
CHAPTER 29. CONVERSION TO COOPERATIVE OWNERSHIP

29-1. INTRODUCTION. Coop conversions are dealt with by a number of program offices within the Department. It is not practical to devise a single set of instructions applicable in all situations because each office approaches the issue from a different perspective. For instance, Housing Development issues underwriting guidelines for the refinance of or conversion to cooperative housing under the *223(f) program. Preservation and Property Disposition has a resident initiatives/cooperative conversion program for HUD sales. The Office of Resident Initiatives covers the conversion of subsidized projects under the Hope II resident homeownership program.

For purposes of Handbook 4350.1, this Chapter addresses a conversion proposal that falls within the purview of Housing/Loan Management. The guidelines developed here are for the use of Loan Servicers who are processing a cooperative conversion under the conditions set forth in this Chapter.

29-2. GENERAL.

- A. Loan Management is responsible for processing a proposal to convert a rental project to cooperative ownership under the conditions specified below. This situation arises during the course of Loan Management's servicing operations and is, therefore, under its purview. A conversion under the conditions set forth in this Chapter does not trigger Housing Development's involvement in the process, i.e., this type of conversion does not involve underwriting or refinancing.
- B. This Chapter covers the situation where an owner wishes to sell a project in order to take out equity leaving the tenants in place.

Eligibility of cooperative conversion under this Chapter is limited to unsubsidized projects with HUD-insured or HUD-held mortgages.

- C. In this Chapter "unsubsidized" is defined as a project which does not (1) have a subsidized mortgage or a direct mortgage loan from HUD at a below market interest rate or (2) receive project-based housing assistance payments.
- D. Why would owners and residents be interested in such a proposal? What do they get out of it? For owners the motivating factor is favorable market conditions. Owners may use the existing project mortgage, which remains in place after the conversion, provided the mortgagee of record has approved the conversion. (See paragraph 29-3). They can sell the project and, under HUD conditions, take out their equity. (See paragraph 29-4.) For tenants, conversion can foster the opportunity for homeownership. (A lot of conversion activity is not expected under current market conditions at the time of issuance of this document, but the guidelines established in this Chapter are in anticipation of possible future consideration.)

- 29-3. CONSENT, SUBMISSION AND REVIEW REQUIREMENTS. HUD (for projects with HUD-held mortgages) or the mortgagee (in the case of projects with HUD-insured mortgages) must give its consent for the conversion. The requirements of Chapter 13 to this handbook, entitled Change in Ownership: Transfer of Physical Assets, Section 3 Part VII (page 13-17) are incorporated here by reference. Chapter 13 delegates authority for approving TPA proposals to field offices. The local HUD office, through the Loan Management Branch, is responsible for processing conversion proposals. Documents required for consideration are submitted to the Loan Management Branch. Owing to the

complexities of these transactions, Area/General Counsel review/consultation is also required.

- 29-4. HOW PROPOSALS ARE STRUCTURED: TECHNICAL REQUIREMENTS.
- A. Following the procedures in Chapter 13 dated 9/91, TPA approvals involve a two-tier process. First the owner must submit all necessary information to HUD for review. Required documentation includes the proposed sales prospectus, budget and projected carrying charges, by-laws, articles of incorporation, occupancy agreement, setup for escrow accounts including the general operating reserve and reserve fund for replacements, and other information as requested by the field office.
 - B. For conversions processed under this Chapter, ownership must convert to a nonprofit cooperative housing corporation/limited equity coop.
 - C. If the field office finds the proposal to be acceptable, preliminary approval may be granted. Owners may then arrange for the sale of corporate shares. Tenants/members buy shares in the coop with proceeds used to buy down the project mortgage, i.e., for instance on an existing Section 207 mortgage. Membership carries the right to occupy a unit within the project. In nonprofit/limited equity coops the return on shares is restricted to a maximum amount based on a formula set forth in the by-laws. The restriction on appreciation upon resale of membership shares is intended to maintain the housing as available to and affordable by low and moderate income families and persons. This is an important difference between non-profit/limited equity coops and market rate coops.
 - D. Final TPA approval may not be granted until a 90% presale threshold has been met. This
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threshold is established in order to protect members, homeownership tax benefits by ensuring that the Internal Revenue Code requirement that 80% of project income be derived from members, carrying charges does not slip.

- E. In addition cooperative conversions must be in accordance with applicable State and local laws and regulations.