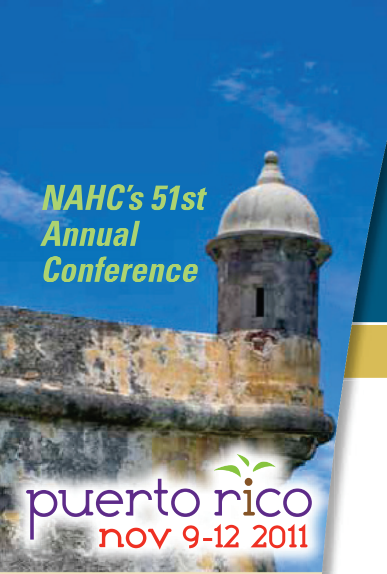

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Housing Cooperatives: An opportunity to provide stable homeownership for moderate income families

By Douglas M. Kleine, CAE

HOUSING COOPERATIVES, an affordable homeownership model that has worked in the US for over 100 years, can and should have a renewed role in achieving the national goal of stabilizing homeownership for moderate income families.

The housing cooperative model has been underutilized for the last 30 years as the country has sought to extend the benefits of homeownership for moderate income families. Focus during this period has been mainly on single family homes, whereas co-ops are a blend of single family and multifamily concepts. Co-ops provide the occupant a stake in all the tax, equity, and estate benefits of single family homes, plus all the tax, financing and operating cost saving benefits of multifamily ownership.

Co-ops protect buyers from the risks of housing bubbles.

Co-ops are a successful and proven concept

Co-ops have a superior record in the US, providing homeownership to 1.2 million families.

Co-ops insured under the HUD Section 213 mortgage insurance program have the best loan performance and lowest default rate of any HUD multifamily program. The Section 213 program requires no appropriation, subsidy or assistance. In fact, the 213 program actually returns the majority of the insurance premium back to the borrowers as a dividend every year.

Assisted co-ops have been proven superior to rentals in side by side comparisons. Studies have shown that co-ops with subsidized interest rates have lower default rates and better quality of life ratings than similarly subsidized investor owned and non-profit owned rental properties. A 2010 study by the Urban Institute found that limited equity co-ops do a better job at preserving long term affordability and have a lower default rate than and other programs providing homeownership assistance to low and moderate income families, such as land trusts, inclusionary zoning and deed restrictions on resale prices.

Co-op ownership is recognized by HUD/FHA; by USDA/Rural Housing Service; by Ginnie Mae, Fannie Mae, and Freddie Mac secondary mortgage market programs; by Federal banking laws; and by the IRS. Housing cooperatives can be created under general state business law and non profit corporation law. No special state statute is necessary.

Co-ops provide stable homeownership, insulated from typical economic default threats

The recent housing bubble exposed homeowners to great risks and few options for exit. Co-ops protect buyers from these risks. For example,

▶ **LOWER CLOSING COSTS.** Co-ops have a single mortgage for many families, and the mortgage remains in place for 30-40 years. Transfer of shares (resales of units) is a personal property transaction in all but a few states, and purchasers therefore avoid costs for title insurance, abstract, survey, deed recording, and related local taxes. In a building by building comparison, co-ops have strikingly lower closing costs than a condo building or a tract of fee simple townhouses or single family detached homes.

▶ **EASIER FOR BUYERS TO MEET CREDIT STANDARDS.** The cooperative corporation is the borrower. The initial lender does not depend on the credit of the individual members or shareholders in the co-op. Instead, the co-op does credit screening of potential members of the cooperative. The

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corporation can be more flexible, take into account valid explanations of past credit difficulties of a potential purchaser, and assume a credit risk that commercial lenders may shy away from, especially in tight credit times. Thus co-ops make it easier for resellers to sell and subsequent buyers to buy.

▶ **PROTECTION FROM CYCLICAL INTEREST RATES.** Because the co-op's financing is long term, resales continue to benefit from a fixed interest rate by virtue of the blanket mortgage remaining in place.

▶ **LONGER MORTGAGE TERM MEANS LOWER PAYMENTS FOR THE LONG TERM.** One method of financing, the FHA Section 213 program, allows for the blanket mortgage to be for 40 years, making the monthly payments lower than with conventional financing, and not exposing buyers to the adjustable rate jumps experienced by single family homebuyers.

▶ **LOWER PAYMENTS DUE TO LOWER TAXES.** Property taxes are assessed on the co-op as a whole, and tax appraisals for a co-op building are usually lower than the sum of appraisals on a similar building of condo units.

Co-ops prevent early term default due to problems often faced by other new homeowners

The cooperative model addresses other problems sometimes associated with new homeowners who might be marginal credit risks. Problems that arise in the early years of ownership are the biggest threat leading to default by single family homeowners. Two studies before the recent crisis revealed that the chances of a low or moderate income first time homebuyer still being a homeowner after 5 years were only about 50%. See *Caroline Reid, "Achieving the American Dream," Center for Social Development, Working Paper 05-02, 2005,* and *C.E.Herbert & E.S. Belsky, "Homeownership Experience of low Income and Minority Households," 10 (2) Cityscape (2008).*

The co-op model handles these problems better. Here are common early year stresses faced by homebuyers and how the co-op model eliminates or ameliorates them:

▶ **SUDDEN BUDGET-BUSTING HOME REPAIRS.** Major repairs are the responsibility of the co-op, not the member. And the co-op's budget and reserves can usually absorb the expense. If the co-op's budget cannot absorb the expense, a co-op is in vastly superior position to a condominium or townhouse association or an overextended single family owner in its ability to borrow in order to finance a repair, and, by borrowing, spread the impact out over several years.

▶ **JUMPS IN REAL ESTATE TAXES FOLLOWING PURCHASE.** Real estate taxes are assessed against the co-op as a whole, and therefore do not jump following each resale within the co-op.

▶ **INTEREST RATE INCREASES IN ADJUSTABLE MORTGAGES.** The co-op's blanket mortgage interest rate can be fixed, and a new purchaser needs little additional financing in the early years of the co-op's life.

▶ **LOSS OF JOB OR OTHER INCOME SOURCE.** Co-ops have a built in sense of community and often initiate workout situations when members face temporary economic adversity. The co-op's ability to act swiftly to evict a delinquent member provides the co-op with an allowance of more waiting time than a single family lender that in most states must act quickly to initiate a lengthy foreclosure proceeding.

Conclusion

Housing cooperatives represent a unique form of homeownership that removes many barriers faced by potential single family and condominium home buyers. Co-ops provide all the benefits of single family ownership, without many of the risks to the lending community or the borrower, thus bringing long term stability to their resident owners. CHB

Doug Kleine, CAE is President of Professional Association Services providing governance training and consulting to co-ops and other nonprofits. He was Executive Director of NAHC from 1999-2007. Previously he served in the Condo and Co-op Branch of the US Department of Housing and Urban Development.