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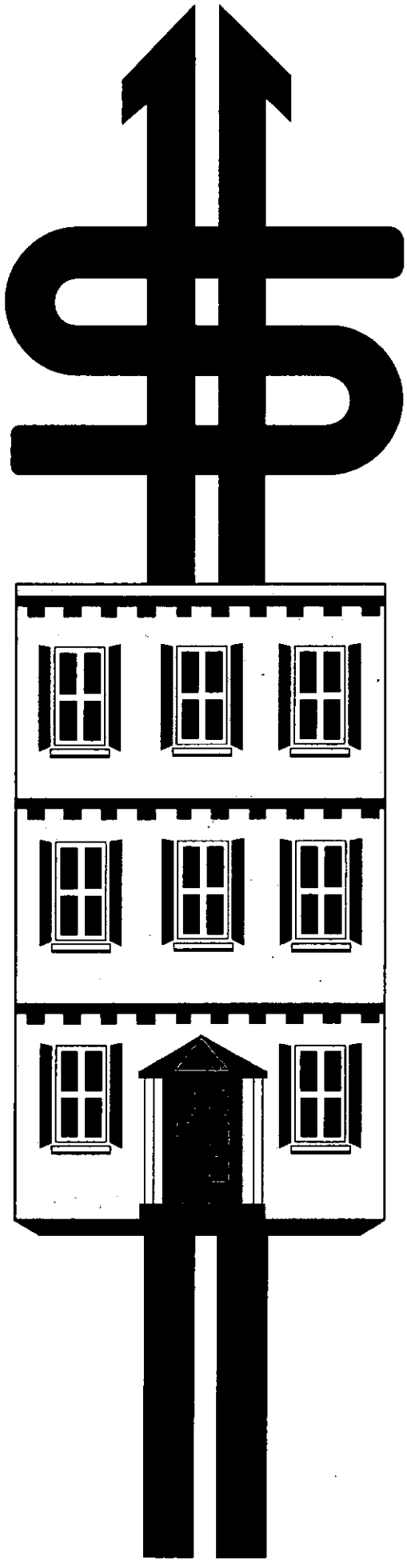

Limited Equity Housing Cooperatives:

A Financing Opportunity for California Lenders

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Funded by:

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Preface

This report is the product of three organizations: the Center for Cooperatives at the University of California, Davis; Rural Community Assistance Corporation in Sacramento, California; and Housing and Community Development Services in Grass Valley, California. Its goal is to increase the amount of private financing available for Limited Equity Housing Cooperatives (LEHCs). Many people contributed to the report's development and publication. We hope that it contributes to the knowledge and understanding both of those involved in cooperative housing and of lenders who may be considering their first cooperative loan.

LEHCs are a special class of housing cooperative that is designed to create permanently affordable ownership housing. Because of rising housing costs, LEHCs are an important option for addressing today's housing affordability crisis. According to the California Association of Realtors, between 1970 and 1990 median wages in California rose 271%, while the median home price rose 746%. LEHCs can provide increased opportunities for home ownership, particularly for first-time buyers and families with modest incomes.

The need for increased home ownership opportunities is particularly critical in California and other high-cost states. The 1990 Census found that only 53.8% of the households in California owned their home and a majority of the households in Los Angeles and San Francisco were renters. The Census also reported that 91% of America's renters could not afford to buy the median-priced home in their region of the country.

Housing cooperatives have unique difficulties in obtaining financing from private lenders, both in California and throughout the nation. This is especially true for LEHCs. The purpose of this report is to familiarize private lenders, government agencies, the sponsors and members of housing co-ops and others with various issues related to the financing of LEHCs. Its primary objective is to help lenders better understand LEHCs. By doing so, they can develop and adopt more appropriate underwriting practices for LEHC loans. The report also aims to educate local governments and co-op sponsors and members so they can anticipate and be prepared to respond to the concerns that lenders raise about financing housing co-ops.

Financing LEHCs is important, viable, and desirable because it can help restore the American Dream of home ownership for a larger number of people. For lenders, LEHCs provide additional opportunities to invest in their communities. The authors hope that this publication will assist lenders in increasing their investments in Limited Equity Housing Cooperatives.

Acknowledgments The Center for Cooperatives, based at the University of California at Davis, was established by the California State Legislature in 1987 in response to the growing need for information and technical assistance by California's cooperatives. The Center carries out and promotes research about cooperatives and provides education and development support to California's cooperatives.

Housing and Community Development Services is a private consulting firm in Grass Valley, California, whose mission is to empower people with modest means to gain and retain the ownership and control of their housing and communities. HCD Services assists and advises government and nonprofit agencies and resident organizations with the development, structuring, financing, and management of various forms of resident owned and controlled housing.

Rural Community Assistance Corporation (RCAC) is dedicated to improving the quality of life for rural communities and disadvantaged people through partnerships, technical assistance, and access to resources. Since its incorporation in 1978, RCAC has worked closely with and on behalf of residents striving to work as a group to convert their housing into resident-owned housing cooperatives.

The research for this report was made possible through a grant from the University of California Center for Cooperatives. As with any research, many individuals participated in the development of this publication. Among the RCAC housing division staffers who shared their research and experience, of particular assistance was James Leonard, who designed and directed the phone survey and developed the data into the initial draft of this publication. Under the direction of William Haack, RCAC Housing Director, other RCAC staffers who contributed included Paul Ainger, Dewey Bandy, Marta Erismann, Shelly Haack, and Ruben Ramos. Gerald L. Rioux and Christine L. Rioux of HCD Services completed and edited the report.

A preliminary draft of this report was reviewed by Art Collings of the Housing Assistance Council, Michael Freedland of Citibank and David Schallich of the National Cooperative Bank Development Corporation. Other lenders contributed their experience and comments along the way. Rob Sadowsky of the Chicago Mutual Housing Network was very helpful. As this report was being developed, he was working with his local lenders to increase the availability of financing for co-ops in the Chicago area. Sadowsky graciously authorized the reprinting of the Network's "Comparison of Typical Underwriting Standards" for rental and cooperative housing and "Cooperative Housing Lending Check List," which are included as appendices of this report.

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I. Introduction

While cooperatives have played an important role in California's economy for over a century, relatively few people are familiar with them or understand how they work. Despite the many legal arrangements that are possible and the various images that people have about them, cooperatives are simply organizations of people who join together to accomplish something. People form cooperative corporations and associations to own housing, operate businesses, market their products, increase their purchasing power, and do any number of other things that they cannot do as well or as economically by themselves. Considering the important role cooperatives play in the United States economy, many people are surprisingly uninformed about them.

Few people realize, for example, that Sunkist is one of California's largest and most successful cooperatives. The numerous agricultural cooperatives in California and the United States have helped our farmers and ranchers to be the most productive in the world. The rural electric cooperatives brought electricity to most of the country and now help create new businesses and jobs by investing their resources in the communities they serve. REI, the sporting equipment retailer, is also a cooperative. And so are credit unions. These consumer cooperatives enable their members to pool their resources and receive goods and services at lower cost.

Housing cooperatives are another of the many kinds of cooperatives that exist in California and the nation. Housing co-ops share many characteristics with other forms of cooperatives. They are owned and controlled by their members. And they are operated democratically for the benefit of their members. Like other kinds of cooperatives, housing co-ops often have difficulty obtaining financing because relatively few lenders understand their structure and operations. This lack of familiarity with co-ops makes it more difficult for lenders to underwrite co-op loans. It also leads many lenders to choose not to serve this segment of the market.

Before dealing with these financing issues and the potential ways that lenders can overcome the barriers to financing LEHCs, it is important to first understand the cooperative ownership structure and how it compares with other ways that housing can be owned.

II. Ownership Structures for Housing Developments

It is very important to remember that the term "cooperative housing" refers only to the ownership structure of the housing. It has nothing to do with the physical structure or characteristics of the housing. Any type of housing can be owned cooperatively. A cooperative housing development can include detached single-family homes, town houses, apartment flats, or even mobile home park spaces and houseboat moorings. The same is true for a condominium project, which is the most typical form of common ownership housing in California.

Under California law, both cooperatives and condominiums are types of common in-

terest developments or CIDs. CIDs are real estate subdivisions that combine both individual and shared ownership interests and responsibilities. The differences between cooperatives, condominiums, and other CID ownership structures are in whether and how the ownership interests are divided and financed and in the degree of interdependency among the individual owners. In co-ops, and particularly Limited Equity Housing Cooperatives (LEHCs), the individual owners have a much higher level of interdependency than do most homeowners.[1]

All cooperatives have membership requirements that contribute to their effectiveness and strength. The members of an LEHC own shares or stock in the cooperative corporation; this gives each member an ownership interest in the housing development and the right to occupy a particular unit. The main difference between membership in an LEHC and a stock cooperative (the general form of cooperative housing in California) is that LEHCs cap the resale value of membership shares by limiting the rate of return on the members' equity. It is this feature that makes this form of ownership a "limited equity" housing cooperative.

Cooperatives have historically been financed with blanket loans that cover all of the units plus the common areas and facilities. The co-op members borrow funds as a group and repay them as a group. The funds needed to repay the loan are collected, along with the funds needed to operate and maintain the property, as part of the member's monthly carrying charges. However, over the past decade individual share loan financing has become increasingly available for stock cooperatives. Some co-ops have a combination of blanket and share financing as a result of this trend. Over time, share loans may become the primary type of financing for stock co-ops. Because their initial share values are set low and increase at a limited rate, share loans are less likely to be used for LEHCs. Consequently, LEHCs are likely to continue to be financed almost exclusively with blanket loans that cover the entire property, and it is this feature that contributes to their financing difficulties.

III. The Limited Equity Housing Cooperative Model

Limited Equity Housing Cooperatives are a special type of cooperative designed to create permanently affordable housing by limiting the resale value of its membership shares. While there are many co-ops with limited and/or structured equity provisions throughout the United States, the definition and requirements for LEHCs are very specific under California law. These were established with the passage of AB 1364 in 1978.

California Health and Safety Code Section 33007.5 (see Appendix B) defines an LEHC as a form of stock cooperative that 1) is formed, at least in part, to serve a public purpose, 2) limits annual increases in the resale value of membership shares, and 3) dedicates all "corporate equity" for charitable purposes. Corporate equity is the net value of the property owned by the LEHC after subtracting any financing debt and the restricted resale value of membership shares. Under California Business and Professions Code Section 11003.4 (see Appendix C), certain LEHCs can be exempt from the subdivision review requirements of the California Department of Real Estate. To qualify for this exemption, the LEHC must 1) receive some federal, state and/or local government financing, 2) obtain relatively little of its development capital from the sale of membership shares, and 3) have a regulatory agreement that is monitored by a government agency.

Under California law, LEHC membership shares can appreciate at no more than 10% per year on a "straight-line" basis. Members can also receive credit for board-approved capital

[1] Additional information on CIDs and further comparisons between LEHCs and other forms of CIDs are included in Appendix A. The Center for Cooperatives' *Cooperative Housing Compendium* (see Bibliography) includes additional information and comparisons. It also describes examples of various types of housing that are owned cooperatively.

improvements to their units. The rate of appreciation is specified in the co-op's legal documents. It may be an index, such as the Consumer Price Index (CPI), or county median income, as well as a fixed percentage or amount. While the maximum allowable rate is 10%, the typical rate is closer to 3%, since the purpose of limiting share appreciation is to keep memberships affordable for households with modest incomes.

IV. The Market for Housing Co-op Financing

There are over 200 housing cooperatives in California that provide more than 25,000 units of housing. These housing cooperatives serve a diverse group, including students, seniors, farm workers, single-parent households, mobile home park residents, and moderate-income families. Factors that spurred their development included economic development, historic preservation, and preventing the displacement of residents from rental units. However, the most frequent reason for forming housing cooperatives is to assure the permanent availability of affordable housing in the local community.

A recent study of California housing cooperatives (Bandy, 1993) found that half of them were created through new construction. An additional 20 percent were converted from another use or form of ownership. The remainder of the surveyed cooperatives combined both elements of new construction and the conversion of existing units. This means that an average of four out of five cooperatives have some need for both construction and permanent financing. Without question, many cooperatives formed through conversion also need some interim, as well as permanent, financing. And, like other forms of housing, cooperatives occasionally need additional financing to support new expansion, improvements, and rehabilitation. This creates an ample market for various types of loans.

Despite the size of this potential market, many lenders are reluctant to finance housing co-ops. However, contrary to common misconceptions about the risks in co-op lending, the national experience with co-op loans is that they are safe. For example, the National Cooperative Bank (NCB) has experienced only four defaults on more than 700 loans it has made to housing co-ops in its 15-year history. This default rate is much lower than what lenders have experienced for other types of real estate, including single-family homes. A Center for Cooperatives study (Kirshner, 1992) reported on the relative performance of HUD loans for low-income co-ops and rental housing. In HUD's 221(d)(3) loan program, the percentage of default claims for co-op loans was approximately half that of loans for rental housing, including projects owned by both nonprofit and for-profit sponsors. The relative default rates for HUD 236 co-ops and rentals were similar. A recent study commissioned by NCB (Calhoun, 1994) reached similar conclusions.

Once lenders become more familiar with LEHCs and learn how to overcome the barriers that have limited their financing of cooperatives in the past, they can receive various benefits, including:

- Helping to meet the affordable housing needs of their communities
- Promoting housing that provides stability and a sense of community for households with modest incomes
- Maintaining good public relations
- Increasing the value of their loan portfolios
- Enhancing their Community Reinvestment Act (CRA) ratings

V. Areas of Lender Concern

In researching this report, a number of lenders were contacted and asked to identify their concerns about financing LEHCs. They raised a variety of issues related to loan-to-value ratios, foreclosures, debt-coverage ratios, share values, vacancy rates, project management, and secondary mortgage market acceptance.[2] All of these concerns can

[2] The secondary mortgage market refers to the sale of real estate loans by lenders to investors and is discussed in greater detail below.

be considered underwriting considerations. Underwriting is the process of evaluating whether or not to make a loan—and why. It involves analyzing both the property and its owner and judging whether the loan will be repaid on time as agreed. Based on decades of experience, lenders have developed underwriting guidelines that include various standards for different kinds of loans, properties, and borrowers.

Underwriting is a risk assessment and it can be more an art than a science, especially for unusual and complex projects. Experienced underwriters weigh the relative importance of the various guidelines for a particular loan application. They can rely on areas in which the application is strong to compensate for areas in which it is weak. This presupposes, however, that the guidelines are appropriate for, and the underwriter is familiar with, the kind of project being underwritten. While this is the case for co-ops in areas of the eastern United States where this form of housing is more common,[3] it is not true in California and in most other areas of the country.

Faced with similar problems securing co-op financing, the Chicago Mutual Housing Association (MHA) organized a lenders' task force to study the issue and help local lenders better understand cooperatives. Earlier this year, the organization published a report entitled "Financing Affordable Housing Co-operatives in Chicago." The report summarizes the conclusions of the task force and is intended to help lenders understand, underwrite, and finance more co-ops in the Chicago area. The Chicago MHA's report includes a chart that compares underwriting standards for multi-family rental housing and co-ops and a checklist for lenders to use when underwriting co-ops (see Appendices D and E, respectively, of this report).

Lenders generally underwrite LEHCs as if they were multi-family rental projects despite the many differences between the two. Once lenders become more familiar and comfortable with LEHCs, their underwriting can become more flexible without increasing their risks. The following three sections of this report address the primary areas of concern that lenders expressed about LEHCs:

- Is there adequate collateral for the loan and can the lender access that collateral through foreclosure or other legal means?
- Is the project financially feasible, both at its inception and throughout the term of the loan?
- Can and will the borrower properly operate and manage the property?

Lenders' concerns with how the borrower's financing needs match the investment needs of the ultimate source of loan funds are also addressed below. This is a critical issue because lenders almost always use someone else's money for their loans, whether that money is from depositors, investments, insurance premiums, or the sale of the loan on the secondary market.

A. Loan Collateral

One of the first things a lender considers when underwriting a loan is whether the property being financed offers adequate collateral for the requested loan. To do this, the lender seeks answers to a number of questions:

1. What is the property's fair market value?
2. Does the borrower have a large enough investment in the property to have a commitment to protect their interest and prevent foreclosure?
3. Are there any legal impediments to foreclosing on the property and obtaining clear title?
4. What are the political and/or public relations ramifications of foreclosing on the property?
5. Can foreclosed property be sold at a high enough value to repay the loan plus holding and marketing costs?

[3] There are approximately 6,000 housing cooperatives in the New York City, northern New Jersey, and Washington, D.C. areas alone.

Market Value

Lenders obtain appraisals to determine the fair market value of properties they finance. LEHCs are generally appraised as rental properties. Unfortunately, LEHCs may actually be appraised at lower values than comparable rental properties. This is because the values of rental properties are based primarily on the projects' net operating incomes. While investors try to maximize their income and profits, co-op members want to keep their carrying charges low.[4] For existing LEHCs that have been able to keep their members' carrying charges low, the projects' lower incomes may result in lower appraised values. Lower appraised values are also likely for both new and existing LEHCs that limit their carrying charges to meet the requirements of government subsidies or to increase their affordability for low- and moderate-income members. In these cases, the LEHCs' values would be higher if the appraiser used the market rents from comparable rental properties instead of the co-ops' actual incomes.

At a minimum, lenders should work with their appraisers to ensure that values for LEHCs with low carrying charges are not appraised too low. If the LEHCs' incomes are lower, market rents for comparable rental properties should be used whenever possible. This can generally be justified even when an LEHC's income is restricted by government contracts and regulatory agreements because these restrictions are typically waived or eliminated upon foreclosure.

Another area of potential concern with LEHC appraisals is that rental properties typically have lower values than ownership properties. Single-family homes, for example, are generally worth more to home buyers than they are to investors. Multi-family housing developments almost always have more value as a number of condominium units than as a single investment property. By the same token, LEHCs should have greater value as groups of ownership interests than as single rental properties. While relatively little market data is available for LEHCs, lenders should try to work with appraisers to quantify the true value of LEHCs based on the combined value of the individual memberships.

Loan-to-Value Ratio

As a general rule, the more money a borrower has invested in a property, the less likely they are to lose it through foreclosure. Because of this, lenders and banking regulators limit the amount they finance and typically require that the borrower invest the balance of the project's cost. Lenders should allow LEHCs to borrow the most that banking regulators will allow, and to substitute government loans and grants for most or all of the balance of the project's cost.

Most of the lenders that finance cooperatives limit their loans to a loan-to-value (LTV) ratio of between 70 and 80 percent. These ratios are similar to those used for multi-family rental housing but lower than for single-family homes. However, LEHCs typically need higher LTV loans so that their memberships are more affordable, especially for lower-income households and first-time buyers. Unfortunately, banking regulators will not allow lenders to make larger loans unless they are insured or guaranteed.

The most common way for lenders to satisfy their LTV requirements and limit their risks, while allowing co-ops to finance the highest possible percentages of their costs, is to combine private financing with secondary financing from a government agency or a nonprofit loan fund. In this situation, the lender finances a comfortable 70% to 80% of the co-op's value. The second mortgage lender finances the difference between the lender's first loan and 90% to 95% or more of the project's total costs. With this arrangement, the co-op memberships can be priced at 5% to 10% of the project's total cost and perhaps even less. Beyond simply providing financing, this type

[4] "Carrying charges" are the individual co-op member's share of the costs of owning and operating the cooperative, and include such items as maintenance and repairs, management expenses, contributions to reserves, insurance, and a proportionate share of the property taxes and payments on the blanket financing.

of government involvement can generate an additional layer of review for the project, as well as technical support that many lenders find reassuring. Because of substantial government participation, Martin Lombardi of the Bank of Mendocino reports that the loan-to-value ratio and other underwriting standards for the bank's loan to an LEHC manufactured housing park were essentially waived.

Mortgage insurance and/or loan guarantees are other ways to eliminate or reduce the lender's risk in providing a larger loan. While very common for single-family home loans, these are rarer for multi-family and co-op loans. However, Dos Pinos Housing Cooperative in Davis, California recently refinanced with a loan through TRI Capital Corporation using HUD's 223(f) mortgage insurance program. Because this loan is government insured, and spread out over a longer term, the co-op has lower monthly payments. The insurance limits the lender's risks and makes the loan more saleable on the secondary mortgage market. Another possibility is for a redevelopment agency to guarantee part of the mortgage payments using the housing set-aside of its tax increment funds. The agency first establishes a payment reserve account which can be drawn upon if the co-op is unable to make its payments. If the payment reserve account is used, the agency replaces the funds that were used in order to maintain an adequate balance in the account to satisfy the lender's concerns.

Since LTV limits are partially based on concerns about how much borrowers have invested in the property, lenders may consider non-financial investments in co-ops. In addition to buying their memberships, co-op members frequently invest considerable time and effort to make the cooperative successful. This is particularly true for rental properties that are converted to co-ops. While this commitment is not easy to quantify, lenders should try to factor it into their underwriting. It may, for example, enable a lender to increase the maximum LTV from 70% to 80% and allow flexibility in other areas.

Another consideration is possible for LEHC mobile home parks. Lenders should take into account the value of the homes located within the park. While their value cannot be included in the LTV calculation because the homes are not actually part of the lender's collateral, they nevertheless represent a significant financial commitment to the co-op by its members. Another reason why this should be considered is because the value of the homes will be impaired if the co-op fails.

Foreclosure

Lenders are also concerned that in the event of foreclosure, they would have to take over and run the cooperative. This may explain why there is a low level of LEHC lending in California. To address this fear, David Kirkpatrick, a California attorney who specializes in cooperative housing law, was consulted. Kirkpatrick stated that this would be the case only if the lender agreed to subordinate its loan to the housing cooperative itself. Whether the loan or the co-op structure has priority affects what the lender receives if the co-op defaults on its loan and the lender has to foreclose on the property. If the co-op structure has priority, the lender takes title to the property as a co-op. Individual co-op members who are current with their monthly payments retain their rights, and the lender obtains the rights—and obligations—of members who defaulted. If the loan has priority, the co-op is dissolved by the foreclosure and any members who are in good standing lose their interests in the property.

For most cooperatives, the California Department of Real Estate (DRE) requires that individual co-op memberships be preserved after the foreclosure of a blanket encumbrance. Without adequate arrangements to protect the rights and interests of individual co-op members, DRE will not issue a public report—the so-called white report—which is generally required before units in a real estate subdivision can be offered for sale to the public. For LEHCs that qualify for an exemption from DRE review and approval, the financing generally has priority over the co-op's legal documents. This allays the lenders' concerns about their lien priority and their ability to foreclose on the collateral for their loan.

Other Collateral Issues

Another concern expressed by the lenders was the effect a foreclosure would have on the lender's reputation. This concern was particularly acute for small, locally-based organizations. They felt that a foreclosure could adversely impact the lender's stature in the community and their business activity. Though their fears are reasonable, lenders can be assured that LEHCs rarely default.

B. Financial Viability

The heart of the underwriting process is evaluating whether or not the LEHC is financially viable, both at its inception and over the life of the loan. Financial viability boils down to whether the LEHC has adequate income to cover its expenses and adequate reserves to deal with any problems that may arise. Lenders are concerned about whether the co-op memberships will be marketable in the future and whether or not this will affect the LEHC's ability to maintain the high occupancy rates that are required for it to be financially viable. In addition, lenders are concerned about the market acceptance of a new LEHC and the ability of the developer and/or sponsor to complete the project on schedule and on budget. Lenders have similar concerns about rental properties that convert to LEHCs. Conversions also raise such additional concerns as the degree of commitment of the current residents to the LEHC. However, if the current residents are highly committed to LEHC ownership, lenders may have fewer worries about the marketing and initial membership sales for conversions.

Debt Coverage Ratio

Since co-ops are generally underwritten as if they were rental properties, the most important factor for most lenders is the debt coverage ratio, or DCR.[5] The DCR is the relationship between the net operating income for a property and the debt service or payments on its financing. It measures whether the project's cash flow after all of its expenses is adequate to cover the loan payments. The higher the DCR, the greater the cushion in a project's budget and the more certainty there is that the loan can be repaid, even if the project's income drops or expenses increase. In addition to providing the lender a sense of security, the cash flow generated by the property provides a profit for the owner.

Because lenders generally underwrite housing cooperatives as they would investor-owned rental housing, they typically require DCRs in the 1.1 and 1.2 range, including a vacancy and rental loss allowance and contributions for both replacement and operating reserves. The use of these same ratios for LEHCs is inappropriate for a variety of reasons. While investors own rental property primarily for the profits that are measured by the DCR, LEHC members own the co-op as their home. In contrast to for-profit projects, LEHCs generally have funded reserves that are dedicated to cover operating and replacement costs and that are supplemented and replenished regularly. Co-ops also tend to have lower vacancy rates and lower maintenance and operating costs than comparable rental properties (Kirshner, 1992; Bandy, 1993). Co-op members can increase their monthly assessment to meet any increased costs. And, if all else fails, co-op members can make up a shortage in their budget through a special assessment of the membership. As a result, LEHC loans should be *safer* investments for lenders than loans for rental housing or commercial projects.

Because of the degree of safety associated with such projects, lenders who have financed LEHCs feel that an overall DCR of 1.05 is sufficient. The staff at California's Department of Housing and Community Development (HCD) believe that a DCR as low as 1.0 can be adequate. Part of HCD's concern with lenders requiring higher DCRs is that higher DCRs either result in higher rents being charged to low-income households or they require government agencies to increase the level of their

[5] The debt coverage ratio is calculated by dividing the net operating income (gross potential income, less a vacancy and loss allowance, minus the cost of managing and operating the property, including operating and replacement reserves) by the loan payments.

subsidy in order to maintain the lower rents and higher DCR.

The National Cooperative Bank (NCB) requires a DCR that is lower than what other lenders generally require, but it is still higher than what the California HCD staff would like to see. NCB requires a 1.15 ratio for their loan and will accept a 1.05 DCR when including all other debt. These ratios are based on their accumulated experience of low delinquency and default rates with LEHCs and other co-ops. Other lenders should consider DCRs in this range, and perhaps lower, when they underwrite LEHCs. They should also be sure that their vacancy and loss factor, and assumptions for expense and reserves,[6] are reasonable and appropriate for the co-op they are financing.

There are a number of factors that lenders can consider in their decision to accept lower DCRs for LEHCs:

- As noted above, the project's reserves can be important. How large are the project's reserves and how do they compare with its needs as based on a reserve study or industry standards? And for existing projects, what has been the historic contribution to the reserve fund(s)?
- Lenders may consider the percentage of income that co-op members pay to live in the LEHC. If a significant percentage are paying less than 30% of their income for housing, the members should be able cover their monthly carrying charges and even increase them without a significant financial burden.
- The historic vacancy rates for the project and other co-ops should be considered.
- Lenders should estimate the cost to live in the co-op—after considering the mortgage interest and property tax deductions that members receive—and compare it with the cost of living in comparable rental or condominium units.
- The lender can also look at the level of resident commitment and participation in the co-op. This is particularly true for existing LEHCs and rental properties that are converting to co-ops.

Shares in the LEHC

People join LEHCs through the purchase of membership shares. Their share entitles them to occupy a unit in the cooperative and gives them voting rights. The cost of each share is specified in the cooperative's bylaws, as is the limit on the rate of annual share appreciation. The share usually must be sold when the member moves from the cooperative and the bylaws generally establish a procedure for selling or transferring shares. The lenders interviewed for this study expressed concerns regarding membership shares.

The correct pricing of member shares was a crucial issue for many lenders. If memberships are priced too low, the monthly carrying charges will be higher, and perhaps more than the members and potential members wish to pay. Having low membership values also reduces the amount of capital the LEHC receives from its members. There is some fear that members whose shares are valued too low will not believe that they have a vested interest in the cooperative. And if members have nothing to lose, they may be less diligent in selling their shares, which can cause vacancy rates to rise.

In contrast, where initial share prices are too high, it may be difficult to market the memberships. Unless enough memberships are sold, the project may fail, leaving the lender with a partially-filled project. And if resale values are too high, even diligent members may be unable to sell their shares. In this case, the co-op would most likely continue paying the lender, but its budgets for property repair and maintenance might be cut. And, over time, the cooperative's affordability and market position would be lost.

[6] According to John Stewart of the John Stewart Management Company, a private company that manages cooperatives, a cooperative's overall management costs are typically 25 percent lower than in comparable rental complexes.

In LEHCs, the level of share appreciation is limited by state law, corporate bylaws, and some financing sources. Lenders may have difficulty understanding why potential members would buy shares that appreciate at less than market rate. Even some members may have difficulty with the idea that their investment receives less than they could get elsewhere. The main reason LEHCs limit share appreciation is to preserve the co-op's affordability for future members, and thereby ensure that affordable housing will be permanently available in the community. Borrowers and lenders benefit from the low appreciation rates because the LEHC becomes increasingly affordable over time which, in turn, leads to lower vacancy rates. And low vacancy rates help reduce the members' carrying charges.

While the Center for Cooperatives found that LEHCs generally handle share transfers adequately (Bandy, 1993), some lenders are concerned about the process. Lenders can review the treatment of share transfers in the LEHC's bylaws to determine whether there are adequate safeguards and protections. They can work with the LEHC to establish a formal process and standards for the resale of shares and approval of new members as a way of further protecting their loans. LEHCs should review the credit history and verify the total household income of all prospective members. They should also evaluate the character and stability of prospective members to determine whether they will become active contributing members of the co-op.

Vacancy Rates

Some lenders expressed concerns about vacancies in LEHCs. Maintaining vacancies at or below the levels the lender estimated when calculating the project's income and DCR will be critical to the LEHC's long-term financial success. Fortunately, high vacancy rates are not a common problem in housing cooperatives. The Center for Cooperatives (Bandy, 1993) found that LEHCs have earned a reputation for low vacancy rates, especially when the initial share costs are reasonable and they have not appreciated beyond what low- to moderate-income households can afford to invest to become members.

Additionally, according to Dave Schallich of the National Cooperative Bank, the cooperative structure gives each member a vested interest in keeping all of the units filled. Their monthly costs and the viability of the co-op are dependent upon the project having few, if any, vacancies. He does believe, however, that co-ops should retain the appropriate professionals when necessary to market vacant units. Lenders may be relieved, not only by the marketing skills of these professionals, but also because they will help the co-op to make objective financial decisions about new members and comply with fair housing and affirmative marketing requirements.

Market Acceptance of New Projects

Since LEHCs are relatively rare in California, some lenders also expressed concern about their marketability. Will prospective home buyers accept membership in an LEHC? Will households who did not think they could become home owners be enticed to become co-op members? How long will it take for the co-op to sell all its memberships? Does the co-op's budget have adequate funds to successfully market the memberships and operate the project during its marketing period?

Lenders will evaluate how attractive the LEHC is compared with competing rental and ownership projects in the market area. The initial membership investment and monthly carrying charges will be important factors in their considerations. While lenders should expect that the costs for new, unsubsidized co-op units are somewhat higher than for those of similar rental units, the LEHC's costs must be lower than those of competing condominium units. If the co-op has a market study, it may be very helpful. Even more helpful would be a waiting list or reservations from prospective members.

With conversion projects, lenders can look at how active current residents are in the conversion process and how committed they are to its success. Was the conversion initiated by the residents or by others? What percentage of the residents support the conversion and how was this percentage established? How will the costs of owning through the co-op com-

pare to renting the property, and what will happen to the residents if the conversion is not successful? Lenders should also consider how successful the project was as a rental.

While much of the lenders' assessment of marketability will be based on the objective financial characteristics and projections of the LEHC, they will also rely heavily on the experience and skills of the team that is developing and marketing the co-op.

C. Project Management

Lenders expressed considerable concern about the management of the LEHC. When they finance a comparable rental project for an investor, lenders can judge the borrower's ability to manage the property based on that investor's past experience managing other rental properties. With a new co-op, the members have no track record on which to base the claim that they can adequately manage the project. Even existing co-ops may have difficulties establishing their ability to properly manage the property.

While some lenders require that co-ops be professionally managed, there have been many successful self-managed co-ops. How can lenders be confident that a co-op—whether professionally managed or self-managed—will be well managed? What can lenders consider as alternatives to prior management experience? How can they ensure that their concerns will be satisfied in the future? And how can co-op members and sponsors present their projects in a way that minimizes lenders' concerns in this area? Some of the alternatives include:

- professional management
- specialized advisors
- management plan
- reserve study
- board training
- membership education
- government oversight
- affiliation with a nonprofit support organization

Professional Management

Because of their concerns about proper management, many lenders will finance only housing co-ops that will retain a professional management company. This generally satisfies the lender's concerns about the co-op's management. It can be a good option for the co-op as well, provided that the co-op is large enough to bear the costs of professional management services and that the management firm understands cooperative housing and treats the members as owners rather than as renters.

Professional management can make a significant difference in how co-ops are run and still not diminish community involvement. The management firm has specialized staff with the experience and skills to manage the property, perform needed maintenance, and keep financial records for the co-op. Because it is their business, the firm also stays abreast of changes in laws and regulations affecting the co-op and its operation.

But simply hiring a management firm does not solve all of the problems. The management firm, the co-op board, and the membership must all have a clear understanding of their respective roles and responsibilities. The co-op board must do its job—there should be a written management plan, an approved budget, reserve studies, and formal procedures for handling members with delinquent payments and for the transfer of memberships. And if the management firm lacks significant co-op management experience, a co-op consultant should be hired to assist the firm and the board through the first year of operations.

Self-Management

Some cooperatives elect to be self-managed. They may prefer this option because it provides cost savings or increases their autonomy. And while self-management may be more appropriate for some of the smaller and less complex cooperatives, lenders should not automatically reject this alternative for larger co-ops. Lenders should be aware that the LEHC membership may include professionals with real estate, management, and other financial experience that can be applied to the man-

agement of the co-op. Granted, self-managed cooperatives do run certain risks, including inadequate bookkeeping, interpersonal conflict, and poor financial decision-making. On the other hand, compared with management firms, their members are likely to have a stronger sense of ownership and a greater personal incentive for maintaining the physical plant and meeting loan obligations.

Successful self-managed cooperatives generally have a long-term relationship with a co-op consultant who provides training and technical assistance to key staff people and the board of directors. The training and assistance may be on an annual basis, or as needed, and it frequently covers topics such as the co-op's legal documents, administrative policies, and financial management systems. These co-ops also establish relationships with attorneys and accountants to provide professional services as needed.

Before rejecting self-management, lenders should consider the skills of the co-op's board and membership, the plans for self-management, and the people who will assist in the process.

The Role of the Co-op Board

Lenders are uncertain about the ability of co-op boards to adopt and follow budgets, perform preventive maintenance, and comply with increasingly complex state and federal housing laws. They are also concerned about how well the boards will deal with delinquent members and the approval of new members. Board stability is another area of concern. While lenders may be comfortable with the current board, will future board members be equally qualified and committed to the co-op's success?

The co-op's board is a key factor in determining how a cooperative is managed. Even when the cooperative is professionally managed, management decisions remain subordinate to the policy decisions and direction of the board. In turn, since the board is democratically elected by the membership, the board itself is subordinate to the will of the membership. Remembering and balancing these relationships is fundamental to the successful operation of a housing cooperative.

Board and membership interference can be a major problem for management. In cooperatives where the role of the professional management has not been clearly defined, individual board and co-op members may overstep their bounds and undermine the managers' day-to-day decisions. This makes it very difficult for managers to do their jobs properly and can lead to a constant turnover in management as well as other problems. In order to avoid these problems, there must be good communication between a well-trained and involved board and the management firm. The board should confine its concerns to matters of policy, leaving implementation to the management. Members, in turn, should be informed both of the policies and their implementation and should maintain good lines of communication with the board.

To stay informed, boards of directors of new cooperatives and new board members of existing cooperatives should receive training on a variety of topics, including:

- nonprofit corporation structure
- roles and responsibilities of the board
- effective decision-making
- budget development
- basic property management
- rules and regulations governing the LEHC and any government financing the project has received

Government Oversight and Co-op Affiliations

Other factors that lenders may consider when evaluating an LEHC's management are whether the co-op will be subject to government oversight and/or whether the co-op is affiliated with a nonprofit support organization. LEHCs that receive DRE exemptions or assistance from various government programs are subject to regulatory agreements. These agreements provide the regulating agency certain rights to review the LEHC's operations and finances. Often, the LEHC must provide an audit and submit proposed operating budgets to

the agency on an annual basis. Lenders should evaluate the regulatory agreement and regulating agency to determine whether the level of scrutiny and review can provide them a greater level of confidence in the LEHC.

In addition, many LEHCs have relationships with established nonprofit organizations that provide the co-op with technical support and assistance. Sometimes the nonprofit agency is the sponsor, or a co-sponsor, of the LEHC. In other cases, the nonprofit is a member of the development team retained by the co-op. In still other cases, the nonprofit is simply a resource that the co-op can turn to for needed information, referrals, and assistance. Lenders should identify any affiliations the LEHC may have, analyze the roles and responsibilities of the nonprofit organization, and evaluate the extent to which the affiliation strengthens or enhances the lender's assessment of the co-op's management team.

Other Factors Affecting Housing Cooperative Management

As noted earlier, share transfers are a source of concern to some lenders. When the original loan is made, the lender is dealing with a known entity. The lender has evaluated the capacity of particular board members to manage the co-op and a particular membership to meet the carrying charges of the cooperative. But that situation can change as the membership changes. Lenders do not have control over who the cooperative accepts into its membership and this loss of control may be perceived as a risk. This risk can be mitigated by the co-op's policies for the marketing and transfer of membership and through an active board training program and formal orientations for new members.

Finally, the participation of the general membership in the cooperative is another indication of how a cooperative takes care of business. In larger co-ops, functional committees are formed. These committees serve as a training ground for new board members and also facilitate regular communication between the members, sponsor meetings, educational workshops and events, and publish calendars and newsletters.

D. Sources of Lending Capital

Over the past two decades the roles and activities of mortgage lenders have changed considerably. The historical perception of lenders accepting deposits from one group of customers and then lending these deposits out to others is long gone. Today, lenders generally originate and service loans for other investors and not for their own portfolios. Loan products have become increasingly standardized so that they can be sold to investors in the secondary mortgage market. Because co-op loans are not standard loans, they have less secondary market acceptance. And when lenders do retain loans in their portfolios, they want the loans' terms to match those of the source of funds for the loans.

Lenders are reluctant to finance even the best properties if their loans cannot be sold on the secondary market or if there is no source of matching capital. This is reasonable from a business perspective, especially for smaller lenders. They quickly lose cash liquidity when their funds are tied up in large portfolio loans and the value of their assets can vary significantly as the money market changes. LEHCs are often viewed unnecessarily harshly in this light. Some of the options available for lenders to access the secondary mortgage market and match capital sources for LEHC loans are identified below.

Secondary Mortgage Market

While most single-family home loans originated in the United States are underwritten and documented so they can be sold on the secondary market, this practice is less common for multi-family loans. This is primarily because the secondary market for multi-family loans is less well developed, less standardized, and not as stable. Investors periodically drop in and out of the secondary market for multi-family loans.

While FNMA (Fannie Mae) largely sets the standards in the secondary market, there are many other potential buyers for LEHC loans. FHLMC (Freddie Mac) and GNMA (Ginnie Mae) will also buy multi-family loans. Insurance companies and retirement funds are largely untapped sources for loan purchases. A

new entry in this field is the Local Initiative Managed Assets Corporation (LIMAC), which was created specifically to buy loans on affordable housing projects. LIMAC is a relatively new institution that was formed by Local Initiative Support Corporation (LISC) to create a secondary market for LEHC and other affordable housing project loans. Both traditional lenders and nonprofit loan funds can originate and sell LEHC loans to LIMAC. As with all secondary market institutions, lenders should contact LIMAC in advance to make sure their loans will conform to LIMAC underwriting standards.

Fannie Mae purchases housing cooperative loans from financial institutions on the East Coast where this form of housing ownership is more common. Some California lenders have also been authorized to originate and sell co-op loans to Fannie Mae. Since Fannie Mae is the largest player in the secondary mortgage market, underwriting, documenting and servicing LEHC loans using Fannie Mae standards will help increase the liquidity of these loans.

In addition to Fannie Mae, Freddie Mac is expected to continue to routinely buy multifamily loans, including loans to housing cooperatives. And by making FHA-insured loans, lenders open the door to selling their LEHC loans to Ginnie Mae. This further increases the loan's liquidity.

Mortgage-Backed Securities

In addition to selling whole and partial loans on the secondary mortgage market, lenders can package loans into mortgage-backed securities. These securities, which generally represent fractional interests in large pools of mortgages, are then sold to investors.

Participation Loans and Loan Pools

Lenders, and especially smaller institutions, that are willing to make portfolio loans may still be concerned about their risks in holding a large loan for a single LEHC in their portfolio. These concerns can be mitigated if a number of lenders split ownership of a loan or a group of loans. This spreads the risks of the single loan among several lenders. SAMCO (Savings Association Mortgage Company) and a number of other lending consortiums throughout California use this approach.

Community Investment Fund Advance

Lenders who are members of the Federal Home Loan Bank system have another option available. They can borrow from the Bank's Community Investment Fund (CIF). The CIF provides long-term (15 to 30 years) fixed rate advances to help capitalize lenders who make community investment loans. This arrangement can provide a source of matching funds for lenders who keep LEHC loans in their portfolio.

Linked Deposits

Another possibility—especially for shorter-term loans—is to seek linked deposits for LEHC loans. With this arrangement, one or more parties agree to maintain deposits with the lender, from which the lender funds specific loans. This should ensure that the lender maintains adequate liquidity. These linked deposits may earn interest at or below the market rate. If they earn below-market interest, the lender's savings can be passed on to the borrowers. Government agencies, religious and charitable organizations, and foundations are potential sources of linked deposits.

VI. Conclusions

The Limited Equity Housing Cooperative is a viable form of home ownership that combines unique characteristics of community-building, permanent affordability, and opportunities for low- and moderate-income households to achieve the American Dream.

Although LEHCs are not a traditional—or even particularly common—form of home ownership, lenders should not be discouraged from financing them. LEHCs have a proven record of low default rates and they typically have high occupancy rates. Because they are owner occupied, LEHCs also have relatively low maintenance and operating costs. More-

over, many LEHCs qualify for government subsidies and credit enhancement which can reduce a lender's risks. In addition, a secondary market and other sources of loan capital are developing for LEHC loans which should allay concerns about loan liquidity. Given all of these factors, LEHCs clearly deserve more attention and support from the lending community.

As has been the case with other forms of community lending, it may take some time for lenders to fully accept LEHCs. To do this, they must first more learn about LEHCs and come to understand the various issues related to this new lending opportunity. They then need to develop appropriate loan products and procedures, and test the market. Once their product is refined and proven, lenders can offer LEHC loans as one of their standard offerings.

This gradual acceptance process has occurred for other types of community lending, such as lending to low-income first-time home buyers, to nonprofit housing corporations, and in inner-city neighborhoods. It can happen for LEHCs as well.

Appendix A

Common Interest Developments

Common interest developments, or CIDs, are real estate subdivisions that in some way combine individual and shared ownership interests. The different forms of CIDs that are recognized in California are:

Planned Developments
Condominiums
Stock Cooperatives
Limited Equity Housing Cooperatives
Community Apartment Projects
Time Shares

To understand the concept of CIDs and their role in the housing market, it may be helpful to think of home ownership as a continuum rather than a fixed state. It is also important to remember that the American legal concept of home ownership is based on holding the "bundle of rights" to a property. Within this context, the question is not "Do you own?" but rather, "What, and under what circumstances, do you own?" The two ends of the home ownership continuum are owning a single-family home in a "standard subdivision" and renting a housing unit of any type. Owning one of the various types of CIDs is somewhere in between, as is ownership in a Community Land Trust or membership in a Mutual Housing Association—two newer forms of "home ownership" that are not formally recognized in California.

Of the various types of CIDs, planned developments (PDs) are the most like standard subdivisions because they are based on individual ownership of both the housing units and the underlying land. In addition to owning their homes and lots directly, the individual PD owners own something in common, such as private roads and community facilities. Condominiums are further down the continuum. Individuals generally own only the airspace within their individual units individually. They share the ownership of the land, buildings, and community facilities and they also share various responsibilities.

Moving further along the continuum, co-op members own shares or stock in the corporation that owns the property—the land and the buildings. They do not own the real estate directly. While members do not receive a deed, they do have the individual right to occupy a particular unit. The owners of a community apartment project share the ownership of their property directly and have certain rights to occupancy of their units. This form of ownership is very rare. With time shares, the ownership interests can be divided into a multitude of different intervals of time spread over multiple units and sometimes even different properties.

Like single-family homes, units in planned developments and condominiums are financed with individual loans. Each owner is responsible for obtaining and repaying the financing on their own unit. In addition, they share the responsibility for operating and maintaining the common areas and facilities in their development and this activity is financed by the assessment of homeowners' association dues. With cooperatives, and LEHCs in particular, the individual owners share the ownership of much more, and consequently have a higher degree of interdependency than do single-family home owners or the owners of units in planned developments and condominiums. They generally share responsibility for repayment of blanket financing and pay for all of the costs of owning and operating the co-op through the co-op rather than directly.

Appendix B

California Health and Safety Code Section 33007.5

Limited Equity Housing Cooperative Criteria

Section 33007.5. "Limited-equity housing cooperative" means a corporation organized on a cooperative basis which meets all of the following requirements:

(a) The corporation is any of the following:

(1) Organized as a nonprofit public benefit corporation pursuant to Part 2 (commencing with Section 5110) of Division 2 of Title 1 of the Corporations Code.

(2) Holds title to real property as the beneficiary of a trust providing for distribution for public or charitable purposes upon termination of the trust.

(3) Holds title to real property subject to conditions which will result in reversion to a public or charitable entity upon dissolution of the corporation.

(4) Holds a leasehold interest, of at least 20 years' duration, conditioned on the corporation's continued qualification under this section, and providing for reversion to a public entity or charitable corporation.

(b) The articles of incorporation or bylaws require the purchase and sale of the stock or membership interest of resident owners who cease to be permanent residents, at no more than a transfer value determined as provided in the articles or bylaws, and which shall not exceed the aggregate of the following:

(1) The consideration paid for the membership or shares by the first occupant of the unit involved, as shown on the books of the corporation.

(2) The value, as determined by the board of directors of the corporation, or any improvements installed at the expense of the member with the prior approval of the board of directors.

(3) Accumulated interest, or an inflation allowance at a rate which may be based on a cost-of-living index, an income index, or market-interest index. Any increment pursuant to this paragraph shall not exceed a 10 percent annual increase on the consideration paid for the membership or share by the first occupant of the unit involved.

(c) The articles of incorporation or bylaws require the board of directors to sell the stock or membership interest purchased as provided in subdivision (b), to new member-occupants or resident shareholders at a price which does not exceed the "transfer value" paid for the unit.

(d) The "corporate equity," which is defined as the excess of the current fair marketed value of the corporation's real property over the sum of the current transfer values of all share or membership interests, reduced by the principal balance of outstanding encumbrances upon the corporate real property as a whole, shall be applied as follows:

(1) So long as any such encumbrance remains outstanding, the corporate equity shall not be used for distribution to members, but only for the following purposes, and only to the extent authorized by the board, subject to the provisions and limitations of the articles of incorporation and bylaws:

(A) For the benefit of the corporation or the improvement of the real property.

(B) For expansion of the corporation by acquisition of additional real property.

(C) For public benefit or charitable purposes.

(2) Upon sale of the property, dissolution of the corporation, or occurrence of a condition requiring termination of the trust or reversion of title to the real property, the corporate equity is required by the articles, bylaws, or trust or title conditions to be paid out, or title to the property transferred, subject to outstanding encumbrances and liens, for the transfer value of the membership interests or shares, for use for a public or charitable purpose.

(e) Amendment of the bylaws and articles of incorporation requires the affirmative vote of at least two-thirds of the resident-owner members or shareholders.

Appendix C

California Business and Professions Code Section 11003.4

"Limited Equity Housing Cooperative" Definition and Requirements for Exemption

11003.4. (a) A "limited-equity housing cooperative" is a corporation which meets the criteria of Section 11003.2 and which also meets the criteria of Section 33007.5 of the Health and Safety Code. Except as provided in subdivision (b), a limited-equity housing cooperative shall be subject to all the requirements of this chapter pertaining to stock cooperatives.

(b) A limited-equity housing cooperative shall be exempt from the requirements of this chapter if the limited-equity housing cooperative complies with all the following conditions:

(1) The United States Department of Housing and Urban Development, the Farmers Home Administration, the National Consumers Cooperative Bank, the California Housing Finance Agency, or the Department of Housing and Community Development, alone or in any combination with each other, or with the city, county, or redevelopment agency in which the cooperative is located, directly finances or subsidizes at least 50% of the total construction or development cost or one hundred thousand dollars ($100,000), whichever is less; or the real property to be occupied by the cooperative was sold by the Department of Transportation for the development of the cooperative and has a regulatory agreement approved by the Department of Housing and Community Development for the term of the permanent financing, notwithstanding the source of the permanent subsidy or financing.

(2) No more than 20 percent of the total development cost of a limited-equity mobilehome park, and no more than 10 percent of the total development cost of other limited-equity housing cooperatives, is provided by purchasers of membership shares.

(3) A regulatory agreement which covers the cooperative for a term of at least as long as the duration of the permanent financing or subsidy, notwithstanding the source of the permanent subsidy or financing has been duly executed between the recipient of the financing and either (A) one of the federal or state agencies specified in paragraph (1) or (B) a local public agency which is providing financing for the project under a regulatory agreement meeting standards of the Department of Housing and Community Development. The regulatory agreement shall make provision for at least all of the following:

(A) Assurances for completion of the common areas and facilities to be owned or leased by the limited-equity housing cooperative, unless a construction agreement between the same parties contains written assurances for completion.

(B) Governing instruments for the organization and operation of the housing cooperative by the members.

(C) The ongoing fiscal management of the project by the cooperative, including an adequate budget, reserves, and provisions for maintenance and management.

(D) Distribution of a membership information report to any prospective purchaser of a membership share, prior to purchase of that share. The membership information report shall contain full disclosure of the financial obligations and responsibilities of cooperative membership, the resale of share, the financing of the cooperative including any arrangements made with any partners, membership share accounts, occupancy restrictions, management arrangements, and any other information pertinent to the benefits, risks, and obligations of cooperative ownership.

(4) The federal or state, or local public agency which executes the regulatory agreement shall satisfy itself that the bylaws, articles of incorporation, occupancy agreement, subscription agreement, any lease of the regulated premises, any arrangement with partners, and arrangement for membership share accounts provide adequate protection of the rights of cooperative members.

(5) The federal or state agency shall receive from the attorney for the recipient of the financing or subsidy a legal opinion that the cooperative meets the requirements of Section 33007.5 of the Health and Safety Code and the exemption provided by this section.

(c) Any limited-equity cooperative which meets the requirements for exemption pursuant to subdivision (b) may elect to be subject to all provisions of this chapter.

(d) The developer of the cooperative shall notify the Department of Real Estate, on a form provided by the department, that an exemption is claimed under this section. The Department of Real Estate shall retain this form for a least four years for statistical purposes.

Appendix D

Comparison of Typical Underwriting Standards

Underwriting Standards	Multi-family Rental	Cooperatives
A. Sponsor/Developer Issues		
*Previous Development Experience	Yes	Yes
*Recourse	Yes	No
B. Resident/Tenant Issues		
*Amount of training	N/A	Certified by MHN/Sponsor
*Recourse	N/A	No
*Credit Checks	N/A	Yes
*Membership in Mutual Housing Assn	N/A	Yes
*Criteria for Selection	N/A	Yes
*Income Profiles	N/A	Yes
C. General Contractor		
*Independent Firm	In some cases	Yes
*Bonding	In some cases	In some cases
D. Property Manager		
*Outside firm	In some cases	Yes
E. Financial Management		
*Operating Budget	Yes	Yes
*Operating Reserves (%)	-	3%
*Replacement Reserves (%)	5%	10%
*Independent Accountant	In some cases	Yes
*Audited Financial Statements	In some cases	Yes
F. Allowable Equity		
*Cash	Yes	Yes
*Second/Third Mortgages	In some cases	Yes
*Share Loans	N/A	Yes
*Private Mortgage Insurance	No	No
G. Lender Underwriting Guidelines		
*Loan to Value (with PMI)	Up to 90%	Up to 90%
*Loan to Value (without PMI)	70-80%	70-80%
*Debt Coverage - all debt	1.2	1.2
*Debt Coverage - 1st Mortgage only	1	1
H. Report/Study Requirements		
*Environmental Report	Yes	Yes
*Appraisal	Yes	Yes
I. Legal Issues		
*Ownership of Land/building	Same entity	May be two different entities
*Lender's Rights Re: Default		

Appendix E

A Cooperative Housing Lending Check List

Development Experience	1. Does the applicant have housing development experience themselves? ___ Yes ___ No How many years? ___ ___ Rental ___ Co-op ___ Single-Family
	2. Is the cooperative working with a professional development consultant or organization? ___ Yes ___ No ___ Years Experience ___ Rental ___ Co-op ___ Single-Family Name of Developer: _____
Property Management	1. Does the applicant have property management experience with multi-family housing? ___ Yes ___ No ___ Years Experience
	2. Who will be the property management agent for the cooperative?
	3. Has the cooperative developed a property management plan? ___ Yes ___ No Copy provided? _____
Fiscal Management	1. Does the applicant have fiscal management experience with multi-family housing? ___ Yes ___ No ___ Years Experience
	2. Who will be managing the finances of the cooperative?
	3. Has the cooperative developed a financial management plan? ___ Yes ___ No Copy provided? _____
	4. Has the cooperative submitted an operating budget with projections for at least two years? ___ Yes ___ No Total annual budget: _____
Reserves	1. What reserves are established? Reserve / Capitalized Amount _____ Annual Budget _____ _____ _____
	2. Are there written policies or procedures for expending reserves? ___ Yes ___ No
Default Mechanisms	In what ways does the project build in mechanisms to ensure that default on the loan will not occur and minimize the overall risks?
	1. Does the applicant have a non-profit community sponsor? ___ Yes ___ No Name: _____
	2. Is the applicant affiliating with the Chicago Mutual Housing Network? ___ Yes ___ No
	3. What steps will the applicant be taking to ensure that their members are adequately trained? ___ Written training plan and procedures ___ Affiliation with the Chicago Mutual Housing Network ___ Other : _____
	4. Are there any mechanisms in place to ensure monitoring of conditions? ___ Affiliation with Network signed ___ Community Land Trust ___ Deed restrictions ___ Other regulatory agreements: _____

[page 1 of 2]

A Cooperative Housing Lending Check List (continued)

Resident and Member Issues	1. Has the applicant completed cooperative housing training workshops? ___ Yes ___ No Training Provider: _____ Describe workshops completed:
	2. Percentage of members trained: ___ %
	3. Are the applicant's membership selection procedures acceptable? ___ Yes ___ No Copy attached? _____
	4. Does the cooperative have a marketing plan? ___ Yes ___ No Copy attached ___
	5. What are the income restrictions?:
	6. Does the cooperative have a waiting list? ___ Yes ___ No How will it be maintained?
Occupancy Agreement and Procedures	1. Does the cooperative have a written and approved occupancy agreement? ___ Yes ___ No Copy attached _____
	2. Does the cooperative have a clear eviction process? ___ Yes ___ No Copy attached _____
	3. What are the terms for the Occupancy Agreement? ___ Renewed Annually ___Open Ended
Applicant History	1. How long have the applicants been in existence as a formal body? _____
	2. Are officers elected? ___ Yes ___ No
	3. Does the applicant have a checking account? ___ Yes ___ No
	4. Do members put up earnest money? ___ Yes ___ No If yes, how much per member? $ _____
General Contractor and Construction Oversight	1. Who will act as general contractor for the project if construction is involved?
Sources of Equity	1. What is the source of equity for the project?
	2. What is the amount of equity? _____
	3. If the equity is from a second mortgage or share loans, has the applicant received a commitment? ___ Yes ___ No
Conversion Process and Plans	1. Does the applicant have a comprehensive conversion plan to achieve cooperative ownership and management within a time frame? ___ Yes ___ No Copy attached _____
	2. At what date does the applicant expect the conversion to be complete?
	3. Who must approve changes to the conversion plan?

Appendix F

Contact List for Further Information

Center for Cooperatives
University of California
Davis, CA 95616
(916) 752-2408

CMHA California Mutual Housing Association
2500 Wilshire Blvd.
Penthouse B
Los Angeles, CA 90057
(213) 385-5365

CMHN Chicago Mutual Housing Network
2125 W. North Avenue
Chicago, IL 60647
(312) 278-4800 ext. 137

FNMA Fannie Mae
135 North Los Robles, Suite 300
Pasadena, CA 91101-1707
(818) 396-5100

FHLB Federal Home Loan Bank of
San Francisco
P.O. Box 7948
San Francisco, CA 94120
(415) 616-1000

HCD Department of Housing and Community Development
State of California
P.O. Box 952051
Sacramento, CA 94252-2051
(916) 445-4775

HCDS Housing and Community Development Services
15313 Sierra Star Lane
Grass Valley, CA 95949
(916) 272-6751

HUD Region IX Department of Housing and Urban Development
P.O. Box 36003
San Francisco, CA 94102-3448
(415) 556-4752

LIHF Low Income Housing Fund
605 Market Street, Suite 709
San Francisco, CA 94105
(415) 777-9804

LIMAC Local Initiatives Management Assets Corporation
733 Third Avenue, 8th Floor
New York, NY 10017
(212) 455-9881

LISC Local Initiative Support Corporation
1055 Wilshire Blvd., Suite 1600
Los Angeles, CA 90017
(213) 250-9550

NAHC National Association of Housing Cooperatives
2501 M Street, Suite 451
Washington, DC 20037
(202) 887-0706

NCBDC National Cooperative Bank Development Corporation
1401 Eye Street, NW Suite 700
Washington, DC 20005
(202) 336-7680

NRC Neighborhood Reinvestment Corporation
125 G Street, N.W., Suite 800
Washington, DC 20005
(202) 376-2530

RCAC Rural Community Assistance Corporation
2125 19th Street, Suite 203
Sacramento, CA 95818
(916) 447-2854

SAMCO Savings Association Mortgage Company
1333 Lawrence Expressway, Suite 415
Santa Clara, CA 95051
(408) 985-8110

Appendix G

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ABOUT THE CENTER FOR COOPERATIVES

The Center for Cooperatives was established by the California Legislature in 1987 to "advance the body of knowledge concerning cooperatives in general and address the needs of California's agricultural and nonagricultural cooperatives."

The Center's objectives are to promote :

EDUCATION. The Center offers formal and informal educational programs to those involved in cooperative management and develops teaching material for all levels of interest.

RESEARCH. To help the state's cooperatives reach their objectives, research is conducted on economic, social and technical developments. A practical aspect of this research: the provision of competitive research grants, and studies for government agencies on how cooperatives can achieve public policy objectives.

OUTREACH. The Center informs the public on cooperatives and their significance to the economy of California.

Located on the University of California Davis campus, the Center serves the public by supporting housing, agricultural, consumer, child care, credit and other cooperatives, drawing its teaching and research resources from both academia and the broader cooperative business community.

For more information about the Center, its programs and publications, call (916) 752-2408, FAX (916) 752-5451, or write to:

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