-op***

Willcox, Roger, ***Mobile Home Park Cooperatives: Today's Most Affordable Housing***

Other Appendices

Rochdale Cooperative Principles

The Rochdale Cooperative Principles have served as a covenant for cooperative development since 1966. They are excerpted below.

The Rochdale Cooperative Principles

(Wording approved by International Cooperative Alliance in 1966)

- 1Membership of a cooperative society should be voluntary and available without artificial restriction or any social, political, racial or religious discrimination, to all persons who can make use of its services and are willing to accept the responsibilities of membership.
- 2Cooperative societies are democratic organizations. Their affairs should be administered by persons elected or appointed in manner agreed by the members and accountable to them. Members of primary societies should enjoy equal rights of voting (one member, one vote) and participation in decisions affecting their societies. In other than primary societies the administration should be conducted on a democratic basis in a suitable form.
- 3Share capital should only receive a strictly limited rate of interest.
- 4The economic results arising out of the operations of a society belong to the members of that society and should be distributed in such a manner as would avoid one member gaining at the expense of others. This may be done by decision of the members as follows: (a) by provision for development of the business of the cooperative; (b) by provision of common services; or, (c) by distribution among the members in proportion to their transactions with the society.
- 5All cooperative societies should make provision for the education of their members, officers, and employees and of the general public in the principles and techniques of cooperation, both economic and democratic.
- 6All cooperative organizations, in order to best serve the interest of their members and their communities, should actively cooperate in every practical way with other cooperatives at local, national, and international levels.

In Other Words

- 1Open membership

- 2Economic democracy
- 3Limited return on invested capital
- 4Patronage rebates
- 5Education
- 6Cooperation among cooperatives

Articles of Incorporation

There is no requirement that the cooperative be incorporated under any particular state statute.

(1) In many states there is no appropriate legislation on the subject of cooperatives; while in others, legislation dealing with cooperative corporations relates to agricultural and marketing cooperatives, and is not applicable to housing cooperatives. Even where state statutes dealing with cooperative corporations permit housing cooperatives, the circumstances of the case may make incorporation there under undesirable.

(2) In the absence of applicable legislation, if the general incorporation statutes permit incorporation of the cooperative pursuant to the FHA model form, such incorporation is unobjectionable. But if appropriate "cooperative" or "non-profit" incorporation legislation has been enacted, incorporation should normally be affected under such legislation.

(3) Determination of the statutory requirements in a given state, and determination of the specific changes in the model form of Certificate of Incorporation needed as a result of such statutes, is a responsibility of the Regional Counsel. Changes in the certificate of incorporation required to meet statutory requirements may be approved by the Director on the recommendation of the Area Counsel. Determination of the statutory requirements in a given state and of the specific changes in the model form of Articles of Incorporation needed as a result of such statutes, as well as the acceptability of other changes proposed by the sponsor or counsel for the cooperative, is a responsibility of the Area Counsel. Such changes may be approved by the Director on the recommendation of the Area Counsel.

(4) The introductory wording in all certificates of incorporation will, of course, vary from state to state to comply with local procedures.

(5) It is preferred that the Commissioner's controls be based on a contract (Regulatory Agreement) rather than on the ownership of preferred stock. Therefore, the skeletal forms of Certificate of Incorporation should be used unless some valid reason exists for the controls to be evidenced via the ownership of preferred stock, in which case the longer forms of Certificate of Incorporation should be used, as described below.

(6) The par value of the common stock or membership may equal the total amount necessary to complete the project over and above the mortgage proceeds, plus the working capital deposit requirement if any. It is possible, however, for the necessary cash to be obtained partly from the sale of stock and partly from other paid-in or donated capital, provided that at time of closing it is shown that the cash is unencumbered corporate property. It is required that each cooperative member be issued a membership certificate or one or more shares of stock.

Sample Cooperative Bylaws

Editors Note: Following are the bylaws of a Massachusetts Limited Equity Co-op in a Tax Credit deal. This co-op was set up so that residents would be involved from the beginning -- even before all the residents moved in. This document is not a substitute

for legal counsel, but it is a good starting point for developing bylaws.

To see the bylaws, click here.

Resale controls - examples of provisions

Some resale controls are stricter in their allowing buildup of equity. Equity buildup can be limited to:

- one dollar plus the value of the original down payment amount;
- the original down payment plus inflation on the down payment amount, usually specifying a specific formula for determining inflation;
- the original down payment amount, plus an inflation allowance, plus the original market value less depreciation of any approved improvements made to the unit; or
- one of the above methods plus an amount that can be attributed to the share of the mortgage principal paid by the member as part of the monthly carrying charge.

Operating budget - considerations

Excerpted from INITIAL OPERATING BUDGET AND INITIAL SCHEDULE OF CARRYING CHARGES, HUD FORM NO. 93240, (APPLICABLE TO ALL COOPERATIVES). Editors note: this information pertains to a budget from developed by HUD for creating an operational budget for a cooperative housing project. There are general lessons for consideration that can be extracted from the document.