

Cooperative Share Loans

Legal Opinion: GHM-0002

Index: 3.110

Subject: Cooperative Share Loans

October 11, 1991

MEMORANDUM FOR: Sheila Y. Walker, Chief Counsel
Detroit Office, 5.4G

Attention: John McFadden, Attorney Advisor

FROM: Mel Belin, Chief Attorney,
Loan Origination & Eligibility Section, GHM

SUBJECT: La Salle Townhouse Cooperative, Detroit
Joliet Townhouse Cooperative, Detroit
Nicolet Townhouse Cooperative, Detroit
Individual Share Loan Financing

This memorandum responds to an oral inquiry, by John McFadden of your office to Edward Ferguson of this office, as to the legality of a mortgage company (specifically, NBD Mortgage Company) making cooperative share loans to the members of the above listed cooperatives. John Frelich of the Multifamily Loan Management section in HUD's Detroit office sent a memorandum to you (a copy of which Mr. McFadden forwarded to this Division) in which he questioned the legality of this type of loan. We are responding to Mr. Frelich's concern about the legality of coop share loans, but defer to you on the specific questions raised in Mr. Frelich's memorandum. These loans are for the refinancing or purchase of a member's cooperative interest and are to be collateralized by the member's stock certificate and occupancy agreement in the above named projects. In addition, you forwarded a copy of a proposed "Recognition Agreement" that is to be executed by the cooperative corporation, the lender and the borrower at the time the loan is closed.

This office has previously opined in a memorandum dated December 12, 1985 (see attached) to Conrad Egan, then Director of the Office of Multifamily Housing Management, that share loans obtained for the purpose of purchasing or refinancing a member's cooperative interest in a HUD-insured cooperative, which are collateralized by the member's stock certificate and occupancy agreement, are acceptable. John McFadden of your office has informed Edward Ferguson of my section that a membership share in a housing cooperative is deemed to be personal property under Michigan law, and therefore the share loan will not constitute a lien on the project.

We have also reviewed the "Recognition Agreement" that was attached to your incoming, and we are requiring the following

changes to the document. Our concerns revolve around Section 7, entitled "Lender's Rights Upon Borrower's Default." In subparagraph "a." there is a reference made to an "Exhibit B" attached, but our copy of the agreement had no such attachment, thus precluding our review of its terms. In order for the cooperative to exercise its unit purchase option rights, Subparagraph "a.i." requires the cooperative to pay the amount due to the lender after a default has occurred on the share loan, even though this may be an amount that is greatly in excess of the, then current, market value. Subparagraph "a.1." must be revised by adding the phrase "or the Transfer Value of the membership as provided in the Bylaws of the Corporation, whichever is less," immediately following the phrase "provided Lender is paid an amount equal to the full amount due under the Loan. . . ." Subparagraph "a.ii." has a prohibition against the cooperative making any change in its "occupancy standards, or its practices pertaining to these standards, without the written consent of the Lender." This language must be deleted because we question the grant of this much control over alienability of the shares to a Lender that may have only one loan, or to several different lenders who may ultimately make such loans available to shareholders at these projects.

Subparagraph "a.iii." subordinates the cooperative's lien (against a resident's shares in the cooperative) for unpaid rent or maintenance to the security interest of the lender, "except for the pro rata share of prior mortgage loans, current real estate taxes and special assessments," (where the lien of the cooperative would not be subordinate). What the exception means is that for the part of the shareholder's rent that would go towards the payment of the project mortgage loan, real estate taxes and special assessments, the cooperative's lien remains superior. If the overall arrangement is permitted, this could have a detrimental effect on the cash flow of the project as a whole, and could possibly increase the chance of a default on the FHA-insured project mortgage and, therefore, this subparagraph must be deleted. In our view, the lender's right to repayment on a delinquent share loan must come from the shareholder, or the value of the share loan upon foreclosure, and the lender must not be permitted to divert potential income from the project. Subparagraph "a.iv." must be deleted in full because it states that terms found in Section 7 of the "Recognition Agreement" will "amend and supersede the terms found in the Proprietary or Operative Documents." Our comments are not intended to be all-inclusive, and they do not preclude you from also requiring changes to the documents submitted by the lender if you find a provision inconsistent with the cooperative's regulatory agreement or bylaws.

Should you have any questions concerning this opinion please contact Edward Ferguson at 8-458-4107.