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Revitalizing the U.S. Department of Housing and Development (HUD) Section 213 Program to Provide Affordable Housing through Cooperatives

Cooperatives and the Section 213 Program:
Housing cooperatives are a shared equity housing model where residents collectively own and control the co-op. To join a housing co-op, members purchase a "share" in the cooperative corporation and obtain the exclusive right to occupy a unit in addition to decision-making power in the co-op's governance. Member-owners, the residents, elect a board of directors to make day-to-day decisions such as budgeting, maintenance, and policies, fostering a sense of community and shared responsibility. This model offers a permanently affordable, community-based approach to address longstanding and increasingly serious gaps in today's housing market.

Section 213 of the National Housing Act[1] provides Federal Housing Administration (FHA) backed mortgage loans to finance the construction, substantial rehabilitation, and conversion of multifamily rental properties to cooperative ownership. This program is often the only source for construction financing of housing co-ops. Historically, Section 213 has primarily been used to support senior cooperative housing but can be used for all types of cooperative housing. To address the current housing crisis and build resilient thriving communities, Section 213 should be revitalized to expand permanently affordable home ownership through the cooperative model and bridge the wealth gap. In FY2023, the U.S Department of Housing and Urban Development (HUD) insured $36.4 million in mortgages for two co-ops hosting 110 units.

Benefits of Section 213 Financing	***Opportunities to Improve Section 213 Financing***
• Long-term, fixed-rate, mortgages create permanently affordable housing for residents across income levels through cooperatives. • Built-in mechanisms to protect co-op members – downpayments paid by members are returned if the project does not materialize. • Institutional oversight from HUD leads to additional success and sustainability of co-ops. • Provides same tax benefits as other types of home ownership offering a positive alternative to rental housing. • Typically, lower interest rates than available through private financing • Incentivizes developers through built-in profit margin (developer's fee) and ongoing revenue through property management.	• Increase awareness and education among HUD HQ and Regional staff to grow support and utilization of Section 213 across the country as a Shared Equity Housing tool. • Increase promotion of Section 213 to fund housing co-ops beyond senior housing, resulting in alternative affordable housing opportunities, providing an additional tool for HUD to address the housing crisis through existing resources. • Allow greater flexibility for co-ops to make advance payments and avoid mortgage lockout periods that prohibit prepayment. • Facilitate co-op housing development by allowing increased flexibility for developers when collecting full down payments. • Support for developers when guaranteeing cash flow for unsold membership shares making it more appealing for developers to utilize the program to its fullest potential.

Section 213 Program Information

Eligible Borrowers:
Non-profit cooperative housing corporations, or qualified sponsors (nonprofit or private investor) who sell the project to a nonprofit cooperative corporation upon completion.

[1] "24 CFR Part 213 - Cooperative Housing Insurance." Electronic Code of Federal Regulations, https://www.ecfr.gov/current/title-24/subtitle-B/chapter-II/subchapter-B/part-213. Accessed 1 August 2024.

Eligible Uses:
Provides insured mortgage loans to finance construction or acquisition of existing cooperative housing projects consisting of five or more units.

- Can cover up to 98% of development cost, but typically ranges from 60% to 95%.
- FHA provides insurance to approved lenders, protecting them against losses in the case of default and, in turn, encouraging lenders to offer lower down payments and interest rates.

Application Process:

1. The eligible borrower meets with the local HUD Multifamily Region Office to determine the feasibility of the project.
2. The eligible borrower submits a preliminary application to HUD to receive a conditional commitment for the project.
3. If HUD provides a conditional commitment, the eligible borrower then works with a HUD-approved lender to submit a final application to HUD. HUD approval is based on market need, zoning, architectural merits, capabilities of the borrower, and availability of community resources.
4. If the project meets program requirements, the local HUD Multifamily Region then issues a commitment to the lender for mortgage insurance.

Approaches to Organizing Housing Cooperatives Under Section 213:
Under Section 213 regulations and guidelines[2], there are three recognized structures eligible for use to develop housing cooperatives. However, in practice, only the "Pre-sale, Management Approach", and the "Conversion/Transfer Approach" have been approved by HUD in the past five years.

1. Pre-sale, Management Approach
The "Pre-sale, Management" approach is the most common structure under Section 213. A qualified sponsor forms the non-profit cooperative corporation and pre-sells shares to future co-op members. Pre-selling co-op shares allows for more flexible loans that can cover a greater percentage of development costs compared to other approaches.

Approach Characteristics

- Title is held by a non-profit cooperative corporation and operates as a management-style cooperative (housing controlled by a co-op board) from its inception
- Governed by a provisional board of sponsor organization's professional staff (may include future residents) controls the co-op development until the first annual co-op board election.
- Typically, 90% of co-op shares are required to be sold to move forward with the project.
- Sponsors guarantee cash flow for unsold shares for a maximum of 3 years, or until sold.
- Co-op members provide an initial payment (referred to as a downpayment) to cover development costs not financed by the insured mortgage. Typically, this ranges from 3-5% of development costs.

2. Conversion/Transfer Approach
Allows for the formation of a non-profit cooperative corporation to purchase an existing rental property and convert it to a cooperative. It operates similarly to the pre-sale management approach, focusing on converting existing properties, offering residents an affordable alternative to renting and greater agency and control over their housing.

Approach Characteristics:

- The mortgage in this type of project is based on the value of the property, not exceed 97% of the appraised value of.
- The cooperative acquiring the property operates under the management approach through the direction of a cooperative board.
- The cooperative corporation establishes a provisional board, under the guidance of a professional management firm, and an attorney knowledgeable of cooperative documents such as articles of incorporation, co-op bylaws, membership certificates, and occupancy agreements to complete the purchase.
- Cooperative membership must equal the amount of vacated or available units and cannot be less than 70% of the total units in the project.

[2] U.S. Department of Housing and Urban Development. (n.d.). *Multifamily Accelerated Processing (MAP) Guide* (HUD Handbook 4550.1, Rev-1). Retrieved from https://www.hud.gov/sites/documents/45501HSGH.PDF#page=11

3. **Investor Sponsor or Non-profit Sponsor Approach**

Under this model, an investor sponsor or non-profit sponsor develops a property, rents units, and then sells cooperative shares to potential members. Once enough memberships are sold, a separate non-profit cooperative corporation is formed, and the property is sold to the cooperative. The sponsor must sell to a management-type cooperative corporation within a period of two years after completion of development. If the sale is successfully completed, the project becomes an insured, management-type cooperative operated under Section 213. If the project is built but is not successfully sold to a cooperative group, the sponsor continues to own it subject to regulations similar to other HUD rental projects, provided reasonable efforts have been made to sell the project to a cooperative group.

Supplementary Cooperative Loans

Supplementary Cooperative Loans for housing co-ops created under Section 213 offer enhanced financial security, providing additional financing to fund improvements, repairs, or the purchase of community facilities for events such as board meetings."