

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
HOUSING PRODUCTION AND MORTGAGE CREDIT - FHA

TRANSMITTAL No.2

February 24, 1976

1. This Transmittal Transmits:  
Revision to HUD Handbook 4550.1, Basic Cooperative Housing Insurance Handbook.
2. Explanation of Material Transmitted:  
Paragraph 1-8 is revised to reflect an increase in the maximum high cost percentage allowance from 45% to 75% in accordance with new legislation, Public Law 94-173 dated December 23, 1975.
3. Filing Instructions:  

Remove: Pages 1-5 and 1-6 dated 11/74	Insert: Pages 1-5 and 1-6 Revised pages dated 2/76
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Assistant Secretary for Housing  
Production and Mortgage  
Credit--Federal Housing Commissioner

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FOREWORD

This Handbook contains the basic procedures for organizing a cooperative housing corporation in accordance with the provisions of the National Housing Act. While the organization of a cooperative is the same under all Sections of the Act, this Handbook specifically relates to the unsubsidized Sections 213 and 221(d)(3) Market Interest Rate programs which are identical except for family unit limitations and the maximum insurable mortgage.

Most of the model forms contained herein are also applicable to the Section 236 program as will be noted in the captions on a number of forms which are common to all cooperatives. Procedural differences which are necessitated by the application of interest reduction, rent supplement payments, and assistance by local housing authorities are set forth in the Basic Section 236 Handbook (4510.1) and the Rent Supplement Handbook (4520.1).

The Handbook is written to reflect the fact that regardless of approach (Presale Management Type, Investor-Sponsor, Non-Profit Sponsor or by conversion of a rental property) the ultimate objective is to create a Management Type cooperative. (Only in the Presale Management Type does a Management Type cooperative mortgagor exist from the inception of the project.) The Management Type cooperative, therefore, is discussed in considerable detail and is incorporated by reference in all other approaches.

Each approach to organizing a cooperative is described in separate Handbooks, as follows:

4550.2, "Presale Management Type Cooperatives"

- 4550.3, "Existing Construction (Conversions)"
- 4550.4, "Supplementary Cooperative Loans"
- 4550.5, "Investor Sponsor and Non-Profit Sponsorship of Housing Cooperatives"
- 4550.6, "Sales Type Cooperatives"

Each Handbook contains the administrative requirements, underwriting procedures, and an appendix of model forms applicable to the approach contained therein. A numerical reference to applicable FHA Regulations is included at the beginning of each handbook, also.

A listing of previous HUD issuances cancelled by these handbooks is contained herein.

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Copies of this handbook should be made available to prospective sponsors who are interested in providing multifamily housing by means of a cooperative approach. They will gain from it an understanding of the factors involved in organizing cooperative housing corporations and of the criteria of sponsorship organizations.

References:

- (1) 4445.1 - Underwriting - Technical Direction for Multifamily Mortgage Insurance
- (2) 4550.6 - Sales Type Cooperative Handbook
- (3) 4515.1\* - Section 235(j) Basic Instructions
- (4) 4545.1\* - Section 207(m) Handbook
- (5) HM 4371.2 - Cooperative Accounting Handbook--Manual Uniform System of Accounts for Cooperative Housing Corporations Using Manual Accounting Systems
- (6) HM 4371.3 - Cooperative Accounting Handbook--Computer Uniform System of Accounts for Cooperative Housing Corporations Using Computer Accounting Systems
- (7) Internal Revenue Service, Publication 523, "Selling Your Home."
- (8) 4550.5\* - Investor-Sponsor and Non-Profit Sponsorship of Housing Cooperatives Handbook
- (9) 4550.2 - Presale Management Type Cooperatives Handbook

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Cancellations: Handbooks numbered 4550.1, 4550.2, 4550.3, 4550.4, 4550.5 and 4550.6 cancel the following portions of Volume VI, Book 2,

of the FHA Manual.

Appendices IV-1, 2, 3, 4, 5, 6, 7  
Paragraph 63402.17-a(1)  
Paragraph 63511-(exceptions)  
Paragraph 63608.6-Note  
Paragraph 63608.6k  
Paragraph 63608.6-o-Note  
Paragraph 63608.6-p-Note  
Paragraph 63616 thru 63616.6

The following FHA Manual, Volume VII, Book 2 references are cancelled: Paragraph 72435.2 and Table 1, Paragraph 72456 thru 72456.19, Paragraph 72514.2 and 3, Paragraphs 72627 thru 72627.2, 72628 thru 72628.2, 72632, 72717 thru 72717.1, 72718 thru 72718.3, 72724 thru 72724.2, 72933 thru 72933.1, 72934 thru 72937, 72943 thru 72945, 72946 thru 72946.5, 72961 thru 72961.6, 72963 thru 72963.5, 73050 thru 73059.8, 73060 thru 73069.4, 73080 thru 73087.7, and 73087.30 thru 73087.36.

Circular HPMC-FHA 4200.11 - Mortgage Insurance on Cooperative  
Mobile Home Parks  
Dated January 4, 1971



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\*See Figure B of Chapter 3 for Model Form





CHAPTER 1. COOPERATIVE HOUSING INSURANCE PROGRAMS

SECTION 1. GENERAL CHARACTERISTICS

1-1. COOPERATIVE (SUMMARY EXPLANATION). "Cooperative" as it is applied to housing means: co-operative (joint operation) of a housing development by those who live in it. All of the property of a cooperative housing development is owned by a corporation. The corporation's "Articles of Incorporation" and "By-Laws" are specially designed so the corporation can be owned and operated by its members (stockholders). A member of a cooperative does not directly own his dwelling unit; he owns a membership certificate or stock in the corporation which carries with it the exclusive right to occupy a dwelling unit and to participate in the operation of the corporation directly as an elected Board member or indirectly as a voter. The law gives a corporation virtually the same rights and imposes the same responsibilities on it as a human being. The law permits only the elected Board to officially act for the corporation. The purpose of a board is to eliminate one-man decisions in corporations. The board is kept small in number (usually 5 or 7) so the membership can elect its most reasonable and talented people to make decisions.

- a. A Cooperative is a Unique Form of Homeownership in that the cooperative corporation holds title to the dwelling units and directly assumes the mortgage, tax and other obligations necessary to finance and operate the development, thereby, relieving the members from any direct liability for those items.
- b. Each Member Signs a Three Year Occupancy Agreement with the cooperative corporation. The agreement automatically renews itself at the end of the three year period if the member is not in violation of the rules adopted by the board of directors or given notice to leave.
- c. Members Support the Cooperative Mortgagor Corporation through their occupancy agreements, which eliminates the necessity for each member to be an individual mortgagor under a mortgage contract.
- d. Each Member Pays His Proportionate Share of a budget that contains an estimate by the board of directors of the annual cost to operate the corporation. If the budget is overestimated each member is entitled to his proportionate share of what is called a "patronage refund".

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- e. Each Member is Entitled to his proportionate share of the real estate taxes and mortgage interest paid by the corporation for use on his personal income tax statement.

- f. If All of the Assets of the Cooperative Corporation are Sold the members in occupancy at that time are entitled to their proportionate share of the amount remaining after all obligations have been paid.
  - g. If a Member Decides to Leave the Cooperative his membership certificate or stock can be sold in accordance with a transfer value and rules set forth in the By-Laws.
- 1-2. BASIS OF OWNERSHIP (SUMMARY). The Articles of Incorporation and By-Laws of a cooperative corporation must be approved by the corporation commission of the State in which it is incorporated before it can legally do business. The By-Laws spell out how the members relate to the corporation and how the governing board of directors will be elected or removed by a majority vote of the membership.
- a. A Membership Certificate is a certificate (like stock) showing evidence of ownership in a cooperative corporation. Rights under the certificate are usually governed by personal property laws.
  - b. An Occupancy Agreement is a contract between each member and the corporation that spells out the rights and obligations of the member to the corporation and the corporation to the member. It basically gives the member an exclusive right to occupy a unit, participate in the government of the corporation, receive tax benefits and equity increases in return for financial and personal support of the corporation. The Occupancy Agreement together with the membership certificate is the basis of cooperative ownership.
  - c. A Subscription Agreement is a document used to sell a membership in a cooperative.
  - d. A Proportionate Share is a percentage developed by dividing the valuation placed on a dwelling unit by the total valuation of the project at the time the cooperative corporation takes title to the property. The percentage attaches to each unit and determines the share of the annual budget to

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be borne by the member living in the unit, his share of the annual amount paid by the cooperative for real estate tax and mortgage interest for his personal tax report and his share of the proceeds, if any, when the project is sold.

- e. The Mortgagor is the cooperative corporation.
- f. The Monthly Charge is the proportionate share of all costs including the mortgage.

- g. Real Estate Taxes are assessed on the property of the cooperative corporation.
- h. Each Member has one vote in the affairs of the cooperative.
- i. The Mortgage Term of a cooperative corporation is usually 40 years. The member is not a mortgagor.
- j. Closing or Settlement Costs are costs in addition to the price of the corporate property including mortgage service charge, title search, insurance and transfer of ownership charges. They are paid when the cooperative first purchases the property. Only a small transfer fee is charged to transfer future membership in the cooperative.
- k. Equity is the increase in the value of a membership certificate over and above the initial or "down payment" resulting from members monthly contribution toward payment of the corporate mortgage.
- l. Subscription or Down Payment funds are required to be held in escrow unused until the viable cooperative is assured. Transfer of membership funds are sometimes escrowed until the transfer is complete.

1-3. BASIC INSURANCE PROGRAMS UNDER SECTION 213.

- a. Management Type Cooperatives.
  - (1) Presale Approach (initiated as a cooperative mortgagor).
  - (2) Investor-Sponsor (initiated with an investor mortgagor entity for sale to a cooperative mortgagor corporation).
  - (3) Conversion approach (acquisition of existing projects by a cooperative mortgagor corporation).

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- (4) Transfer of Physical Assets (transfer of a project insured under some other section of the Act through assumption of the assets and liabilities).
  - b. Sales Type (initiated by a cooperative corporation for sale and conveyance of dwelling units to individual purchasers).
  - c. Mobile Home Park Cooperatives (ownership of the park spaces and community facilities by a management type cooperative corporation).
  - d. Supplementary Loans (available to management type

cooperatives for repairs and for financing the resales of cooperative membership certificates).

1-4. BASIC INSURANCE PROGRAMS TO ORGANIZE A COOPERATIVE UNDER SECTION 221(d)(3) MARKET INTEREST RATE AND SECTION 236.

- a. Pre-Sale Cooperative (initiated with a cooperative corporation mortgagor).
- b. Investor-Sponsor (initiated with an entity that is regulated like a Limited Dividend corporation mortgagor).
- c. Non-Profit Sponsored (initiated with a non-profit corporation mortgagor).

1-5. CHARACTERISTICS OF THE INSURANCE APPROACHES TO ORGANIZING A COOPERATIVE. The term "Management Type" refers to characteristic of all cooperatives from the time they come into existence as a cooperative mortgagor (administration and control of management is under the auspices of the cooperative) i.e., in the Investor Sponsored approach it is a management type cooperative mortgagor that acquires the project from the Investor-Sponsor mortgagor.

\*1-6. MORTGAGE LIMITS.

Section 213-98% of FHA estimate of cost.  
Section 221-100% of FHA estimate of cost.  
Section 236-100% of FHA estimate of cost.

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\* (Investor-Sponsor Mortgagor under Section 213 may obtain a 90% Mortgage which is increased to the above limits upon sale to cooperative mortgagor). A 100% mortgage is available under Section 221. However, 10% is held in escrow to reduce the mortgage to 90% if the project is not sold to a cooperative. The sum of the per-unit limit under the appropriate section of the National Housing Act.

1-7. PER-UNIT LIMITS UNDER SECTION 213.

	Non-Elevator	Elevator
0-BR	\$19,500	\$22,500
1-BR	21,600	25,200
2-BR	25,800	30,900
3-BR	31,800	28,700
4-BR, or more	36,000	43,758

1-8. PER-UNIT LIMITS UNDER SECTION 221(d)(3) MARKET INTEREST RATE AND SECTION 236.

Non-Elevator                      Elevator

0-BR	\$16,860	\$19,680
1-BR	18,648	22,356
2-BR	22,356	26,496
3-BR	28,152	33,120
4-BR, or more	31,884	38,400

NOTE: The Assistant Secretary-FHA Commissioner may increase the foregoing dollar amount limitations by an amount not to exceed 50 percent in any geographical area where he finds \* cost levels so require.

- 1-9. COOPERATIVE HOUSING MORTGAGE INSURANCE. Mortgages are insured by HUD on cooperative housing projects of five or more dwelling units to be occupied by members of nonprofit cooperative ownership housing corporations under Section 213 of the National Housing Act. These insured loans may be used to finance: construction of a project; rehabilitaiton and acquisition of an

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existing project by a cooperative corporation; improvement or repair of a project already owned by the cooperative corporation, and resale of individual memberships; construction of projects of individual family dwellings that will be bought by individual members with separate insured mortgages; and construction or rehabilitation of projects that the owners intend to sell to nonprofit cooperatives. Insured loans under Sections 221 and 236 are primarily restricted to new construction and substantial rehabilitation.

- 1-10. ELIGIBILITY OF MORTGAGORS. Applicants may be nonprofit cooperative-ownership housing corporations or trusts (with permanent occupancy of the dwellings restricted to the corporation members or the trust beneficiaries); nonprofit corporation or trusts organized to construct homes for members of the corporation or beneficiaries of the trust; qualified sponsors who intend to sell the project to a nonprofit corporation or trust. Application is made through a lending institution approved by HUD as a mortgagee.

- 1-11. COOPERATIVE HOUSING INSURED UNDER SECTION 221(d)(3) MARKET INTEREST RATE. Cooperatives are eligible for mortgage insurance under this Section of the National Housing Act. Except for a few modifications the policies, forms and procedures which have been worked out over the years for the insurance of cooperative mortgages under Section 213 are also applicable to Section 221 Market Interest Rate cooperatives.

a. The principal point requiring a different approach

from Section 213 is the limitations on the mortgage amount and a loan ratio of 100% of the Replacement Cost.

- b. The three types of mortgage transactions applicable to the Section 221 cooperative program are:
- (1) Management Type Cooperatives with a Presale Requirement (Section 221). The basic procedures under this approach are the same as in Section 213 and the same forms of Commitment for Insurance (Forms FHA 3206 and FHA 3209) are used. \*
  - (2) Purchase of Nonprofit Sponsored Projects by a Management Type Cooperative (Section 221). This procedure allows properly motivated nonprofit groups to initiate projects intended for transfer to cooperative ownership after completion of construction and sale of the necessary cooperative memberships.

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- (3) Investor-Sponsor. In Section 221(d)(3) Market Interest Rate cases initiated on an Investor-Sponsor basis:
  - (a) The Investor-Sponsor entity is organized with requirements similar to a limited distribution mortgagor insofar as any project operational income is concerned.
  - (b) An escrow equal to the difference between the maximum mortgage amount available to the cooperative and the lesser amount of mortgage funds available to the investor-sponsor, will be held by the mortgagee and will not be paid to the investor-sponsor unless the project is converted to a cooperative form of operation within two years from the date of completion.

1-12. COOPERATIVE HOUSING FOR LOWER INCOME FAMILIES UNDER SECTION 236. Section 236 establishes for lower income families a housing assistance program in the form of periodic interest reduction payments by the HUD-FHA to the mortgagee. The details of this program are set forth in the Section 236 Handbook. The model forms and documents (except for special language concerning income limitations) and the approaches to organizing a Section 236 cooperative are similar to the Section 221(d)(3) Market Interest Rate Program.

1-13. ESTABLISHING ELIGIBILITY FOR FUTURE INSURANCE.

- a. The Section 213 Statute does not require the project

to have been previously covered by an FHA-insure mortgage, but does require in cases where construction was commenced after September 23, 1959, that the construction must have been subject to HUD inspection and that prevailing wage requirements must have been complied with. A procedure has therefore been established which permits these statutory eligibility requirements to be complied with in those cases where the structures are not to be constructed with HUD-insured financing, but where the parties which to establish statutory eligibility to obtain insurance at some future time under the provisions of Section 213(i).

- b. This Procedure requires the use of FHA Application Form No. 3201, specifying insurance upon completion (Management Type). Language should be typed on its face stating that although a wage determination may be applied for pursuant thereto and that an inspection fee will be collected based on the amount of the application, such application will be subjected to appropriate underwriting processing. Such

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(1-13) underwriting processing shall be limited to consideration of acceptability of the proposed project under current HUD location and property standards. The amount applied for, on which the fees are based, should bear a reasonable relationship to the probable construction cost. Thus, the form will be utilized as a procedure making possible the determination of eligibility for subsequent transfer to an application under Section 213(i) of the Act provided all other prerequisites then applicable are met.

- (1) Upon filing the application, an application fee will be required as in all other Management Type projects and an inspection fee must also be paid prior to the commencement of construction computed on the basis of \$5.00 per thousand of the amount applied for.
- (2) If a mortgage is subsequently insured under Section 213(i), the fees thus paid will be credited against those required under Section 213(i) processing.
- (3) Language should be included in Application Form 3201 to the effect that the parties understand that the HUD-FHA by accepting same is not obligated in any way to issue a commitment, and that, if it at some future time does so, all processing and underwriting determinations, including the mortgage amount, etc., will be accomplished in accordance with such policies and

procedures as the HUD-FHA may, at that time, determine to be applicable.

c. The Sponsors should be advised in writing as follows:

- (1) "This will acknowledge receipt of the application filed by you in the above case for the sole purpose of enabling you to establish statutory eligibility pursuant to Section 213(i) of the Nation 1 Housing Act, as amended. It is to be understood that no commitment will be issued pursuant thereto and, if a request is later made by you for transfer of this application to said Section 213(i), such application will be accepted and processed subject to the then prevailing HUD-FHA requirements and procedures, and subject to such fees as may be payable at that time. The application and inspection fees which have been paid will be credited toward the fees then payable.

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- (2) It is to be understood that prior to commencement of construction, all of the following requirements must be complied with in a manner satisfactory to the Assistant Secretary-FHA Commissioner:
  - (a) The Drawings and Specifications for the project must have been approved by HUD-FHA.
  - (b) The project shall be completed strictly in accordance with said Drawings and Specifications except as they may be modified by changes formally accepted in writing by HUD-FHA.
  - (c) Any contract or subcontract executed for the performance of the construction of the project shall comply with all applicable labor standards and provisions of the regulations of the Secretary of Labor and shall contain the Equal Opportunity Clause in the HUD-FHA required form.
  - (d) Prior to the beginning of construction the applicant shall deliver to the Assistant Secretary-FHA Commissioner the contractor's certification regarding prevailing wage requirements, HUD-FHA Form 2482 and the general contractor's and subcontractor's statement, HUD-FHA Form 2482-A.
  - (e) During the course of construction, HUD-FHA shall at all times have access to the



property and the right to inspect the progress of construction. If the project is not completed within a reasonable time, HUD-FHA may require the payment of an additional sum to cover the estimated cost of further inspection required by reason of the delay.

- (3) Nothing herein contained shall be construed as an express or implied agreement on the part of HUD-FHA to issue any commitment.

1-14. SUPPLEMENTARY COOPERATIVE LOANS.

- a. For Improvements or Repairs. A cooperative insured under Section 213 may obtain an insured supplementary loan to

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(1-14) finance improvements or repairs on the property covered by the mortgage or to acquire community facilities. The supplementary loan procedure is limited to management type cooperatives, the maturity cannot exceed the remaining term of the mortgage (except as indicated below) and the loan amount when added to the balance due on the mortgage cannot exceed the original principal amount of the mortgage, unless improvements or additional community facilities are involved, in which case see Section 213.7(1)(1) of the Regulations. This legislation differs somewhat from the home improvement loans under Section 220 in that the loan will normally be made in connection with a project already covered by an insured mortgage loan and will thus be simpler insofar as eligibility and loan security questions are concerned and will in some respects resemble an "open end" loan. Properly implemented it will be advantageous to HUD as well as the occupants by enabling the mortgage security to be repaired and improved when deemed necessary or advisable by HUD.

- b. For Financing Membership Resales.

- (1) The 1964 amendment to Section 213(j)(1) of the National Housing Act extended insurance for supplementary cooperative loans to include a loan made for the purpose of financing cooperative purchases and resales of memberships which involve increases in equity; but, in such resales the cash down payments by the new members must not be less than those made on the original sales of such memberships. To be eligible for a loan to finance the purchase and sale of a cooperative membership, at least three years must have elapsed since the final endorsement of original

mortgage and the latest insured supplemental cooperative loan for this purpose.

- (2) The Housing and Urban Development Act of 1968 further amended Section 213(j) by authorizing FHA insurance of supplementary loans to housing cooperatives which purchased housing from the Federal Government under uninsured mortgages which represented a part of the purchase price of the housing. Such loans are subject to the usual Section 213(j) supplementary loan limitations, except that the maximum maturity may be up to 10 years beyond the remaining term of the uninsured mortgage where the loan is for major rehabilitation or modernization and the mortgage is more than 20 years old.

1-15. TECHNICAL ADVICE AND ASSISTANCE. "The Commissioner is authorized, under the provisions of Section 213(f), of the National Housing Act with respect to mortgages insured or to be insured under Section 213 to furnish technical advice and assistance in the organization of corporations or trusts of the character described in subsection (a) of this section and in the planning, development, construction and operation of their housing projects." Every effort should be made to provide such advice and assistance. Where the HUD-FHA Director considers it desirable he may request the assistance of the Office of Underwriting Standards. \*

1-16. CONSTRUCTION FEATURES. In order to be successful, a cooperative housing project must be designed so as to be conducive to long term occupancy. Its external design must be attractive and the landscaping should characterize home ownership. Likewise, thought must be used in the interior layout of the structure(s). The lobby (in a highrise) is the point of first impression insofar as the interior is concerned and it should not be skimpy. Once a structure has been built, it is generally impossible to correct layout deficiencies. Some projects have proven to be unsalable on a cooperative basis because the room sizes were too small. This is particularly true where a project was originally designed as a rental and is being converted to a cooperative. The income group to be served has a bearing on the construction features which may be included but all cooperative projects should make adequate provision for community facilities. Skimpiness in construction characteristics should not be tolerated, giving consideration to the fact that occupancy will be by cooperative owners who will normally be anticipating occupancy on a longer term basis than tenants. The members will need adequate space for group activities and will be interested in construction features which will minimize maintenance expense.

- a. Community Facilities. In cooperatives, space should be provided for meetings of the Board of Directors and of the members, as well as other appropriate community facilities to the extent that the economic realities of the undertaking permit. This space should, to the extent practicable, be designed for dual usage so as to furnish recreational as well as meeting facilities. Community facilities are mandatory under sales type projects, as more fully described in Reference (2) of the Foreword.

- b. Commercial Facilities. While the project must be designed principally for residential use, commercial facilities adequate to serve the needs of the occupants may be included. However, there is a preference for projects whose financial stability can be assured without undue reliance upon income from rental of stores, professional suites, offices, laundry concessions or other non-dwelling sources. Rental rates proposed for the commercial facilities should be at least equal to the minimum required to support that portion of the debt service and real estate taxes attributable to commercial facilities.
- 1-17. SINGLE OCCUPANCY UNITS. Section 213(g) of the Act makes specific provision for insurance of housing for single persons. It is therefore possible that a project may contain a high percentage of efficiency units in a special purpose cooperative, such as a cooperative designed for occupancy by elderly persons. While under these circumstances, an entire project could be composed of units for single occupancy, with or without cooking facilities, care must be exercised to guard against transient occupancy. In a normal Section 213 cooperative, emphasis is placed on larger type units, rather than on efficiencies, since continued family occupancy is contemplated.
  - 1-18. COOPERATIVE CHARACTERISTICS.
    - a. Board of Directors. Each member of a cooperative is entitled to one vote, in the election of a Board of Directors and on situations where the By-Laws reserve to the membership the right to vote, regardless of the dollar amount of his investment. The business affairs of the cooperative are conducted by its board of directors. The board of directors is elected by and from the membership. A procedure is provided whereby the members may remove directors should they decide to take such action. It is the responsibility of the board of directors to approve a budget, establish monthly carrying charges, pass upon transfer of membership, establish resale policies, enter into management contracts, promulgate "house rules", etc.

Sometimes boards appoint committees from the membership to assist and advise them in carrying out these functions. A housing cooperative is therefore an incorporated association, jointly owned by the residents, and operated without profit for the benefit of such owners.

- (1-18) b. Initiation and Control of a Cooperative. Cooperative housing projects may be initiated and controlled from their very inception by the consumers who intend to occupy the housing. Some types of cooperatives are in fact formed in this manner. Except in very small projects, however, this is virtually impossible because the successful formation of cooperative housing projects requires a knowledge of many complex skills and the expenditures of considerable sums of money in order to generate a plan to the point that public solicitation can safely be commenced. Therefore, except in rare instances, HUD-FHA does not permit the public to be solicited nor down payments to be collected until the site has been arranged for, detailed architectural plans drawn, projections of construction and operating costs prepared and approved, and the organizational documents prepared and approved.
- (1) Consumer-oriented organizations have been created specifically for the purpose of coordinating all of the foregoing services on behalf of the cooperative to be formed. (See Sponsorship Organizations, Section 2 of this handbook.) Most HUD cooperatives, at the present time, are being formed in this manner.
  - (2) Regardless, however, of the manner in which the cooperatives are initiated, it is required that they all provide for the basic democratic government described above after the projects have become operational. HUD does not permit the sponsor or any other interested party to retain ownership, stock control, or any other interest in the cooperative (unless he were to own an individual membership the same as any other member).
  - (3) The project must be built in a manner which meets HUD minimum property standards and provision is made for HUD inspections during construction. HUD prescribes the form of construction contract which must be used and passes upon the acceptability of many other things, such as title papers, bonds, escrows, construction guarantees, etc.

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- 1-19. NONPROFIT AS IT RELATES TO THE COOPERATIVE AND ITS SPONSORSHIP. The mortgagor under Section 213 (other than an investor-sponsor) is a nonprofit corporation. Member-occupants pay a monthly carrying charge, based on an approved budget, in an amount estimated to be sufficient to meet all costs of maintenance and operation, required reserve deposits and loan servicing costs. While the cooperative mortgagor must be nonprofit, those who contract with the cooperative, such as architects, builders, attorneys, cooperative housing specialists (or organizations which provide all legal, organizational and marketing services), etc., are, of course, entitled to compensation.
- 1-20. APPLICATION OF COST CERTIFICATION TO DIFFERENT COOPERATIVE PROGRAMS. Cost certification is not required in sales type projects nor in existing construction projects insured pursuant to Section 213(i). In management type projects and in investor-sponsor projects the mortgagor corporation is required to make the cost certification for such as the architects fee, builder's fee, cooperative agent's fee, etc. (If there is identity of interest, as determined by the HUD/FHA Director, the builder must also certify as to his cost.)
- 1-21. PRESALE OF UNIT MEMBERSHIPS. The presale requirements vary for each approach to organizing a cooperative. The commitment, however, must reflect the presale requirements established in the section pertaining to the approach being used. If a variance is permitted (such as in the presale management approach), it must be made at some later date, during the sales program, when evidence indicates that it would be safe to do so. If the section pertaining to a particular approach does not specifically allow a variance, \* approval to lower the presale requirement must be obtained from the Office of Underwriting Standards. \*
- 1-22. ESCROWS. The following escrows are required:
- Insurance of Advances - Management and Sales Type: Prior to initial endorsement, the mortgagee will collect the following cash escrows:
- a. A working capital deposit to be maintained and disbursed by the mortgagee in accordance with the terms of the commitment for insurance.
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- b. Funds necessary over and above mortgage proceeds for completion of the project, in an amount to be determined by the Field Office.

- c. Funds to cover the estimated cost of off-site improvements, unless other arrangements satisfactory to HUD have been made. (An Off-Site Bond, FHA Form No, 3213, may be used in lieu of a case escrow deposit.)
  - d. An amount equal to 10 percent of the total advance for legal, organization and marketing fees (in management type cases only), unless 25 percent of the allowance for legal fees is not to be disbursed at initial closing. Such amount will be held by the mortgagee pursuant to the terms of a Holdback Escrow Agreement until final closing.
- 1-23. SAFEGUARDING OF DOWN PAYMENTS. The By-Laws require that all funds collected from member-stockholders be deposited in escrow until such time as they are required to meet the initial closing cash requirements described above.
- 1-24. ASSURANCE OF PERMANENT FINANCING. There shall be no solicitation of memberships in the mortgagor corporation until written assurance of permanent financing has been supplied to HUD.
- 1-25. DOWN PAYMENT REQUIREMENTS.
- a. Section 221 Cooperatives. Although a 100 percent mortgage is possible in the Section 221 program, a cash investment is deemed essential to give the members a sense of cooperative ownership and therefore a minimum cash investment from the subscribers equivalent to 1 percent of the valuation attributable to his unit will be required. Unit valuations are set forth in Article 9 of the Information Bulletin.
  - b. Section 213 Management Type Cooperatives Including Cooperatives Purchasing Investor-Sponsor Projects: HUD-FHA establishes the mortgage amount and the difference between this amount and the total cost of the project must be supplied at closing in order that the loan may be closed on a sound basis. The mortgage amount is limited by the bedroom limitation in addition to the percentage limitation, and therefore substantial down payments may be necessitated depending upon the cost of the project. A

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(1-25) minimum cash investment from the subscribers equivalent to 3 percent of the total cost reflected in column 2 of Article 9 of the Information Bulletin will be required to close the loan transaction. If this produces funds in excess of those required for closing, such excess may be added to the General Operating Reserve or the Reserve for Replacements.

- c. Financing Down Payments: The funds required of the cooperative to close the loan must be paid by the cooperative in cash without any borrowing by the mortgagor. However, there is no objection to the borrowing by individual members provided:
- (1) The required down payment is paid to the cooperative mortgagor in cash;
  - (2) The mortgagor incurs no liability in connection with the individual's borrowing;
  - (3) At least \$100 of the required down payment consists of the subscriber's unborrowed funds;
  - (4) The borrowing is on reasonable terms, preferably by a lender independent of the sponsorship;
  - (5) The transaction is handled in such a manner as not to confer any voting rights on the lender;
  - (6) Any resale of the membership must be in accordance with the provisions of the By-Laws which, among other things, requires approval of the new occupant by the Board of Directors; and
  - (7) In its credit analysis, the FHA will take into account any borrowing of the balance of the down payment in arriving at a determination as to the individual's acceptance from the credit standpoint.
- d. Voluntary Additional Down Payments: FHA Form No. 3232-B, Model Form of Additional Down Payment Agreement, is used by initial subscribers in Sections 213 and 221(d)(3) Market Interest Rate projects who desire to reduce the debt service charge to be included in their monthly payment by voluntarily making larger down payments than those required. The additional payment is applied by the cooperative to reduce the principal amount of the mortgage which would otherwise have been applicable and consequently reduces the amortization and mortgage insurance premiums required

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of the cooperative. The voluntary additional down payments are made prior to closing the cooperative mortgage transaction and operate to reduce the monthly charge to the individual member involved. If the member at some future time transfers from the project and the cooperative exercises its option to purchase his membership, the cooperative will give recognition to the additional down payment in the computation of the transfer value. This FHA Form (3232-B) is designed for use in connection with 40-year mortgages which bear interest at a percentage ranging from 6 percent to 8 1/2 percent. Request for revised figures should be made to the Office of Underwriting Standards where voluntary additional down payments are desired in connection with other than 40-year \*

transactions, or where the interest rate is other than that set out in the table on this form.

- 1-26. TESTING THE MARKET. It is the policy not to permit solicitation prior to issuance of the HUD-FHA commitment and HUD-FHA approval of the organizational documents. The purpose of this limitation is to avoid involvement of the consumer's down payments until such time as there has been a thorough study of the proposal by the HUD-FHA and it appears reasonably likely that the project will, in fact, go forward and certain consumer safeguards have been established. However, there is no intention to preclude interested parties from ascertaining the number of people in the area who would be interested in the development of a particular housing project, provided that individuals do not obligate themselves at that point to join the cooperative. The sponsor cannot collect down payments at the time he is thus testing the market, although he may collect a small amount (not exceeding \$200) to evidence sincerity, provided such sum is refundable at any time at the option of the prospective purchaser.

In such instances, the sponsor should be admonished not to make any representations, oral or written, that there have been any HUD-FHA approvals in connection with the project and should be advised that all deposits must be escrowed in such manner as to fully protect the depositors.

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- 1-27. REQUESTS FOR FEASIBILITY ANALYSIS. The basic Multifamily Housing procedures are applicable. References therein to FHA application Form 2013 should be deemed to be a reference to FHA Form 3201 in cooperative cases. The 3201 form differs in that it contains, among other things, a section on personal benefit expense and an allowance for marketing expense. The required exhibits are also different.
- 1-28. ASSISTANCE PAYMENTS TO MEMBERS OF SECTION 213 COOPERATIVES PURSUANT TO SECTION 235.
- a. While there is no mortgage insurance program available to cooperative members under Section 235, under certain circumstances members of Section 213 cooperatives may receive the benefit of assistance payments provided for under Section 235(b). To qualify for such assistance, the applicant shall be one of the following:
- (1) A member of a Section 213 cooperative project which was constructed or substantially rehabilitated within two years prior to applying for assistance payments. The dwelling must have had no occupant previous to the Section 235 assisted members.



- (2) A member of any existing cooperative, which is currently financed by a mortgage insured under Section 213, who:
  - (a) Qualifies as a displaced family;
  - (b) Is a family that includes five or more minors living in the household;
  - (c) Occupies low-rent public housing at the time the application for assistance is filed.
- (3) A member who acquires membership from a previous member who received Section 235 assistance.
- b. The amount of mortgage attributed to the cooperative unit shall not exceed \$18,000, except that such amount may be increased to \$21,000 in the case of a family of five or more persons occupying a unit containing four or more bedrooms. These amounts may be increased to \$21,000 and \$24,000, respectively, in high cost areas.

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- c. The amount of mortgage attributable to a particular unit is determined by applying the factor set forth in column 3 of paragraph 9 of the Information Bulletin (FHA Form 3241) against the project mortgage amount.
- d. Reference (3) of the Foreword sets forth the general policy and procedural instructions for Section 235. Processing of the applications for assistance for individual cooperative members will be basically in accordance with instructions contained in that reference.
- e. Since the mortgage is insured under Section 213, most of the Section 213 procedural requirements will be applicable. Thus, Application Form 3201 should be used and the commitment will be issued on FHA Form 3206. No modification of Forms 2264-A or 2264-B are required. The underwriting analysis will conform to Section 213 instructions. The usual 90 percent presale requirement also applies. (Assistance payments under Section 235 and 236 may not be combined.)
- f. Those Section 213 subscribers anticipating assistance payments under provisions of Section 235 must, of course, qualify under Section 235 procedures. If the sponsor of the Section 213 project anticipates sales to members requiring such assistance, he should arrange for a reservation of Section 235 funds prior to or contemporaneous with the filing of the Section 213 application. In the process of approving members for the Section 213 cooperative, the Field Office will

determine whether the applicants are entitled to assistance under Section 235 in the manner spelled out in the Section 235 instructions. Forms 3100 and 2900, with supporting exhibits will be required.

- g. Existing documents used in the Section 213 program will be utilized with necessary modifications. Instructions as to the required modifications may be obtained, on a case basis, from the Office of Underwriting Standards.

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1-29. COOPERATIVE MANAGEMENT HOUSING INSURANCE FUND.

- a. Background. When the Section 213 program was enacted in 1950, mortgages insured thereunder were covered by the General Insurance Fund, the same fund which covered the

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(1-29) Section 207 rental program. It was not a mutual fund. To create a new Cooperative Management Housing Insurance Fund (CMHI Fund) Sections 213(k), (l), (m), (n), and (o) were added by Section 208(a) of Public Law 89-117 in 1965. Perfecting amendments were made to Section 213(k) in 1966 and to 213(o) in 1968.

- b. Provisions of the Statute. The mutuality provision applies to management type cooperatives, investor-sponsor projects which have been acquired by a cooperative corporation, and supplementary cooperative loans under the provisions of Section 213(j) relating to property improvement and repair loan or loans covering community facilities. Section 213 sales-type cooperatives are not included and are still covered by the General Insurance Fund. Insurance premiums are paid to HUD for the account of the cooperative insured mortgages and are credited to the CMHI Fund, which is a revolving fund.

- c. Operation of the CMHI Fund. Outstanding commitments and the insurance of any mortgage or loan insured prior to the enactment of the 1965 act have been transferred to the CMHI Fund. Loans to cooperatives (as defined above) insured after August 10, 1965, are automatically included and are assigned project numbers in the "23000" series. Sales type and investor-sponsor projects are assigned numbers in the "30000" series. The statute provides for the establishment of a General Surplus Account and a Participating Reserve Account in the CMHI Fund. Aggregate net income, or net losses sustained, are credited or charged to the two accounts and there may be distributed to the cooperative mortgagor corporation(s) a share of the participating reserve account, in such manner and amount as the Secretary

may determine to be equitable and in accordance with sound actuarial and accounting practices. (Information regarding implementation of these provisions may be found in the FHA Regulations, Section 213.276.)

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## SECTION 2. SPONSORSHIP AND SPONSORSHIP ORGANIZATIONS

### 1-30. SPONSORSHIP.

- a. The Terms Sponsorship, Sponsoring Agent, Consumer Sponsor, Consumer-oriented Sponsor and Servicing Organization, Investor-Sponsor and Nonprofit Sponsor have all been used to describe the entity which helps organize a housing cooperative. The discussion that follows is intended to explain how cooperatives come into existence and to establish criteria that must be met to qualify as a sponsor which can stand in the stead of the prospective owners of a cooperative during its organizational period.
- b. Management Type Cooperative. Regardless of sponsorship, the ultimate goal of the endeavor is to form or convert to, a management type cooperative.
- c. Investor-Sponsor. The investor-sponsor starts as a separate and distinct, profit motivated, mortgagor approved by HUD which rents units on a month-to-month basis until such time as sufficient memberships have been sold and the project is transferred by the investor sponsor to the cooperative in accordance with the requirements of the particular mortgage insurance program. If it is not sold, the project remains a profit motivated rental operation. In these cases the cooperative corporation is organized separately. The Investor-Sponsor may be a profit motivated individual, partnership or corporation.
- d. Non-Profit Sponsor. The non-profit sponsor is a non-profit corporation. It is a separate and distinct mortgagor approved by HUD which rents units on a month-to month basis until such time as sufficient memberships have been sold and the project is transferred by the non-profit sponsor to the cooperative in accordance with the requirements of the particular mortgage insurance program. If it is not sold, the project remains a non-profit rental operation. In these cases the cooperative corporation is organized separately. The non-profit sponsor can only be a corporation.
- e. Presale Management Type Cooperative. A presale management type cooperative differs substantially from the investor and nonprofit sponsored cooperatives. In

the presale management approach, title is held by a cooperative corporation and it becomes a management type cooperative mortgagor from the inception.

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In insurance of construction advances cases, HUD becomes involved as the insurer of the mortgage, after the presale requirement has been met and it endorses the mortgage note for insurance subject to the conditions set forth in its commitment to the lender. At this point in time the presale management cooperative will be functioning with a temporary Board of Directors (called the provisional board).

1-31. PROVISIONAL BOARD OF DIRECTORS

- a. Timing. From inception to such time as the buildings are constructed or rehabilitated, as the case may be, and the cooperative is organized into a functionable entity (called the organizational period) a presale management type cooperative corporation must have a consumer or "consumer-oriented" Provisional Board of Directors to act for it.
- b. Existing Structures. A Provisional Board of Directors must also be used in presale management type cooperatives and in converting existing projects to management type cooperatives under Section 213(i) and in cases where a management type cooperative is acquiring a project from an investor/builder sponsor mortgagor or a limited dividend sponsor mortgagor.
- c. Composition. The Provisional Board may be made up of individuals who are:
  - (1) Members of a non-profit housing foundation trust or public body (as applicable) which provides for coordination of all legal, organizational, marketing and development services activities through a subsidiary organization or by contract with a qualified consumer-oriented organization organized for the sole purpose of providing such services. In such cases, to meet the requirement that the cooperative be represented by an independent attorney, the legal representation must be through a separate contract.
  - (2) Members of a non-profit housing foundation, trust or public body (as applicable) which coordinates the legal, organizational, marketing and development services activities obtained by separate contract from qualified professionals.
  - (3) The principals of a non-profit corporation which provides for legal representation from an

independent attorney and coordinates that activity with organizational, marketing

- (1-31) and development services activities which may be handled by qualified staff personnel or by separate contract with qualified professionals or professional organizations. (See Typical Services provided by Provisional Board.)
- (4) Individuals all of whom have served a minimum of one year on the Board of Directors or have previously served on the Provisional Board of a successful housing cooperative. Acting as a group the individuals will provide for and coordinate the legal, organization, marketing and development services activities by separate contract with qualified professionals or professional organizations.
- (5) Theoretically the provisional board of directors could be composed of people who are subscribers for unit memberships in the proposed cooperative. Pragmatically, however, it is not always possible to find consumers with the desire, the housing expertise and cooperative business acumen, which would be necessary to make up a provisional board of directors (and a working group) capable of carrying out the development services, organizational and marketing tasks that are involved in forming the cooperative. There is marketing tasks that are involved in forming the cooperative. There is nothing to preclude a HUD-FHA Director from approving a provisional board made up of prospective consumers to develop the project and market the memberships, where the expertise is evident. As in all other sponsoring arrangements an independent attorney, architect and management agent must be used. It may be necessary to contract for other professional services. It should be kept in mind that the consumer board members will not only be representing themselves at the bargaining table but also the consumers to whom they will be marketing other unit memberships. While they must be capable of sound bargaining on behalf of the cooperative they must also be sufficiently objective in negotiating with the builder to bring the project to a point of completion. A HUD-FHA Director will, therefore, require an organizational plan and screen the assemblage of consumers and professionals as carefully as he would a professional sponsorship organization. There must be no identity of interest between the provisional board and the builder or the seller

of an existing project or with any other party that would adversely influence the cost of the project.

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- (1-31) d. Qualifications of Provisional Board Members. The provisional made up of no less than three directors who can show evidence of:
- (1) Their ability to bargain in good faith for and on behalf the cooperative and its prospective membership during the organizational period.
  - (2) Sufficient cooperative housing acumen to understand the contracts that they, as a board, will be required to review and execute on behalf of the cooperative.
  - (3) The absence of any identity of interest with the builder, or any other party, which would adversely influence the cost of the project.
- e. Previous Participation. The temporary officers and directors of the provisional board and the agents or agencies to which delegations have been contractually made must have a good record in any previous participation, in any program covered under the National Housing Act or any other business venture.
- f. Certifications. The provisional board members must provide the HUD-FHA Director with the following certifications:
- (1) There is or will be no identity of interest between the cooperative's provisional officers and directors on the one hand and the builder, subcontractors, material suppliers and manufacturers on the other,
  - (2) There is or will be no identity of interest between the provisional board on the one hand and the lender on the other. This does not preclude contracts for services made at arm's-length under the provisions of criterion No. 6 or where an identity of interest is determined by HUD to be beneficial to the cooperative and has been approved by HUD.
  - (3) There is or will be no identity of interest between the provisional officers, directors and the land owner from whom the cooperative has purchased or is to purchase the land upon which the project will be built; unless such identity of interest is beneficial to the cooperative and has been approved by HUD.

- (1-31)      (4) The contracts for the construction of the project and purchase of the land have been or will be negotiated on an arms'-s-length basis.
- (5) The provisional officers and directors of the cooperative understand the sponsorship criteria, will abide by it and will bargain in good faith to develop a consumer cooperative as such is contemplated by the National Housing Act.
- (6) Agents will be selected on the basis of their professional ability. Such agents will further certify that they have no identity of interest with the builder, subcontractors, material suppliers, manufacturers or any other party which would adversely influence the cost of the project.

g. Typical Services which must be Provided for by the Provisional Board.

- (1) Development of all aspects of the project.
- (2) Acquisition of the land.
- (3) Construction or rehabilitation of the improvements.
- (4) Architectural (or engineering if required) services.
- (5) Architectural supervision.
- (6) Legal Services.
- (7) Organizational services.
- (8) Marketing services.
- (9) Management services.
- (10) Educational services.

All of the above services will be provided for by separate contract except in the following situations:

- (1) A Cooperative Agency Agreement will be used where the provisional board enters into contract with a non-profit corporation for organizational services and delegates the authority to such non-profit corporation to coordinate and contract for all of the other nine services listed above.
- (2) Where a non-profit organization provides both the provisional board and additional staff to perform functions, such as the marketing of unit memberships, those functions will be set forth in an agreement of understanding between the non-profit entity and the cooperative entity.

1-32. ORGANIZATIONAL PERIOD

- a. Critical Period. The organizational period of cooperative corporation (from inception until construction or rehabilitation is completed and all of the units are occupied by members) will be the most critical period in its existence. It is during this period of time that the cooperative is legally constituted and the provisional board of directors is empowered by the articles of incorporation to carry out the highly complex business of bargaining and executing contracts on behalf of the cooperative corporation. It is also the period of time when the provisional board is duty bound to market the memberships and organize the cooperative into a sound business operation which can, upon termination of the organizational period, be governed by a succeeding board, elected by and from the membership. The Officer and directors that comprise the provisional board, therefore, must be of high caliber, knowledgeable in cooperative housing and completely dedicated to the interests of the cooperative corporation and the prospective membership they are representing.
- b. Expertise. The organizational period of a cooperative require special legal, organizational, marketing, development and management expertise, which, regardless of the knowledge and dedication of the provisional board, must be obtained mostly from professionals (attorneys, architects and management agents).
- c. Professional Assistance. During the organizational period the provisional board acting as sponsor will normally enter into separate agreements, acceptable to HUD, with one or more professional organizations, in which it has confidence, to negotiate and give legal substance to its policies for acquisition of the land, construction of the dwelling units, organization of the cooperative and marketing of the unit memberships. Legal, organizational, marketing and development fees, established by HUD, are available for payment to organizatins who provide such services.
- d. Allocation of HUD Legal, Organizational, Marketing and Development Services Allowances. In all of the above situations where a separate independent contract with a professional organization is permitted, the organization may perform more than one of the activities of qualified to do. However, it



develop-services comprise both legal and administrative functions. If, for example, a law firm separately contracts for both legal and organizational work there must be a sufficient amount of the organizational allowance remaining to pay the cost of accounting and other administrative functions in the organizational category.

- e. Contractual Detail. Each contract for legal, organizational, marketing and development services, entered into by the provisional board, must contain details which are sufficient to permit a determination of the typical value of the services in the area where the project is located. When the provisional board provides coordination and other development services it will be entitled to a reimbursement of its expenses from the development services allowance. Where the board delegates such responsibilities under circumstances permitted by HUD the development allowance will be paid to the delegate.
- f. Architectural Agreements. Instructions relating to architectural contracts and payments of fees are set forth in Reference (9) of the Foreword (Chapter 4, "Initial Endorsement" and Chapter 9, "Architectural Requirements").

The provisional board should be admonished to select a supervising architect that is in no way associated with the builder or other parties seeking to derive a profit from the project. The supervising architect is, in effect, the professional eye of the provisional board with respect to construction details. It is incumbent upon the field office Director to carefully review past relationships between the proposed supervising architect and the builder prior to approval of the supervising architect. Any savings realized out of architectural or any other agreements entered into by the provisional board must insure to the benefit of the cooperative owner/mortgagor entity.

- g. Evidence of Responsibility. A newly formed agency or sponsorship organization must be able to show evidence to the field office Director of sufficient capital or letter of credit to carry out the responsibilities for which the legal, organizational, marketing and development services fees will be paid.

CHAPTER 2. COOPERATIVE MOBILE HOME PARKS

- 2-1. PURPOSE. To provide instructions for processing applications under Section 207 where the mortgagor is a cooperative association organized for ownership of a mobile home park.
- 2-2. REGULATIONS APPLICABLE. The Section 207 Regulations are applicable in all instances.
- 2-3. TYPES OF COOPERATIVES ELIGIBLE. A Presale Cooperative Management Type is the only type eligible.
- 2-4. GENERAL ELIGIBILITY CRITERIA AND INSTRUCTIONS FOR SPONSORS. Reference (4) of the Foreword sets forth basic information for the sponsor and outlines required exhibits in developing mobile projects.
  - a. Use FHA Form 2013 in lieu of FHA Form 3201 for all stages of processing. Amend this form by adding a box entitled "Cooperative Mortgagor" in the heading. Check this box.
  - b. The Field Office must approve the cooperative organizational and sales documents which include the information bulletin, the charter and by-laws, the subscription agreement and occupancy agreement prior to any solicitation for membership in the cooperative. FHA Regulatory Agreement Form 3225 should be used in place of FHA Form 2466.
  - c. Use FHA Commitment Forms 3206 and 3209 in lieu of FHA Forms 2432 and 2457. Delete any reference to Section 213 on both forms and substitute Section 207.
  - d. Follow the closing instructions in FHA Forms 3257-A or 3257-D in lieu of Form 1022.
  - e. Prior to the initial endorsement of the mortgage, the mortgagor must secure cooperative members approved by HUD-FHA for at least 90 percent of the spaces in the project.
  - f. The Field Office must be certain that the organization of the cooperative, the sale of memberships in the cooperative, the management of the cooperative, and the maintenance of cooperative accounts and records are maintained in accordance with the instructions contained in this Handbook and References (5) or (6) of the Foreword.

CHAPTER 3. BASIC STRUCTURE AND ORGANIZATION OF COOPERATIVE CORPORATIONS INSURED UNDER THE NATIONAL HOUSING ACT

3-1. INTRODUCTION. All cooperative corporations, prior to solicitation for memberships, must obtain HUD approval of the following organizational documents: Articles of Incorporation; By-Laws; Regulatory Agreement; Information Bulletin; Subscription Agreement; Occupancy Agreement and Cooperative Agency Agreement, if any. In the case of Existing Construction projects and cooperatives purchasing Investor-Sponsored projects, a Sales Agreement is also required. In addition, the approval of the Attorney General or other governmental official of such documents may be required in some States.

3-2. MODEL FORMS OF ORGANIZATIONAL DOCUMENTS IN GENERAL.

- a. Model forms of the required organizational documents have been issued. If followed, with such modifications or changes as may be necessitated by local statutes or by conditions peculiar to a specific project, they will meet HUD-FHA requirements and should provide the basis for a sound organization. The legal adequacy of the organizational documents will be determined by the Area HUD Counsel and the Director is responsible for their approval from the administrative standpoint.
- b. In order to expedite the examination of the organizational papers, the parties should be required to submit not only typed copies thereof but also marked-up drafts on the model forms, with changes therein shown by deletions and interlineations.
- c. Any change in the model forms which would have an adverse effect on policies set forth in the Regulations or this Handbook requires the prior approval of the Office of Underwriting Standards. This approval will be given only after submission of the proposed documents with the HUD-FHA Director's recommendations. A brief statement of the reason for each change and citation of state law, if relevant, should accompany these drafts.

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- d. The model forms and documents described in this Chapter of the Handbook are basic in the organization of a management type cooperative. Each section covering a different approach in organizing a cooperative, i.e., Investor-Sponsor, Sales Type, etc., has a model form or document containing the appropriate language or conditions for that approach.

3-3. MODEL FORMS OF INFORMATION BULLETINS, SECTION 213 AND SECTION 221 (d)(3) MARKET INTEREST RATE.

- a. FHA Form No. 3241. This form is used in Insurance of Advances, and Insurance upon Completion cases by all unsubsidized management type cooperative corporations except those purchasing an "Existing Construction project under Section 213(i)" or an "Investor-Sponsored" project.
  - b. FHA Form No. 3241-A. This form is used by Management Type cooperatives purchasing an "Investor-Sponsored" project or an "Existing Construction" project.
- 3-4. GENERAL INSTRUCTIONS APPLICABLE TO ALL INFORMATION BULLETINS. An Information Bulletin is not a formal legal document but it must accurately describe the proposed cooperative and the method in which it is being organized. It must contain general information concerning the cooperative housing concept and direct the attention of the subscribers to the formal documents that legally constitute the corporation. Some of the other items of information that will be covered by it are as follows:
- a. U. S. Income Tax Deductions. The model forms indicate that under normal circumstances, the cooperative members may deduct from their gross income for tax purposes their proportionate share of real estate taxes and mortgage interest paid by the cooperative. The Information Bulletin should not, however, contain any estimate or tabulation of the tax savings, since this will vary according to the income and deductions of the individual taxpayer.
  - b. Cooperative Housing as New Residence for Income Tax Purposes. A member of a cooperative has available to him the same basic federal income tax advantages available to a home owner who sells his home and purchases a new one.

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- (3-4) Residence has been defined by the Internal Revenue Service to include a cooperative apartment. If a person sells or exchanges his principal residence at a gain, the gain is taxable. However, if within the year before or the year after the sale, the seller buys and occupies another residence, the gain is not taxed at the time of the sale if the cost of the new residence equals or exceeds the adjusted sales price of the old residence. More complete information about this can be obtained from Reference (7) of the Foreword. Cooperative members are also entitled to state income tax deductions in some jurisdictions.
  - c. U. S. Securities and Exchange Commission Requirements. Securities may be exempt from SEC registration requirements, pursuant to Section 3(a)(11) of the Securities Act, if the issuing corporation (1) was organized under the laws of a particular state; (2)

transacts business solely within such state; (3) makes the security offering exclusively to residents of such state; and (4) effects sales of the securities only to bona fide residents of such state who do not intend to resell the securities to non-residents. If examination of the mortgagor's papers reveals that the stock issuance has not been handled within these limitations, written evidence of SEC clearance is required. The SEC has indicated in some cases that a cooperative corporation set up on a membership, as distinguished from a stock, basis may be excused from SEC registration. Rule 235--General Rules and Regulations under Securities Act of 1933 exempts cooperatives from registration under circumstances stated therein.

- d. State Securities Requirements. The organizers of cooperative housing corporations should ascertain what state requirements, if any, pertaining to the issuance of securities must be complied with prior to solicitation for memberships. For example, the states of California and New York have specialized requirements on this subject.
- e. Estimate of Monthly Carrying Charges. The Information Bulletin contains a schedule showing the estimated monthly carrying charges which will be payable by the members. It is on the basis of this schedule that members are solicited. Their decision may be influenced by the fact that a management agent and HUD have approved the

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(3-4) adequacy of the amounts shown. It is, therefore, essential that the expenses on which this schedule is based not be underestimated.

- f. Review and Coordination of the Information Bulletin to the Budget. The Director should designate a member or members of his staff who are experienced in property management, preferably cooperative property management, to review these estimates against the HUD Data Bank at the time that the Information Bulletin with its attendant schedule of carrying charges is submitted for HUD approval. It is required that the budget and estimate of carrying charges be set forth on the Model Form of Operating Budget HUD Form 93240, as discussed in the pages to follow. The Reviewer should recognize that the sponsorship may have a tendency to underestimate expenses so as to facilitate sale of memberships in the project, and he should, therefore, closely examine the estimates submitted by the sponsorship and management agent and increase them if he feels them to be inadequate. Such increased estimates should, of course, be the ones to be reflected in the Information Bulletin.
- g. HUD Approval of Changes in the Format of Information

Bulletins. The model forms described above may be adapted for use by a cooperative servicing agent or its counsel with such changes as may be deemed necessary under the circumstances and with the approval of the HUD-FHA office. It will be the responsibility of the Area Counsel to determine when departures are of such substance that they should be cleared with the Office of Underwriting Standards. \*

h. Personal Benefit Expense (PBE).

- (1) The cooperative budget and schedule of carrying charges does not reflect PBE expenses. They are the direct responsibility of the individual members.
- (2) The PBE items (set forth in the application and in the Occupancy Agreement) gives the members an opportunity to exercise individual control over some expenses that relate to them personally.

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- (3-4) (3) PBE usually includes decoration of the interior of the member's unit and may include other items, such as utilities, which are paid for directly by the cooperative member.
- (4) The cooperative home ownership concept may lend itself to more extensive self-help than the painting and decoration of unit interiors. If it is used more extensively, e.g., in areas of grounds maintenance, painting of common areas, etc., it must be done in accordance with a plan that is approved by HUD.

- i. Proportionate Factor of Unit Valuation to Total Valuation. In Item 9, Column 2 of the Information Bulletin a valuation is set forth for each unit in the project. A decimal factor should be developed by dividing the valuation assigned each individual unit by the total valuation of all units in the project, e.g., a unit with a \$10,000 valuation in a \$1,000,000 total valuation develops a proportionate factor of .0100 (1%). Increases and decreases in carrying charges should be apportioned by the use of this factor. The factor may also be used to determine the proportionate share for each unit of the total amounts paid by the cooperative for mortgage interest, real estate taxes and other line items on the budget. Interest and real estate tax information is useful to the members in connection with their filing of federal income tax returns. The interest and real estate taxes attributable to a unit may need to be broken down further in projects receiving HUD federal assistance to determine how much an assisted member has actually paid. Management agents should check further IRS rulings in connection with assistance payments as there has been no specific ruling as of the

date of this Handbook.

- j. Articles/Certificate 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 thereunder undesirable.

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- (3-4) (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.

3-5. MODEL FORMS OF CERTIFICATES OF INCORPORATION.

- a. FHA Form No. 3234-B. This form is used by cooperatives in Sections 213 and 221 where a Regulatory Agreement is used for control.
- b. FHA Form No. 3235. This form is used in management type projects and, as revised, covers both stock and membership corporations. It applies to Section 221(d)(3) as well as to section 213. This is the form which is used when there is no Regulatory Agreement.

3-6. MODEL FORM OF REGULATORY AGREEMENT, FHA FORM NO. 3225. This agreement is used by Management Type cooperatives under both Sections 213 and 221 when the Certificate of Incorporation, Form 3235, is used. In situations where one cooperative mortgagor owns two or more projects, each covered by an HUD-insured mortgage, the Regulatory Agreement shall be deemed a default under all other Regulatory Agreements executed by the cooperative.

3-7. MODEL FORM OF BY-LAWS, FHA FORM NO. 3245. This form is used in Management Type Mortgagor Corporations under Sections 213 and 221. The By-Laws set forth the rights, duties and responsibilities of the individual members, the officers and the directors; and will permanently govern the internal organization and operation of the cooperative group. The date of the annual meeting of member-subscribers must be incorporated in it.

3-8. MODEL FORM OF SUBSCRIPTION AGREEMENT, MANAGEMENT TYPE, FHA FORM NO. 3232. This form is appropriate for use in Section 213 and Section 221. A supplement to this form, FHA Form No. 3232-A relating to credit is required for each subscriber in these sections.



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- 3-9. MODEL FORM OF ADDITIONAL DOWN PAYMENT AGREEMENT, FHA FORM NO. 3232-B. This form is used by initial subscribers in Section 213 or Section 221 projects who desire to reduce the debt service charge to be included in their monthly payment by voluntarily making larger down payments than those required.
- 3-10. MODEL FORMS OF OCCUPANCY AGREEMENTS.
- a. FHA Form No. 3237. This form, as revised, is appropriate for use in Sections 213 and 221 cooperatives composed of one mortgage parcel. An Occupancy Agreement, fully executed, is required from each member in all management type projects. (For Interim Lease see Reference (8) of the Foreword.)
- b. FHA Form No. 3237-B. This document is similar to FHA Form No. 3237 except that it is used where the cooperative is to be composed of more than one mortgage parcel.
- 3-11. COOPERATIVE AGENCY AGREEMENT. In cases where the cooperative corporation is represented by a cooperative sponsoring organization, an agency agreement is used to spell out the relationship between the cooperative and such organization. No model form has been issued on this subject due to the variations in services, charges, and methods of payment involved. The form used is subject to clearance by the Director of the Field Office and no Washington submission is required in this connection, except that in cases where HUD is being requested to certify the cooperative to GNMA as a "consumer cooperative" the proposed agreement must be submitted to the Office of Underwriting Standards. \*
- 3-12. "CONSUMER COOPERATIVE" CERTIFICATIONS TO GOVERNMENT NATIONAL MORTGAGE ASSOCIATION. Section 305(e) of Title III of the National Housing Act provides for the certification by the Secretary of HUD, under appropriate circumstances, to GNMA that a particular cooperative under Section 213 is a "consumer cooperative." A consumer certification procedure is not, however, required if the project is located in an urban renewal area, inasmuch as the GNMA allocation is made from another GNMA fund, nor for similar reasons is such a procedure required where the project is to be insured under Section 221.

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- a. Where the Director, after reviewing the facts in each case, has determined that a particular cooperative is entitled to a consumer certification, he shall forward his recommendation on the subject to the Office of Underwriting Standards. \*

- b. If such certification is ever required the HUD-FHA Director should forward the certification in accordance with the section of this Handbook titled Sponsorships and Sponsorship Organizations, together with his recommendations. (See Chapter 1.)
  - c. In those cases where the cooperative is represented by a sponsoring agent having no interest in the builder or landowner, additional certification shall be obtained from the sponsoring group to the effect that there is no identity of interest between the sponsoring individual(s), or the officers, directors, and stockholders of the sponsoring organization, and the builder or landowner. In such cases the person or organization representing the cooperative must also submit a copy of its proposed cooperative agency agreement, as well as a statement setting forth its experience and qualifications in acting on behalf of cooperative corporations. The circumstances of a particular case may require further information or certification, as it is important that the Director satisfy himself that no identity of interest exists.
- 3-13. HUD FUNCTIONS DURING SOLICITATION PERIOD. HUD's functions during this period are primarily those of review and approval or disapproval of proposed members from a credit standpoint. In Management and Sales Type cases, until sufficient membership has been attained and approved by HUD and the required sum of money over and above the mortgage has been raised, there will be no endorsement. Rapid processing of subscription agreements is essential to successful development of the cooperative and it is expected that they will be processed as received in convenient groups rather than withholding processing until all units have been sold.
- 3-14. INITIAL OPERATING BUDGET AND INITIAL SCHEDULE OF CARRYING CHARGES, HUD FORM NO. 93240, (APPLICABLE TO ALL COOPERATIVES). This form should be prepared at the same time as the Information Bulletin and must reflect current estimates.

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- (3-14) a. One of the Prime Responsibilities imposed by the By-Laws on the initial and subsequent Boards of Directors of a cooperative is to adopt an annual operating budget and HUD-93240 is to be used for this purpose. The form is coded to the Uniform System Chart of Accounts and can be expanded to serve the more complex cooperatives.
  - b. The Annual Cost of Operating a Cooperative varies with the characteristics of the development, whether it is new construction or rehabilitation, and the services required by its owners.
  - c. Budgets should be prepared by listing the annual

expenses that result from a study of the characteristics and experience of the development and not by working backward from what is considered to be the current market rentals of the area.

- (1) A Schedule of Carrying Charges and a management agent's opinion as to its adequacy must be included in the Information Bulletin. Therefore the Initial Schedule of Carrying Charges must be prepared considerably prior to actual operations. Column 5 (New Annual Budget) should show expense items reflecting the best judgment of the sponsorship and management agent. The HUD-FHA office will reflect any revisions it considers appropriate in the last column, and the schedule reflected in the Information Bulletin must give effect to these revisions. The expense projections contained in the Project Analysis (Form No. 2264-C) are made for a different purpose and should not necessarily be regarded as adequate for the cooperative budget. Upon final approval of a budget it should be forwarded to the appropriate underwriting section for inclusion in the Data Bank.
- (2) Estimates of Income, particularly in budgets prior to the attainment of operating experience, must be conservative. In the initial budget, the estimated income from garage space must not exceed fifty (50) percent of the total for this item shown in the Project Analysis (FHA Form No. 2264). Such budget should not reflect any estimated income from such miscellaneous

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sources as laundry machines, telephone services, vending machines, etc. Income from commercial space may be reflected only to the extent of leases actually executed with the HUD-FHA office approval.

- (3) Fixed Charges are requirements affecting the budget entries on lines 49 through 54 (Ground Rent, Mortgage Insurance Premium, Interest, Principal, Replacement Reserve and General Operating Reserve) are set forth in the Regulatory Agreement and/or the Commitment for Insurance. The total income on line 68 must be at least equal to the total expense on line 58. The income from carrying charges on line 59 must agree with the annual total in the schedule of carrying charges.
- (4) The expenses should be compiled as realistically as possible. Tax authorities, insurance companies, utility companies, suppliers and manufacturers of project equipment are good sources of information. Local building owners and managers associations are also good sources of information. The catalog of a

large retail store is useful in estimating the cost of supplies and equipment. Other cooperatives with comparable facilities and services, that have been operating for more than one year, can also be a valuable source of information.

- (5) In all Section 213 and 221(d)(3) Market Interest Rate cases in which down payments of less than \$500 are involved, the initial operating budget must contain an allocation for vacancy and collection losses of at least 2 percent of the budget otherwise projected. If the experience of nearby or comparable projects indicates this to be inadequate, a higher percentage should be required. Budgets prepared after the cooperative is in actual operation should contain such allocation as is justified by its own operating experience.

- 3-15. OPERATING BUDGET AND SCHEDULE OF CARRYING CHARGES DEVELOPED AFTER OCCUPANCY. Column 1 will show the prior year's budget and Column 2 the actual figures for the previous twelve months'

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operation. Column 4 will be used to adjust for increases or decreases that may be necessary and Column 5 will show the proposed operating budget for the coming fiscal year. The HUD-FHA Office will use the last Column to show any revision in estimates.

- 3-16. GENERAL INFORMATION FOR PREPARATION AND SUBMISSION. Additional information can be found on HUD Form No. 93240.
  - a. Replacement of Withdrawals From the General Operating Reserve. Provision must be made for replacing withdrawals with deposits during the next fiscal year (or in accordance with a previously approved repayment plan). Such deposits, over and above the amounts required to meet the regular annual requirement must, therefore, be included on line 54 of the Operating Budget.
  - b. Painting Reserve. Experience has demonstrated the value of establishing such a funded reserve as a means of avoiding special assessments.
- 3-17. BUDGETING FOR A SINGLE COOPERATIVE CORPORATION HAVING SEVERAL MORTGAGE PANELS. A cooperative that has been developed in sections, wherein each section imposes a separate mortgage obligation on the single corporation, may operate on a consolidated budget reflecting the total operation. The books of account, however, must be kept in a manner that will permit financial identification of each mortgage panel.

- 3-18. BUDGET APPROVAL. The form is required to be signed by the managing agent, a Director of the cooperative and the HUD-FHA Office. A copy as finally approved should be available for examination by the cooperative members.
- 3-19. PLAN OF OPERATION. Each annual budget must indicate the management plan that is intended to be used to implement it. The plan should cover such items as the following:
- a. Schedule of personnel to be directly employed by the cooperative - including their compensation and duties.
  - b. How often will a property manager from the management company visit the project?

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- c. Will the managing agent attend all Board Meetings?
  - d. What member committees are organized to assist in management (Budget, Grounds, Collections, Finance)?
  - e. Will the management agent or resident manager contact delinquents in person?
  - f. Is a delinquent member called before the Board prior to turning his account over to an attorney or collection agency?
  - g. Have the maintenance personnel been given a maintenance and operations guideline to keep the cooperative's operating costs at the lowest possible level?
  - h. Have the on-premises personnel been given copies of plans, specifications, and corporate documents, and have they been made aware of the requirements imposed by the Regulatory Agreement on the management firm?
  - i. If any expense items (grounds maintenance or painting and decorating) have been reduced by use of self-held techniques, the detailed plan should be submitted.
- 3-20. ALLOCATION REAL ESTATE TAXES. The reviewer should compare the data from other projects on taxes and other operating expenses with the estimates which have been submitted. The estimates should not deviate significantly from the totals on Form 2264 without proper justification. The importance of providing subscribers with the soundest possible estimate of carrying charges cannot be over-emphasized.
- a. Real estate taxes are admittedly difficult to forecast. The HUD-FHA reviewer should examine the amount for real estate taxes estimated by the sponsor for reasonableness by comparing the sponsor's estimate with the amount of taxes being charged for similar properties in the area. It should be borne in mind that real estate taxes have been constantly increasing in many areas. Both the

sponsor and the HUD-FHA should take this factor into consideration.

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- b. If long-term real estate tax abatement or if exemption from taxes is claimed by the sponsor, approval of the HUD General Counsel must be obtained.
- 3-21. GENERAL OPERATING RESERVE. The Regulatory Agreement requires that the cooperative establish and maintain a general operating reserve by allocation and payment thereto monthly of a sum equivalent to not less than 3 percent of the monthly amount otherwise chargeable as carrying charges. When the GOR account reaches 15 percent of the annual carrying charges, the monthly accrual rate may be reduced to 2 percent; and when the GOR account equals 25 percent of annual carrying charges, such monthly accruals may be discontinued until the account is reduced below 25 percent.
- 3-22. ALLOCATION FOR REPLACEMENT RESERVE. The Reserve for Replacements is one of the items included in the budget upon which the carrying charges are predicated, and must at least equal the amount required by the Commitment. The kitchen ranges and refrigerators in most cooperative units are assets of the corporation. The replacement reserve must, therefore, be sufficient to cover such items if included under the project mortgage, and likewise carpets and air conditioning, if any. These items should not be treated as personal benefit items. If the cooperative feels an incentive is necessary so that residents will be encouraged to take optimum care of the equipment covered by the reserve, there is no objection to its restricting disbursements so that one unit cannot draw more than its pro rata share of the accumulated reserve.

The above requirement also applies in Section 213 cooperatives except where down payments of \$500 or more are involved and it is customary for individuals to own their equipment as personal property. In such cases, a replacement reserve is required for items of corporate responsibility and not the items of personal property. Equipment such as kitchen ranges and refrigerators and carpets and drapes may properly be handled as personal benefit items in such situations. The By-laws and Occupancy Agreement must clearly indicate whether the corporation or the individual is responsible.

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- 3-23. OPINION OF INDEPENDENT MANAGING AGENT. The Information Bulletin is required to contain the opinion of a professional independent management agent as to the adequacy of the schedule. The management agent must be acceptable to HUD. It is expected that the management agent's opinion on this subject will be arrived at objectively and will not be

influenced by any desire to make the project more attractive from the sales standpoint. If a management agent has underestimated carrying charges in earlier projects without reasonable explanation, the HUD-FHA Director must require the opinion of another agent in future projects.

- 3-24. REVISION OF SCHEDULE PRIOR TO OCCUPANCY. In some cases, as a result of the time lapse between preparation of the Initial Schedule of Carrying Charges and the date of initial occupancy, there are changes in operating expense estimates sufficient to justify a revision of the operating budget and schedule of carrying charges.
- 3-25. FIGURES. The following Figure "A" schematically shows the financial structure of a cooperative corporation. Figure "B" is a sample of the budget format of a cooperative corporation.





## FORMS APPENDIX I

Following are the model forms discussed in this Handbook as necessary to the basic structure and organization of cooperative housing projects. These forms are subject to revision from time to time and care should be taken to secure the most recent revision before they are used.

A listing of the forms applicable to the several approaches which have been developed is displayed in the Handbook covering their respective instructions.