



# Home Base

## The Playbook for Cooperative Development



# Acknowledgments

## About this edition

When *Home Base—The Playbook for Cooperative Development* was first published in 2006 by NCB Capital Impact (now Capital Impact Partners and part of Momentus Capital), its purpose was clear: to provide practitioners with a practical guide for developing housing cooperatives. Supported through funding from the National Cooperative Bank (NCB), that original edition sought to strengthen a field that has long offered communities a pathway to stability, self-determination, and lasting affordability.

Nearly twenty years later, the need for this work has only intensified. The ongoing housing crisis continues to deepen, placing pressure on individuals, families, and entire communities across the country. In this environment, the need for models that create **permanently affordable housing**—and that place residents at the center of decision making—has become ever more evident. Nonprofit housing developers, community-based organizations, and resident leaders alike are turning to cooperative housing as a tool that not only addresses cost but strengthens community ownership and resilience.

This revised manual emerges in response to that growing demand. It offers updated guidance, grounded examples, and practical tools to support those embarking on cooperative housing development today. Our hope is that it serves as a trusted resource—one that both honors the foundations of cooperative development and equips a new generation of practitioners to advance it.

We extend our deep appreciation to the **Cooperative Development Foundation (CDF)**, whose support enabled this new edition. Primary funding was provided to CDF by the **Robert Wood Johnson Foundation**. The views expressed here do not necessarily reflect the views of the Foundation.

**Capital Impact Partners**, part of the **Momentus Capital** branded family of organizations, is a leading nonprofit Community Development Financial Institution (CDFI) that provides a variety of services to support communities including:

- Community development real estate and working capital lending to community facilities delivering key social services
- Training and mentorship programs that break down barriers to professional growth
- Impact investments for growth-stage businesses creating social impact

Capital Impact has disbursed more than \$3.0 billion since 1982. The organization's leadership in delivering financial and social impact has resulted in Capital Impact being rated by S&P Global and Fitch Ratings and recognized by Aeris.

**National Cooperative Bank (NCB)** For over 45 years, National Cooperative Bank has served businesses that seek to make a positive local impact, because NCB believes it's simply the right thing to do. Since its founding, NCB has an uncommon mandate to ensure its efforts benefit those most in need, supporting low-income communities and the expansion of cooperative initiatives. With this guiding principle, NCB contributes to the building blocks of sustainable communities: investing in clean energy; small businesses and affordable housing; expanding access to healthy food and affordable health care; plus much more.

**The team of writers/editors for the revision:**

Terry Lewis—Center for Community-Based Enterprise (C2BE) (one of authors of original Playbook)

Brel Hutton-Okpalaeke—Homestead Community Land Trust (formerly with North American Students of Cooperation (NASCO))

Supported by: Hanan El-Youssef and Mary Griffin, Cooperative Development Foundation

## Table of Contents

INTRODUCTION—SLIDING INTO HOME .....	5
CHAPTER 1—HOW THE GAME WORKS: <i>Understanding Co-op Basics</i> .....	7
The Game.....	7
The Goal.....	7
Who Can Play .....	8
The Playing Field.....	8
The Rules .....	8
How Are Cooperatives Financed? .....	10
Different Ways to Play: Ownership Variations .....	11
CHAPTER 2—GETTING READY TO PLAY: <i>How To Get A Co-op Started</i> .....	16
Playing to Win, or for the Love of the Game?: Creating a Vision and Mission .....	18
Devising a Winning Strategy: Planning and Preparation.....	19
Who are the players? The Development Team.....	20
Paid to Play: Fees for Professional Services .....	32
A Note on Initiation Strategies .....	33
CHAPTER 3—THE FIRST INNING: <i>The Cooperative Development Process</i> .....	36
Swinging for the Fences: Physical Development .....	36
Running the Bases: Organizational Development.....	55
CHAPTER 4—KEEPING SCORE: <i>Financing Cooperatives</i> .....	62
To Swing or Not to Swing: Pro Forma Financial Projection .....	62
Sticking to the Base Lines: Cash Flow Pro Forma .....	64
The Three Bases: The Phases of the Development Budget .....	64
Moneyball: Making Sense of and Optimizing Debt, Equity, and Social Investment Sources of Funding .....	69
Use and Care of Funding.....	86

CONCLUSION—THE BOTTOM OF THE NINTH: <i>Additional Resources</i> .....	88
List of Appendices.....	88
App. 1—Aztech Agreement.....	89
App. 2—Cost Allocation Sheet .....	92
App. 3—Development Flow Chart—Example .....	92
App. 4—Development Flow Chart—Template.....	93
App. 5—Financial Report—Operating.....	94
App. 6—Financing Comparison Worksheet—Example.....	95
App. 7—Financing Comparison Worksheet—Template .....	96
App. 8—IRC Section 216 .....	97
App. 9—IRC Section 42(i)(7).....	98
App. 10—Overview of Co-op Documents .....	101
App. 11—Sample Sales Price Analysis.....	102
Dear Reader—Please note this very important tip! .....	102
App. 12—Federal Funding for Cooperative Housing .....	103
App. 13—IRS Revenue Procedure 1996-32 .....	104
App. 14—Sources and Uses.....	112
Glossary of Terms.....	113

# Introduction Sliding into Home

When the first edition of this manual was published, we asked: if life were a baseball game, homeownership would be like sliding into home base. We still think our baseball analogy makes sense, even if some of the aspects of the game have evolved and changed. In partnership with the Cooperative Development Foundation and with support from a grant from the Robert Wood Johnson Foundation, we are excited to share this updated edition so we can keep coaching the team of people and communities around the country harnessing the cooperative model to meet their housing needs.

In the United States, homeownership is like the goal of “home base”—a place to call one’s own; a place that gives us a stake in our community; a place that keeps us safe. Unfortunately, home base remains out of reach for many. Skyrocketing real estate prices, building management practices, soaring insurance costs, stagnant wages, and other factors keep owning an apartment, condominium, or single-family home difficult at best, and oftentimes impossible.

Cooperatives can change that. Cooperatives are the pinch hitters that can help players round third and slide into home. They offer a homeownership model that allows residents to create wealth through reduced monthly housing costs and by building equity over time. Additionally, cooperatives empower residents by giving them control over building management and operations.

The benefits of cooperatives include:

- Lower costs related to converting cooperatives, as compared to condominiums
- Lower cost of homeownership through reduced per-unit land and construction costs as compared to single-family homeownership
- Preserving affordability of homeownership in order to meet policy goals
- Shared involvement of resident owners in asset and building management
- Avoiding displacement of longtime residents upon expiration of affordable housing subsidies and restrictions (including Low Income Housing Tax Credits)
- Providing an elegant exit strategy for owners of existing rental buildings, for whom the building’s residents provide a highly motivated buyer.

So how do you slide into home? This interactive guide is designed to help show you how cooperatives are created. It provides resident associations with a better understanding of cooperatives, the development process, and how to be smart consumers. It also provides sponsors and developers with a detailed overview of cooperative creation through new construction and conversion.

While there is no substitute for experience in real estate development, this guide helps new players assemble a development team and understand the game plan, including:

- How to convert or construct a housing cooperative
- How to finance the development of a housing cooperative, including sources of funds
- A basic curriculum for training resident owners and their boards of directors

We are excited to share this information—updated from the first edition to better reflect challenges and opportunities of the current market—to help demystify the development process for housing cooperatives and thereby increase the supply of this valuable form of affordable housing. Now let's play ball!

# Chapter 1 How The Game Works: *Understanding Co-op Basics*

## The Game

Housing Cooperatives are a framework to bring people together to collectively own and manage the building(s) in which they live and are an alternative to a condominium association or a single-family subdivision. The cooperative housing ownership structure is most often used in multi-family buildings such as apartments, townhomes, or cohousing. **Throughout this manual, the game we're playing is developing multi-family limited-equity and market-rate cooperative housing.**

**Why multi-family?** While families living in nearby single-family homes could be part of a co-op, residents with a vested interest in shared property are more likely to be part of a co-op. The multi-family structure affords a highly useful model to work from and provides tax and social advantages that are worth discussing as part of this manual.

*Social example:* On the social side, the close proximity of residences fosters relationships among co-op resident-owners and encourages stronger community ties through frequent neighborly interactions.

*Tax example:* On the tax side, IRC Section 216 allows members to deduct their proportionate share of the cooperative's property taxes and mortgage interest on their individual income tax returns. In addition, the cooperative itself may also deduct these payments—effectively permitting a double deduction.

## The Goal

**After the co-op constructs or purchases a building, each buyer becomes a homeowner by purchasing a share in the co-op and signing a proprietary lease.** Their share gives them the right to occupy the particular apartment, townhouse, or dwelling specified in the lease. The cooperative corporation itself owns the land and buildings. Together, the residents own 100 percent of the cooperative corporation, while the cooperative corporation owns 100 percent of the real estate/property title.

## Who Can Play

Co-ops at their core adhere to the Principle of Voluntary and Open Membership by setting parameters for membership and allowing any prospective member who meets the co-op's requirements to join. All types of people at all income levels live in co-ops. Every race, ethnic group, profession, and age group is represented. Famous examples of luxury cooperatives include the Watergate in Washington, D.C. Another example is the Dakota in New York City where Leonard Bernstein, Roberta Flack, and John Lennon lived. Some co-ops accommodate senior citizens by offering special activities and services designed with their interests in mind. Some even limit ownership and occupancy solely to seniors. Other co-ops are set up to serve the interests of artists (loft-type structures), college students (even providing meals and study areas, as well as a place to live), or people with a variety of disabilities. Other cooperatives are designed specifically to be affordable to low- and moderate-income people.

While the co-op's requirements limit who can be a member, a co-op or prospective co-op may engage the support of other non-members in the development process, as outlined in Chapter 2.

## The Playing Field

Cooperative ownership can be applied to any type of multiple-unit physical structure or even the division of bare land. Physically, co-ops can be made up of townhouses sharing walls with the homes next to them; single family or duplex structures; garden apartments; walk-ups; mid-rise and high-rise buildings; fraternity-style or dormitory structures for students; individual building sites within a cooperative subdivision; manufactured housing parks; and even marinas.

Proximity of residences facilitates relationships among the co-op resident/owners. It may encourage community ties based on neighborly interactions. Usually, all of the residences in a co-op are under one roof in a low- to high-rise structure or in contiguous rows of townhomes, duplexes or single structures. In addition, the individual dwelling units often are of similar design, varying only in the number of bedrooms and bathrooms. In these cases, the expenses are more likely to impact all owners similarly, and combining costs of maintenance and rehabilitation brings significant economies of scale.

## The Rules

### **How does a housing cooperative work?**

Owners/residents democratically control the building's management and operation. They come together as a corporation and pay a monthly amount that covers the land and buildings' costs, including the costs of maintenance, operations, property taxes, insurance, and principal and interest payments on the cooperative's mortgage.

Cooperative owners each own a cooperative interest that is the combination of two things:

1. The co-owner's ownership interest in the cooperative corporation (represented by a certificate of ownership or corporate shares), and
2. An exclusive right to occupy a particular dwelling unit (that is owned by the cooperative corporation), which is represented by an occupancy agreement or proprietary lease.

Each ownership interest gives the co-owner a *pro-rata* undivided interest in the cooperative's property as a whole and the right to participate in the democratic governance of the cooperative. This "pro-rata undivided interest" means the owner has purchased *a proportionate part of ownership of the corporation* that owns the land and buildings, not the real estate itself. The cooperative still owns the real estate in total. The owner's right to occupy the specific dwelling unit continues as long as the individual is both a co-owner of the cooperative and abides by the occupancy agreement.

When someone buys a condominium, they are purchasing the real estate. This includes the interior space of the unit—from the air within the walls to the paint on the back walls of the unit—along with a proportional ownership interest in the building's and land's common areas. Because each condo unit is treated as a separate piece of real estate, the development and purchase process tends to be more expensive than for cooperatives. Every condo sale requires its own real estate transaction and recording, which adds cost.

Despite these differences, both condos and co-ops offer similar benefits, such as financing, potential tax deductions, and opportunities to build equity. Cooperatives, however, can offer unique advantages through the use of blanket mortgage financing.

## The Value of Limited Equity

One of the greatest affordable housing challenges is the growing gap between what people can afford to pay for housing and what it costs. This gap between needs and available resources has widened so significantly that many policy makers and developers are questioning the traditional model of dividing all housing into ownership and rental. Under a "limited equity" approach, the appreciating value of the property is controlled and leveraged to promote affordable housing. The models created around the country that capture this limited equity approach vary. Limited-equity cooperatives, community land trusts, and deed-restricted homes are the most common. In addition to enabling long-term affordability, sometimes these models address rising housing costs, such as insurance, heating fuel, and maintenance by approaching them on a shared basis, providing economies of scale. The need for and acceptance of these models is rapidly growing.


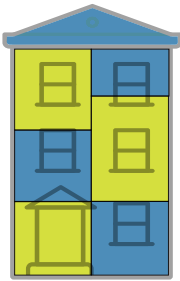
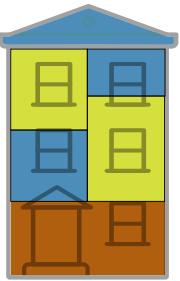
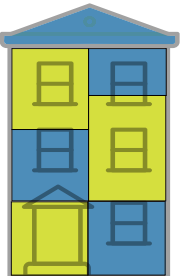
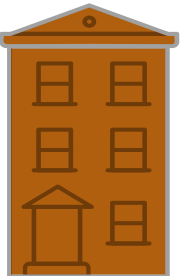
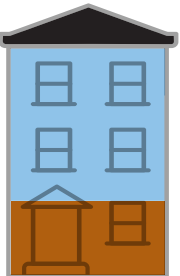
## How Are Cooperatives Financed?

Many advantages of cooperative homeownership come from the flexibility available in cooperative financing. Because the cooperative corporation owns the land and buildings as a whole, the cooperative can mortgage the property as a whole. Co-op corporation ownership is financed with a “blanket” or “underlying” mortgage. The cooperative can use a blanket mortgage to pay for the initial acquisition of its real estate, refinance existing debt, or finance major improvement and rehabilitation projects. Because the co-op corporation itself is the borrower, only the corporation is liable to the lender. No individual co-op member has legal liability to the blanket lender.

Because each individual cooperative homeowner has an ownership interest, he or she can borrow against that interest in the same way that a single-family or condominium homeowner can borrow against his or her ownership interest. This is known as a “share loan.” Because the individual member is the borrower, only the individual member is liable to the lender. The cooperative corporation has no legal liability for a member’s share loan.

Cooperatives can be financed using only blanket debt, only share debt, or a combination of the two. Government funds or even grants can also be applied to financing the blanket or share loan. This allows cooperative developers a great deal of flexibility in matching the financial circumstances of the people likely to buy into a particular co-op.

### HOW EQUITY AND DEBT IS SPLIT IN MULTIFAMILY HOUSING MODELS

 <p><b>Single Family Model</b></p> <p>20 percent Equity 80 percent Debt</p>	 <p><b>Condo Model</b></p> <p>Different levels of debt and equity for each individual unit and unit-owner</p>	 <p><b>Cooperative Model OPTION 1</b></p> <p>30 percent blanket debt with various levels of share debt and equity for each member-owner</p>
 <p><b>Cooperative Model OPTION 2</b></p> <p>No blanket debt with various levels of share debt and equity for each member-owner</p>	 <p><b>Cooperative Model OPTION 3</b></p> <p>98 percent blanket debt HUD section 213 financing</p>	 <p><b>Cooperative Model OPTION 4</b></p> <p>&lt;10 percent restricted equity &gt;60 percent untapped equity 30 percent blanket debt</p>

### How are cooperatives managed or maintained?

Cooperatives operate at-cost. This means that the cooperative's annual budget reflects its best estimate of the exact cost needed to properly operate and maintain the land and building(s). These costs can include management, maintenance of the grounds and building structures, funding appropriate reserves, paying property taxes and insurance for the cooperative, and making principal and interest payments on the co-op's blanket mortgage.

Cooperatives can either hire a property management company to manage the building or decide to “self-manage” the property by hiring their own employees to operate and maintain the property. If the property is very small, cooperative owners may even play a role in property operations, depending on the cost and the available time and expertise of the particular cooperative owners.

Homeowners pay monthly charges consisting of their proportionate share of one month's worth (or one-twelfth) of the cooperative's annual budget. The size and location of the apartment can affect the amount or proportion of the resident's monthly share. These monthly payments are referred to by different co-ops as “occupancy charges,” “carrying charges,” “housing charges,” “assessments,” or “maintenance charges.” We will refer to them as occupancy charges.

At the end of each fiscal year, any surplus from the occupancy charges is used to benefit all of the member-owners. The funds can become part of the next year's budget, keeping increases in occupancy charges to a minimum. These net savings can also be added to the co-op's reserves for future needs, such as building repairs. Or they can be returned to the homeowners as “patronage” dividends in proportion to each owner's monthly occupancy charge. This last option is a unique feature of cooperative ownership.

## Different Ways to Play: Ownership Variations

### Fee Simple Limited-Equity Co-op

This guide focuses on the most basic of cooperative ownership structures: the “**fee simple**” cooperative. In the fee-simple cooperative, the cooperative corporation owns all of the land and buildings and the individual cooperative members own all of the cooperative interests. But variations of this exist and are used to meet a variety of specific needs—both organizational and financial.

The variations include:

### Land Leases/Land Trusts

The land on which the cooperative structures are built is owned by a third party (i.e., neither the cooperative corporation nor any of its members), which grants a long-term lease of the land to the

cooperative corporation. The cooperative corporation owns the improvements (buildings, etc.) on the land. Cooperatives generally involve land leases or land trusts for one of two reasons:

- 1) the land itself is quite valuable and the owner wishes to retain a long-term interest in order to redevelop it after the lease period; or
- 2) the land lease provides for the enforceability of important restrictions on the use of the land, such as the ongoing affordability of acquisition and occupancy of the housing constructed on it. The lease/land trust provides the landowner/trustee with a compelling means to enforce resale and cost restrictions on both individual cooperative interests and the cooperative improvements as a whole.

### Leasehold Cooperatives

A variation on the fee-simple cooperative ownership structure. In leasehold cooperatives, a third-party entity owns the land and buildings in fee-simple and rents them as a whole to the cooperative corporation. Cooperative interests become interests in the corporation's leasehold rights (rather than its ownership rights) with coupled governance rights similar to those found in fee-simple cooperatives.

Leasehold cooperatives are most often created to allow for the use of Low-Income Housing Tax Credits (LIHTCs) in financing cooperative development. Due to the nature of the LIHTC program, the holders of the tax credits must be the actual owners of the housing in order to qualify to use the credits to reduce their federal income tax liabilities. However, the holder of the tax credits may not also be a resident of the building. In many cases, the leasehold cooperative may have the right of first refusal to purchase the property at the end of the LIHTC compliance period.

### Mutual Housing Associations

This term has been used to describe a wide variety of situations. It may denote a situation in which a non-profit organization owns one or more sets of land and buildings that are cooperatively operated by their residents or substantially involve residents in asset or building management. In this situation, the non-profit organization may have a governance structure composed solely of representatives of cooperative co-owners, of cooperative co-owners and representatives of the communities in which the cooperatives are situated, or solely of community representatives.

Alternatively, the term may denote a situation in which one or more fee-simple cooperatives come together to create a non-profit organization that provides professional management or other services to its member-cooperatives on a mutual basis. In this situation, the governance structure of the non-profit is likely to be composed largely or exclusively of representatives of the cooperative co-owners. Mutual housing associations are generally created to provide strength and stability to small cooperatives or as an alternative method of assuring long-term housing affordability.

In other cases, mutual housing associations can be a permutation or combination of the two situations.

### Land-Only Cooperatives

These cooperatives involve a situation in which the land itself (and certain common improvements) is owned cooperatively but the dwelling units are owned individually by members of the cooperative. This may include boats in a marina, manufactured housing units on pads in a manufactured housing community or “mobile home” park, or even conventionally built single-family structures.

## AT-A-GLANCE: HOUSING COMPARISON CHART

	Market Rate Co-op	Limited Equity Co-op	Group-Equity Co-op	Condominium	Rental	Single Family
<b>Ownership</b>	Owner residents are sole owners through a corporation, which owns the land and buildings. Each owner has exclusive rights to occupy a particular dwelling unit in perpetuity.	Same as a market rate co-op.	Co-op owns land and buildings. Each member has exclusive rights to occupy a particular dwelling unit during the term of the lease. Members do not own shares of the corporation.	Unit owners take title to the air space to the back of the paint on the walls of a particular unit plus an undivided interest in the land and buildings.	The landlord owns the land and buildings. Each tenant has the exclusive right to occupy a particular unit during the term of the lease.	Owners take title to the land and building.
<b>Monthly Costs</b>	Homeowners pay monthly operating costs to the cooperative—a proportionate share of total operating costs, blanket debt principal and interest, property taxes, insurance, and reserves. Homeowners with share loans make individual principal and interest payments directly to the share lender.	Homeowners pay monthly operating costs to the cooperative—a <i>pro-rata</i> share of total operating costs, blanket debt principal and interest, property taxes, insurance, and reserves. Share loans, if any, are small and may be serviced by the cooperative, a credit union, nonprofit, or governmental entity. Homeowners with share loans make individual principal and interest payments.	Members pay monthly operating costs specified in the lease to the cooperative—a proportionate share of total operating costs, blanket debt principal and interest, property taxes, insurance, and reserves.	Homeowners pay monthly condo fees to the condominium association—a <i>pro-rata</i> share of total operating costs, insurance, and reserves. Homeowners with mortgages make principal and interest payments directly to each lender. Each owner makes his own property tax payments through monthly escrow or directly to the local government.	Tenants pay the rent amount specified in the lease, which may include the landlord's profit margin, typically based on the highest price the market will bear, rather than actual costs.	Homeowners with mortgages make principal and interest payments directly to the lender. Owners make their own property tax and insurance payments through monthly mortgage escrow payments or directly to the insurance company and local government.

	Market Rate Co-op	Limited Equity Co-op	Group-Equity Co-op	Condominium	Rental	Single Family
<b>Maintenance &amp; Repairs</b>	Cooperative is responsible for exterior maintenance. Cooperatives can choose how they allocate responsibility for dwelling unit maintenance repairs between individuals and the cooperative.	Cooperative is responsible for exterior maintenance. Many limited equity cooperatives assume most or all responsibility for dwelling unit maintenance and repair in order to even out and reduce costs to their owners.	Cooperative is responsible for all maintenance and repair.	Condominium association is responsible for exterior maintenance. Individual unit owner is responsible for all dwelling unit maintenance and repair.	Landlord is responsible for all maintenance and repair.	Owner is responsible for all maintenance and repair.
<b>Purchase Price/ Move In Costs</b>	Purchaser pays market price for shares/ownership. <i>Pro-rata</i> share of cooperative's blanket loan remains in place. Purchaser assumes seller's obligations under occupancy agreement. Few or no closing costs.	Purchaser pays low price for shares/ownership. <i>Pro-rata</i> share of cooperative's blanket loan remains in place. Purchaser assumes seller's obligations under occupancy agreement. Few or no closing costs.	Member typically pays first and last month's rent plus a security deposit.	Purchaser pays market price for the condo unit. Purchaser becomes obligated to pay monthly condo fees. Closing costs include legal fees, recording costs, and title insurance.	Tenant typically pays first and last month's rent plus a security deposit.	Purchaser pays market price. Closing costs include legal fees, recording costs, and title insurance.
<b>Financial Liability</b>	Homeowners have no personal liability on cooperative's blanket loan. They are obligated under their occupancy agreement to make monthly operating cost payments to the cooperative. Homeowners with share loans are personally liable to the share lender for the amount of the loan.	Same as a market rate co-op.	Members are obligated under their leases to pay monthly rent until the end of the lease term.	Homeowners are obligated to pay monthly condo fees to the condominium association. Unit owners with mortgages are personally liable to their lenders for the amount of the loan.	Tenants are obligated under their leases to pay monthly rent until the end of the lease term.	Homeowners with mortgages are personally liable to their lenders for the amount of the loan and are responsible for home maintenance costs.

	Market Rate Co-op	Limited Equity Co-op	Group-Equity Co-op	Condominium	Rental	Single Family
<b>Community Control</b>	Cooperative has the right to approve all potential buyers. Homeowners democratically govern the cooperative and elect a board of directors to oversee operations. Cooperative can terminate ownership and evict residents who violate the occupancy agreement, forcing them to sell their shares to new buyers.	Same as market rate co-op.	Cooperative has the right to approve all potential members. Cooperative can terminate membership and evict residents who violate the occupancy agreement. Homeowners democratically govern the cooperative and elect a board of directors to oversee operations.	Condominium association has little to no control over the sale of units or behavior of unit owners. Unit owners democratically govern the condo association and elect a board of directors to oversee operations.	Tenants have no voice in who moves in and no control over the behavior of other residents.	Owners have no control over who moves in nearby and no control over the behavior of neighbors. Owner has the right to sell or rent their home to the buyer or tenant of their choice.
<b>Facilities Improvements</b>	Three methods are available to finance cooperative rehab, replacements, and improvements: 1) establishment and funding of replacement reserves; 2) new long-term blanket financing; 3) assessment of individual owners for their <i>pro-rata</i> share of the total rehab cost	Same as market rate co-op.	The cooperative is responsible for rehab replacements and improvements.	Two methods are available to finance condo rehab, replacements, and improvements of the common elements: 1) establishment and funding of replacement reserves; 2) assessment of individual owners for their <i>pro-rata</i> share of the total rehab cost.	The landlord is responsible for rehab replacements and improvements.	The owner is responsible for rehab replacements and improvements.
<b>Property Management</b>	Cooperative owners democratically elect a board of directors, which hires and oversees property management firm or can self-manage.	Same as market rate co-op.	Cooperative members democratically elect a board of directors, which hires and oversees property management firm or can self-manage.	Unit owners democratically elect a board of directors, which hires and oversees property management firm or can self-manage.	The landlord hires and oversees a property management firm or uses its own management firm.	Owner is individually responsible for property management and all aspects of the property.

	Market Rate Co-op	Limited Equity Co-op	Group-Equity Co-op	Condominium	Rental	Single Family
<b>Tax Benefits</b>	Cooperative owners enjoy all of the income tax benefits of homeownership, including deduction of interest on their share loan, their portion of property tax payments and the interest on the blanket loan. In most states, owners receive whatever property tax benefits are available to other homeowners.	Unless the cooperative has given them up in exchange for tax-exempt financing or nonprofit corporation status, cooperative owners enjoy all of the income tax benefits of homeownership. In some states, there are additional property tax benefits or savings due to the limitation of resale prices.	Members receive no income tax benefits of homeownership. Often exempt from property taxes, from which are otherwise typically passed through to members as part of their rent.	Condominium unit owners enjoy all of the income tax benefits of homeownership. In most states, condominium unit owners receive whatever property tax benefits are available to other homeowners.	Tenants receive no income tax benefits of homeownership. Rental properties often incur higher property taxes, which are typically passed through to tenants as part of their rent.	Owners enjoy all of the income tax benefits of homeownership. In many states, homeowners receive property tax benefits in the form of lower assessments or lower tax rates.
<b>Home Equity</b>	Cooperative owners build equity as the value of their cooperative interest increases and as their share loan debt is paid down.	Growth in equity is limited through a restriction of resale prices. Generally a formula is used to determine the resale price and the portion that the seller will receive of the increased value of their cooperative interest.	Any increase in value belongs to the cooperative. The member receives no direct benefit from the increased value. The cooperative may use the equity for expansion or redevelopment.	Unit owners build equity as the value of their unit increases and as their mortgage is paid down.	Any increase in value belongs to the landlord and typically reflects itself in increased rents. The tenant receives no benefit from the increased value.	Owners build equity as the value of their home increases and as their mortgage principal is paid down.

## Chapter 2 Getting Ready to Play: *How to Get a Co-op Started*

Whether you're a real estate developer looking to create a cooperative housing development, or a group of like-minded folks looking to put together a better living situation, the overall development process will largely be the same. The individual processes listed below will occur throughout the **5 development phases** of the project: **Ideation**, **Incorporation**, **Pre-development**, **Development & Construction**, and **Permanent Operation**:

1. An **initial vision** for the project is created by the Sponsor, which includes a statement of need that the co-op addresses.
2. A **development team** is recruited.
3. A **strategy** for the project will be created and tested, and the initial vision finalized.
4. The **corporate and financial plan** is implemented.
5. The **marketing plan** goes live.
6. The **physical plan** is implemented.
7. The **operational and handoff plan** goes live.

While this process appears linear, each process will overlap, and many actions will depend on others. A roadmap for the co-op that includes the dependencies and critical decision points will be essential for the project to move forward. A greatly simplified roadmap is below; see Appendix: "Development Flow Chart" for a more detailed example.

Ideation [Develop the Idea]	Incorporation [Create the Organization(s)]	Pre-development [Arrange the financing, acquisition, & construction]	Development & Construction [Execute the financing, acquisition & construction]	Permanent Operation [Unit sales, permanent financing & operation start]
Initial Vision				
Development Team				
Strategy & Vision				
	Corporate & Financial Plan			
		Marketing Plan		
		Physical Plan		
			Operational & Handoff Plan	

Some co-ops get started, literally, from the ground up— what is called new construction. Others begin with the acquisition and rehabilitation of vacant buildings. Still other co-ops involve the conversion of an existing, occupied rental property to cooperative ownership— with or without major rehabilitation.

Because Home Base is a manual about co-op development, all of the development steps are focused on co-ops. However, the basic steps outlined are usually required for any well-conceived multifamily residential development, whether co-op, condo, or rental. The real estate development process requires diverse skills and expertise in real estate development, finance, marketing, law, engineering, architecture, and project management. The cooperative development team must bring those skills together— along with training and stewardship.

## Playing to Win, or for the Love of the Game?: Creating a Vision and Mission

Cooperatives exist to serve a community’s shared social and economic needs. Cooperatives are a means to an end, not an end unto themselves. A cooperative’s purpose should be a tangible move toward a world where that stated need is met. **This world where that need is met is the cooperative’s “Vision.”** If the Vision is enacted, the co-op project has been a success, and unless doing so would return the world to a state where the need is unmet, the co-op can shut down. (Most co-ops exist perpetually for this reason.) The initial vision for the co-op will likely come from one or two people in conversation, and in the early stages will evolve over time as more stakeholders contribute to it. Do not, however, equate this shifting nature with an inconsequential one. The vision will solidify and once solid will be the guiding directive of the project.

A Vision of a cooperative may be,

*“A world in which all residents in the neighborhood of 34th and Jackson St have the opportunity to cooperatively own a home.”*

Critically, **this Vision must be something that is not true yet.** This defines the social or economic need of the community, and thus the cooperative’s purpose for being. If the Vision is already true, there is no need to create the co-op in the first place, and it will fail. **There is no more important agreement within the organizing group than around the Vision of the co-op.**

The Vision statement will inform the co-op’s **Mission—the types of actions the co-op will complete to achieve that Vision.** As the Mission will define the legal existence and policy of the cooperative, this must be explicit, achievable, and articulable, while allowing flexibility in action. Like a mission given in a military context, the mission should express an objective accomplishment, and the limitations on the actions required to complete it. A co-op’s Mission expresses what the cooperative

must *not* do just as much as it expresses what it must do. Any action taken by the co-op must be justifiable within the context of the Mission.

The Mission may be as simple as,

*“To operate as a cooperative and to take any actions permitted in the state this organization is incorporated in.”*

This does not provide any direction to members or funders what the cooperative may do. A mission statement should provide at least enough information to inform the members what types of actions are permissible, such as,

*“to Provide secure and cooperatively managed housing in the Mt. Pleasant neighborhood.”*

Having a more specifically articulated Mission helps in marketing, recruitment, design, and every other aspect of the project, but comes at the expense of limiting the co-op’s freedom to act. Therefore, something closer to,

*“The co-operative’s Mission is to address the lack of market-rate workforce housing in the Mt Pleasant neighborhood by creating and maintaining secure and cooperatively-managed housing where residents can build equity, while maintaining and contributing to a sustainably-managed waterfront,”*

is something that will far better inform corporate design and marketing choices, while leaving the co-op wide room to act. It also clearly indicates that the co-op is creating market-rate workforce housing, not luxury, unaffordable housing, which may be disallowed by potential funding sources, or rejected by members. This is the typical level of specificity co-ops adopt.

Actions or initiatives taken outside the parameters of the Mission are prohibited and have a colloquial name—“mission creep.” If you find that your co-op’s required actions are pushing the boundaries of the Mission, it is time to consider either restating the mission or abandoning the action.

Early in the development process, a critical eye will need to be given to whether the Vision and Mission are representative of the needs and desires of future co-op residents, as without community input, a cooperative development can easily become a mismatch and very difficult to sell.

## Devising a Winning Strategy: Planning and Preparation

The Co-op’s Strategy or “**Strategic Plan**” is a document made up of the set of **Strategic Objectives** the co-op must meet in service of accomplishing its Mission within a set time limit, subject to the team’s Mission scope and resource limitations. During the start-up and development phase, the time that you will typically be focused on is the period up to completion of the co-op’s development,

and one year operating thereafter. This Strategic Plan period is where we will direct our focus in this guide. **Once operating, most cooperatives adopt strategic plan intervals of 3-5 years.**

Your Strategic Plan should answer the “Who, What, Where, When, and Why” questions about the **Strategic Objectives** (actions and outcomes that are critical to accomplishing its Mission). It should exclude actions or outcomes that are not critical to the mission. During the development of the co-op, the Strategic Objective, “Developing the Co-op” is a critical action. For it, you will need answers to each:

**Example Strategic Objective: “Developing the Co-op”**

**WHO:** *The Initial Development Team*

**WHAT:** *Will form a cooperative association and develop a 50-person Limited-Equity Housing Co-op building.*

**WHERE:** *Within the Central District.*

**WHEN:** *Between 2026 and 2030*

**WHY:** *To move closer to our Vision of all residents having cooperative housing access. Failing to do so or meet 50 units would undermine our community’s expectations.*

“**HOW**” each Objective will be met will be answered in the co-op’s Business Plan. The business plan for the project is a living document subject to the Mission scope limitations of the organization. This document will need to be shared with each of the parties in the Development Team, all future members, and funders, who will use it to determine the feasibility of the project or their involvement, and should be written with that in mind. Beyond those parties, the Business Plan should be considered private, confidential, and not shared with any other potential competitors, as other developers may use that information to outcompete your team.<sup>1</sup>

## Who are the players? The Development Team

A **development team** is the group that makes the cooperative development project happen. It can be made up of individual members of a single organization or bring together many individuals and organizations. While resident-members of the cooperative *may* be members of the development team, they won’t necessarily make up the whole team. In fact, it is highly unlikely they will, as the team will require players with specialized skills and resources, many of which will not be easily found in your first group of residents. You may not have identified all of these players early in the ideation phase, but by the time you have reached the pre-development phase of your project, these should be in place.

<sup>1</sup> For projects receiving public subsidy, the authority providing funding may require your Business Plan be submitted in full, and released to the public 1-2 years later as a matter of public record. (This provides transparency surrounding funding decisions, but allows for confidentiality during the development phase.) The publicly-available business plans of successful projects are excellent sources of information.

## The Players

- Sponsor
- Coordinator/Project Manager
- Financial Packager
- Attorney
- Architect and Engineer
- Marketer
- Trainer
- Management
- Accountant
- Insurance Broker

The full team described in this section would most likely be used in a large project, approximately 150 units or more. In smaller co-op development, multiple roles may be played by a single person.

## Roles of the Players

### SPONSOR

For every cooperative, there is a **development sponsor**: a person or organization who is the final decision-maker, takes responsibility for outcomes, and provides the energy to carry the process through. The sponsor can be an individual or organization, for-profit or non-profit, with real estate development experience. It can also be a church group or charitable organization with little or no development experience, an apartment owner seeking a fair price for the property, or a well-orga-

### A Note about Scale

The number of units in an existing building or a planned building will greatly impact the project and the number of people needed for the development team. Typically, it is best practice to attempt as large a co-op as your team is able to finance and manage. It's possible to create a small co-op, but there are a number of costs that do not vary much, regardless of the size of the project. Because of this, it may not be as cost effective to create a small co-op as to create a larger one. While often the legal minimum number of units in a cooperative may be 5, small co-ops are harder to create and harder to operate once in place and often prove infeasible. A co-op development project can be feasible with as few as 10 units, though targeting 50 units would be better. When there are fewer than 25 units, with lower carry charges it is difficult to attract and pay for the cost of a professional property manager. It is also difficult for a small co-op to maintain leadership because the responsibilities of serving on the board can't be passed to as many individuals as in a large co-op.

nized group of residents looking to buy their building. Whether the sponsor puts up a substantial investment or obtains most of the necessary start-up funding from other investors or cooperative owners, its effectiveness will come from having a substantial stake in the outcome of the development process, whether it is money, ideology, or reputation.

### Responsibilities

During the ideation phase, the sponsor explores options, assesses needs, learns the co-op process, and formulates a plan. By the end of this phase, the sponsor should have the appropriate team and plan prepared to finance and implement the project in a professional manner. The sponsor should also understand state law and procedures as they relate to co-op formation. (Chapter 3 will address details of the ideation, incorporation, and pre-development phases.) Where the sponsor may be an organization or unincorporated group, these responsibilities should typically be broken out among individuals, and the decision-making process of the sponsor should be established at the outset.

## Will They Be Fans or Players? Existing Residents

Major differences in the development process will stem from the presence of residents in an existing building. In the case of conversion of a rental building, existing residents are the best and most likely source of owners for the planned cooperative.

Where there are existing residents, it is critical to know the degree of resident support for a cooperative, what role they want to play in the development and conversion process, and whether or not there are any prohibitions on resident displacement.

Typically, if existing residents seek to be members of the future cooperative, they or a subset thereof can and should be included within the group that makes up the Sponsor.

Prohibitions on displacement can come from state or local laws, existing federal or state contracts, or from local governments or governmental agencies. Prohibitions can also be a condition of any social financial investment that will be necessary to make the cooperative affordable to its target market. Any such prohibitions must be a central consideration in planning a cooperative conversion and determining its feasibility. Residents who wish to stay and not purchase into the cooperative can often be able to remain as rental tenants of the cooperative. The presence of an existing group of residents will lead to differences in marketing strategies, timing of owner and board training, and the early involvement of prospective owners in the development process. Other aspects of development will be the same, whether or not there are existing residents.

### Skills

Few sponsors have all of the skills and capacities necessary to carry out every task involved in cooperative development. Therefore, the rest of the development team provides additional skills and capacities. Beyond the members of the development team, the sponsor will generally reach out to lenders; community groups; community leaders; and local, state, and sometimes even offices of federal agencies to provide critical resources to the development process.

### COORDINATOR/PROJECT MANAGER

Next to the role of sponsor, the most critical role that must be filled is the development coordinator or project manager. When the sponsor is a for-profit or non-profit corporation with substantial real estate development experience, a member of its staff typically fills this position. This individual or organization will oversee the entire development process.

### Responsibilities

While various individuals on the team will manage important aspects of the cooperative development, it is the development coordinator who will:

- Oversee the creation of a business plan, timeline, and development plan
- Assemble and contract with the architect, attorney, and other members of the development team
- Ensure that the development team tasks are being completed on schedule
- Coordinate meetings of the team
- Oversee and assist team members with their tasks
- Create and update a financial *pro forma* and apply for financing, or oversee and work with the financial packager to do this
- Facilitate cooperation and communication among team members
- Ensure all government and other approvals are completed on schedule
- Oversee the creation of the cooperative corporation, consistent with state legal requirements
- Make sure that residents and/or buyers are fully informed and appropriately involved in the development process. This last step is especially critical when existing residents are in place.

### Skills

To be effective, the coordinator must have excellent communication, political, and project management skills. Ideally, the individual or organization that fills the role will also have two sets of critical expertise—in real estate development and finance, and in housing cooperative organizational structure and operations. At a minimum, the development coordinator should have substantial expertise in one of these areas and be ready to work closely and effectively with a team member that has substantial expertise in the other area.

As the Coordinator's responsibilities are essential to the project, it is typically best practice to engage an entity or team to fulfill this. Having a corporate entity or team as Coordinator helps to minimize risk brought by a single person's inability to perform and forces the Coordinator to use good documentation.

### FINANCIAL PACKAGER

In smaller developments, typically those less than 50 units, this responsibility falls to the development coordinator/project manager. The financial packager obtains the financing, often from a variety of sources, called the "capital stack".

#### Responsibilities

The role of the financial packager involves:

- Analyzing and presenting financing options for the cooperative based on market analysis, incomes of existing or projected residents, construction and/or rehabilitation requirements, and acquisition prices
- Assisting in the preparation of applications for pre-development loans from government programs or private sources to cover fees for architects, attorneys, and other expenses before construction
- Assisting in the preparation of the financial pro forma, including the development budget and first-year cooperative estimated operating budget
- Participating in contract negotiations for property acquisition
- Preparing applications for loans, subsidies, and other forms of investment
- Assisting in the selection of and communication with lenders
- Monitoring the construction/rehabilitation program from a financial perspective and updating the pro forma accordingly
- Providing input in drafting cooperative documents, developing marketing programs, establishing cooperative operations, and arranging for owner training that complies with social investment requirements. A sound development process will require the consideration of several basic financing options and likely many changes to the original option chosen as events and complications unfold.

#### Skills

The financial packager must be imaginative, able to "make the numbers work" to meet the cooperative's future needs and have access to funding sources. The financial packager must be able to translate the needs of the cooperative into something workable for funders, as often funding sources do not have significant experience with cooperative finance.

As important as being able to *access* funding is delivering that funding *when it will be needed*. A competent financial packager will keep abreast of the overall project timeline, and coordinate that with the timelines of the financiers.

The capital stack will change multiple times throughout the project, and the Financial Packager must be able to quickly and accurately adjust the project's financial plan. As these changes often involve substantial impacts for the project, the Financial Packager must also be an effective and candid communicator with other team members. Where possible, entering into a fiduciary relationship (where the financial packager must act in the Sponsor's best interest) is advisable.

## ATTORNEY

To successfully develop a housing cooperative, a number of complex legal hurdles must be cleared. The sponsor or developer needs an attorney who can navigate the many legal issues that arise during the development process. Attorneys vary significantly. Meet with more than one prior to retaining them.

### Responsibilities

The development team attorney plays a number of important roles and is crucial to:

- Negotiating the purchase of land or an existing multi-family building
- Negotiating and drafting contracts between the sponsor and outside members of the development team
- Reviewing and negotiating loan documents
- Drawing up the documents that structure the legal existence of the cooperative corporation and its relationship to individual cooperative owners
- Helping to file the necessary application and plans for the creation of the co-op corporation
- Explaining the legal structure and requirements of the cooperative corporation, if an existing resident group is the sponsor or directly involved.

### Skills

The four primary considerations in selecting an attorney are: expertise, flexibility, capacity, and fee.

- **Expertise** refers to the experience and skill the attorney will bring to the development process. Among the skills that may be needed are negotiation, resident education, and possibly litigation. Areas of knowledge required should include cooperative experience, tenant statutory rights, real estate contracts, partnership and non-profit corporate structure, conversion of ownership form from landlord to cooperative ownership, tax implications, financing, and the structure and management of cooperatives.

- The attorney should have the **flexibility** to work in non-traditional ways. Where an existing group of residents is involved or a deep social investment is sought, the attorney may need to spend time patiently responding to questions at night or weekend meetings. Creativity may be needed to solve financing problems or resolve conflicts among the sponsor, residents, social investors, and community representatives who each have a stake in the development. The attorney must be accessible—willing to return phone calls promptly and available to answer questions and deal with problems as they arise.
- **Capacity** refers to an attorney's time and supporting resources. An attorney may be experienced in all areas but not have the time to commit to a new project. A less experienced attorney on the other hand, may have sufficient time to learn new subjects but will need to consult with other attorneys in order to do a competent job. Supporting resources are especially important when litigation is involved.
- Attorney **fees** can be a significant part of the soft costs of cooperative development. Soft costs are out-of-pocket expenses that are not directly related to property acquisition, construction, or rehabilitation. One way to reduce fees is to have more than one attorney. If the sponsor is a thinly funded community nonprofit or a low-income resident group, it may be necessary to rely to some extent on free legal assistance. Specialized issues involving cooperative structure, tax questions, or syndication scenarios may arise, requiring the expertise of a specialty attorney. It is important that one specific attorney has the clear responsibility for an end result, no matter how many attorneys or other professionals contribute to the work. Many attorneys will defer payment for a large part of their fees until construction financing.

### Hirer Beware

It is not advisable to have a building resident act as an attorney for either the development team or a resident group, particularly for free. No matter how willing a resident/attorney may be to help out, their paying clients and other demands often overshadow good intentions. Cooperative development is a unique field and requires specialized expertise. Lastly, there is potential for perceived or real conflict of interest and exploitation. Neither is it advisable to try to lower legal fees by limiting the attorney's scope of work too tightly. At a minimum, all cooperative documents and contracts should be drafted or reviewed by and discussed with the attorney. The attorney should take the lead in assuring that state corporations and securities requirements are met.

### ARCHITECT AND ENGINEER

An Architect and/or Engineer will only be a part of the team if there is significant construction planned. If there is, they become indispensable. An Architect can provide overall project de-

sign according to typical building standards. For structural work that needs load calculations, an Engineer is needed. Typically, an Architect is sought first, and an Engineer as needed. The Architect and/or engineer will create a feedback loop with the Financial Packager and Project Coordinator—as design costs come in, they will be evaluated for financial feasibility, then for project appropriateness.

### Responsibilities

If doing any significant construction, the need for architectural and engineering reports will arise early in the development process. In new construction, these professionals will be called upon to analyze prospective sites and make judgments as to what can reasonably be built and whether the location is desirable. Construction plans must meet local zoning restrictions. Utility and sewage lines must be readily available or affordable to install. The stability of the soil, the purchase price, and the number and type of units to be built are crucial early considerations.

An Architect will typically take responsibility for shepherding the project through local zoning and planning approval. One who can work with local planning and zoning officials is worth their weight in gold, especially because in many municipalities, cooperative development requires conditional or non-standard permit approval.

Where existing structures are involved, early reports will provide a preliminary building evaluation of the structures and their environmental hazards. A “Phase 1 Environmental” report from an environmental engineering firm will detail any evidence of concerns—for example lead paint, asbestos, underground storage tank leakage, etc. The engineer’s evaluation (of mechanical systems, structure, roof, etc.) should describe the building, including apartment unit plans, and evaluate the major systems like plumbing and electricity. It should make recommendations for rehabilitation based on code requirements, energy conservation, resident need, and sponsor/cooperative input into amenities and materials required to meet market conditions. The evaluation should include a statement of probable construction costs for a variety of scenarios—from minimal upgrades to optimal improvements. These financial estimates are crucial to the financial packager who will use them to create the development budget, projected annual operating budget, sources and uses, cash flow projections, and other *pro forma* financial statements needed for initial loan applications.

### Skills

The architect should be familiar with local building codes and approval processes, be creative in design, be able to communicate well with the sponsor/cooperative, and depending on the construction management method chosen, have good construction management experience that ensures the construction timeline is met.

## MARKETER

For the cooperative to come into being, individuals must purchase cooperative interests. Some individual or organization that is part of the development team needs to identify those people and help them buy into the co-op.

The marketing responsibilities and skill sets required will be slightly different depending upon whether the property is new construction or rehabilitation of an existing inhabited building.

### Responsibilities

The Marketer's role is fundamentally to ensure that all the units in the cooperative are sold quickly in the first round. Once the units are sold, the marketer's role transfers either to the Property management company or to the cooperative board itself.

A certain amount of units may need to be “pre-sold”—sold before the project breaks ground or effects a co-op conversion. The Marketer will be responsible for ensuring that these are sold during that pre-sale period.

If present, existing residents represent the most logical marketing prospects. Often, one or two tenant leaders who understand cooperatives and are supportive of the effort can have a major impact in marketing to other tenants. Or, the idea for the cooperative may have sprung from residents' organizing activity.

When there are existing residents, the primary marketing task is to organize and train the existing residents, including around whether to approve the co-op, and prepare them to purchase unit shares. When an existing owner of a rental building wishes to convert the building to a cooperative, the property management company will often be the most important player in defining the success of the conversion. Nothing better demonstrates the advantages of ownership than converting to a more effective, resident-responsive management style. An overlap between management and marketing can also reduce development costs. When there are no current residents, or the cooperative needs to identify additional buyers, the Marketer should educate local community and housing groups and real estate brokers on cooperatives and enlist their involvement in advertising and marketing campaigns to identify potential buyers.

It may be necessary for the cooperative to hire a real estate agent to ensure that the cooperative sells out. A real estate agent does not fully replace the role of the Marketer. Real estate agency is supplemental, even if it does overlap with much of the Marketer's role. The Marketer remains fundamentally responsible for the overall strategy for marketing the units in line with the co-op's mission.

### Skills

Basic sales techniques should be complemented with special knowledge and attitude sets. Communication skills, an understanding of cooperative structure and operations, and a profound respect for the needs and capacities of the resident population are required. In addition, the marketer should have the ability and commitment to retain new owners after the purchase agreement is signed but before the property is ready for occupancy.

### TRAINER

Cooperative housing management and understanding of cooperative principles are not universal skillsets but are universally required for members to operate a co-op. Training on these topics is thus an essential part of the cooperative development process. A Trainer can be an individual or organization and ensures that the residents and board have the necessary skills to manage the organization.

### Responsibilities

A trainer is responsible for teaching buyers the basics of homeownership, the cooperative structure and their roles and responsibilities before they become cooperative homeowners. The cooperative structure depends upon active member participation, so the Trainer must both ensure members are *able* to participate and that they actually *do*. The Trainer should create a curriculum for onboarding new co-op members and make it available to all prospective members. It is very reasonable to expect any prospective member to complete this basic training.

Another key aspect of development is board training. Responsible leadership must be developed and nurtured to lead and manage the cooperative. Further, the continuous encouragement of new leadership must be built into the process of cooperative governance, and a commitment to ongoing owner and board training must be built into the cooperative's operating philosophy. The Trainer should set the co-op off on the right foot by establishing key performance metrics that the board can use to examine itself with and training the board on how to use them. Basic competency training in property management must also be issued to the board, as well as training on how to evaluate a management company. Without the competency for management responsibility to fall back upon the co-op board, the cooperative will be left unable to function if the Management company underperforms.

Underpinning basic member training and board training is an understanding of the Cooperative Principles, which the Trainer must include throughout their curriculum.

### Skills

A good trainer will have solid expertise in cooperative governance and experience in working with cooperative corporations. They critically must be able to develop rapport with participants.

The Trainer must also be competent in cooperative property management. As cooperative training is an unregulated field, it is very easy for a Trainer to not have significant depth of experience in practical, rather than theoretical property management. When evaluating a potential Trainer for the Board and Members, carefully evaluate their tangible experience.

#### PROPERTY MANAGER

Most co-ops will require services from a property manager, or management company to take care of operating and maintaining the building. Some co-ops will be able to provide hired management services internally while others will look for an external property management company to act as a consultant with its own hired employees. All co-ops should have experienced management with good references.

Co-op-serving property management companies are increasing in number, to the point now that the services that co-ops need are fairly well-defined in the industry. Where a management company that explicitly serves cooperatives cannot be located, a management company that serves condominium associations is likely competent.

#### Responsibilities

The co-op will want management that can either provide full services or be willing to develop a plan that includes participation by the cooperative. The management must understand the co-op structure and provide complementary services. This includes meeting with the board at least once a month and providing a full and easily understood accounting of that month's activity. Depending on the state or municipality, management companies for common interest communities like co-ops or condo associations may have additional legal responsibilities outlined.

Typical Management Company responsibilities include:

- Collecting Carrying Charges
- Maintaining Member records
- Accounting
- Maintenance request management
- Capital Reserve Study solicitation and issuance
- Marketing and web presence management
- Issuing Notices
- Filing annual reports (in conjunction with the board)

*While some or all of these responsibilities may be handled by members or in-house, contracting with a professional management company is a way to keep governance of the co-op separate from daily management of the co-op, and helps to minimize the corresponding training requirements.*

### Skills

A management company should be capable of executing a complex, repeating workflow without interruption and be responsive to member needs. Most management companies attempt to automate as much of this as they can through implementing an owners' portal, which should track maintenance and other requests, contain key organizational documents, and serve as a vehicle for notices and other resident communication.

Where Federal Housing Administration (FHA) insured financing or Section 8 assistance is anticipated, management should have experience working with Housing and Urban Development (HUD)-assisted projects. (See the Glossary of Terms and Appendix: Federal Funding for Cooperative Housing for details on these programs.)

The management company should have familiarity with other subsidy financing that may be part of the project.

Finally, management must understand that cooperatives are different from rental properties, in that the board makes major decisions and the management reports to the board.

### ACCOUNTANT

Rapidly in a co-op development project, large sums of money and equity must be mobilized, often through complex flows. From the beginning to the end of the project, that money and equity needs to be accurately tracked and accounted for, typically with an audit at the transition from the development period to the operating period. Poor financial record keeping is one of, if not the single, most likely reason for a startup organizing group to collapse. A professional accountant or accounting firm allows the group to have a single source of truth regarding the state of the team's finances. It further ensures they are recorded according to Generally Accepted Accounting Principles (GAAP), which will allow outside entities to clearly understand the organization's financial reports, and know they are representative. Some smaller projects have the financial packager fill this role, but that is not advised.

### Responsibilities

The Accountant must accurately and regularly track and report on the finances of the organization according to GAAP standards. Any development project will require tax filing; the Accountant should be responsible for compiling these returns.

### Skills

An accountant or accounting firm should either be a Certified Public Accountant (CPA) or have a CPA supervising a bookkeeper who does regular data entry. They should understand cooperative share value recording and any other financing instruments the Development Team intends to use.

## INSURANCE BROKER

An insurance broker is one of the last parties to bring onto the team. Their role is solely to secure sufficient insurance to mitigate the myriad risks that the co-op development project will face. Insurance brokers are almost always individual representatives from a larger company. Without sufficient insurance, the project may find itself unable to qualify for funding, or the team may be placed at significant personal risk.

### Responsibilities

The Insurance Broker should secure bids for insurance for the multiple phases of the development project, and bring them to the Financial Packager to incorporate into the budgets. During development, at least General Liability, Builders' Risk, and Directors' and Officers' insurance should be sought, and during operation, Building Owners' (Property), General Liability, and Directors and Officers' Insurance is needed.

### Skills

The Insurance Broker must be able to navigate multi-unit cooperative insurance requirements in the state in which you are operating and should maintain a current brokerage license.

## Paid to Play: Fees for Professional Services

Members of the development team can charge by the hour, a flat fee, or a contingency fee.

**Hourly rates** are most common for attorneys and financial professionals. They will tend to fall within a general range for each profession in its respective geographic location. A more experienced professional, who may charge a higher fee, may consume less time and incur fewer costs in the long run. A retainer or minimum fee may be required in situations where the fee is based on an hourly rate.

**Flat fees** are most common for architectural and engineering firms. Some firms may be willing to do some of the pre-development work without payment with the understanding that, if development proceeds, they will be hired and paid to do the work.

**Contingency fees** are generally an agreed-upon percent of financing or percent of total development costs that are paid after successful completion of the project. Some fees may be deferred until later in the development process and are paid from a source such as construction or permanent loans, proceeds from the sale of cooperative interests to owners, or from a combination of different sources. Hourly or contingency fees are most common for financial packagers and development coordinators, especially where roles are combined in a single development consultant organization.

**Management fees**, on the other hand, will be paid on an ongoing basis over the entire life of the cooperative. Sometimes, a management company can be persuaded to become part of the development team in exchange for a contract once the cooperative begins operations.

### Payment for Sponsors

Sponsors, whether non-profit or for-profit, will also be paid for the cooperative development. The sponsor will need to recover its investments both for out-of-pocket costs and for the organization's time and effort. The sponsor will typically receive the bulk of its payment at final closing, when the property is ready for occupancy by owners, permanent financing is put in place, and purchases by cooperative owners are finalized. The sponsor's return can come in cash from the mortgage taken out by the cooperative, the sale of the building to cooperative owners, or a combination of the two. The sponsor can take unsold shares as part of its compensation. Sponsors can also take back mortgages on the cooperative land and buildings and, in this way, receive a return on its investment, its fees or profits, plus interest over time. The sponsor's compensation and the developer's fee are typically between 7.5 and 15 percent of total development costs, including acquisition.

## A Note on Initiation Strategies

These are real considerations to keep in mind throughout your project. They will impact every decision you make.

**1. PARTY INTERESTS**—The parties who make up the Development Team have individual and distinct personal interests. An “interest” is something that a party stands to gain or lose as a result of a decision. Interests are often the primary reason a party makes a choice or takes an action. When making decisions, policies, or plans, consider some of the interests of different parties listed below and how they may conflict. Legally, interests are considered purely through a financial lens, but may be interpersonal or reputational as well. Avoiding or at least disclosing legal conflicts of interest is something each Team member will be responsible for throughout the project.

#### 1.1. Developer

- Reputation/portfolio
- Fee
- Equity risk

#### 1.2. Sponsor

- Reputation
- Long-term affordability of unit acquisition (possibly)

#### 1.3. Lender

- Repayment
- Underwriting/loan cost recovery

- Loan loss risk & reserve (higher risk loans require additional reserve that cannot be used for lower risk income-generating lending)

#### 1.4. State/municipality

- Zoning
- Reelection
- Affordability

#### 1.5. Social investors

- Alignment with mission

#### 1.6. Resident-members

- Long-term affordability of unit occupancy
- Member control
- Appreciation of unit value (possibly, but usually)

## 2. STARTUP MODELS

### 2.1. Resident Right of First Refusal (ROFR)

- Pre-development financing is the first major hurdle. Unlike other models, residents typically do not have immediate access to unrestricted equity for pre-development costs. Further, distributing these costs across a group requires coordination, collaboration, and a formal organizational structure.
- Localities that have institutionalized ROFR make it easier to pursue this model. If your state or municipality has not done so, consider advocating for legislative action. Presenting examples of functioning states or municipalities with effective, supportive legislation can be highly persuasive in moving this forward.

### 2.2. Developer-led Multi-family Housing development

- Developers who have done Multi-family Housing Co-op development have established capacity to do it.
- Handoff to the member-residents is the major concern of Developer-led Multi-family Housing developments. If the Developer is not already working with a stable and organized co-op entity, the Developer must have access to the resources needed to organize the member-residents into forming a cooperative entity and sufficiently provide the substantive initial training to the member-residents that they will be able to manage the co-op entity and building long-term. The Developer must prioritize this work to avoid project failure and reputational harm post-development.

### 2.3. Sponsor-led Multi-family Housing development

- Centered social concern is the hallmark of sponsor-led development.

- The primary challenge is capacity. Partnering with an aligned developer often helps address this concern. Alternatively, if the Sponsor assumes the Developer's role, securing highly capable general contractors, lawyers, and accountants is essential.
- 2.4. Co-op as part of a larger development (commercial/residential structure)
- For any project where the co-op is part of a larger commercial or residential structure, you need municipal support. This may not require direct financial participation, but must include formal approval and backing for the project.
  - The co-op is still the co-op. It must remain a distinct entity with its own governance and decision-making authority. Even if the larger structure is an LLC, land trust, or other entity, the co-op should maintain its own independent legal standing.
  - Relationships between organizations must be explicit and contractual.

## Chapter 3 The First Inning: *The Cooperative Development Process*

COOPERATIVE DEVELOPMENT involves two parallel processes: physical and organizational development.

- **Physical development** is a multi-step process that includes site or property selection, financial feasibility analysis, design, financing, site or project acquisition, permitting, construction, and start-up of operations.
- **Organizational development**, also a multi-step process, includes entity creation, owner sales, owner and leadership training, and transfer of control from the developer/sponsor to the cooperative's member-owners.

While many of the steps in physical and organizational development occur simultaneously—and some, like marketing, could fall into either category—each still requires dedicated attention.

THERE ARE NO SHORTCUTS: Different combinations of sponsors and development coordinators distribute responsibilities in varying ways, and other development team roles may be bundled or divided among team members and organizations in different ways. For simplicity, we refer to the locus of responsibility across many of the development as the “sponsor/developer.” Keep the complexity of real-world team roles in mind as you work through the outlines of physical and organizational development.

### Swinging for the Fences: Physical Development

There are two types of physical development:

- **Converting an existing building**, possibly with moderate renovations.
- **New construction or “gut renovation” of a vacant building** is sometimes used in place of “substantial rehabilitation,” a standard term used by lenders for significant restoration or refurbishment of an existing building.

The initial steps in converting an existing property to cooperative ownership are different from those for new construction. The two types converge later in the process and become more similar.

## The 8 Steps of the Physical Development Process

Our description of the Physical Development Process is divided into eight steps. While these steps typically occur in order below, they may vary or be pursued simultaneously depending upon the project.

STEP 1: Project concept

STEP 2: Site evaluation and selection using market demand studies and feasibility analysis

STEP 3: Preliminary financing decisions and preparation

STEP 4: Finalizing assembly of the development team

STEP 5: Financial packaging

STEP 6: Essential commitments

STEP 7: Property acquisition and construction

STEP 8: Operations start-up

### STEP 1: Project Concept

The first step is to define what type of project you intend to develop. In the case of converting an existing building—as opposed to undertaking new construction, certain decision points can be simplified or abbreviated. The project concept can then be outlined in a document to present to stakeholders.

#### DECISION POINTS

One of the first decisions is whether to do a new construction or renovation. Renovation projects are suitable for buildings where residents have expressed interest in purchasing their apartments or when a building has a substantial number of vacancies. In markets with higher vacancy rates, acquisition and renovation costs are often lower than the costs of new construction. In low vacancy rate markets, new construction may be the better option. It may also be preferable in markets where existing properties are not as adaptable to cooperative housing—for example, where many buildings are small, with fewer than 20 apartments.

**Neighborhood selection:** Part of the decision-making will be defining the neighborhood or neighborhoods where you will look for sites. Neighborhood selection research should include discussions with real estate brokers, local government officials, building owners, local neighborhood associations, and community development corporations. (See Step 2 to learn how to select a site.)

**Identifying the likely market:** Identifying the likely market for the cooperative units is the next crucial decision to be made. Key market factors include household sizes, desired apartment size, community or building amenities, and income levels. Cooperative ownership typically appeals to renters interested in ownership. In markets where cooperatives are less well known, many households may find that cooperatives are the only path to homeownership. In some cases, a cooperative may target a specific market segment—like artists or seniors—which may require more focused market research.

Identifying the market helps define the type and size of units to be developed, the construction standards, the required local services and amenities, and the prices that will be affordable to that group of households. Comparing affordable purchase prices with the actual cost of purchasing and developing the site also informs how much subsidy will be required. If the necessary subsidy exceeds what is typically available from local government or charitable sources, the project may not be feasible—or may require additional time to secure support from subsidy providers.

Typical sources of information for identifying likely cooperative buyers are census data, city and state community development and housing reports, local homeownership counseling agencies and consumer credit agencies, real estate brokers, and existing cooperative or condominium developers. Some homeownership counseling agencies or non-profit homeownership programs might also be potential sources.

Cities with populations over 80,000 usually prepare publicly available Consolidated Plans to receive certain types of federal funding, and these often contain useful market data. Home Mortgage Disclosure Act (HMDA) data, organized by census tract and zip code, can show you the mortgage application and approval numbers and patterns and whether the area is gaining or losing residential investment.

**Concept paper draft:** Based on the above information, the sponsor will write a one-to-two page concept paper that can be given to the board of directors, relevant staff, potential residents, partners, and people who might be helping to identify a site or finance the project. The write-up should include:

**Description of what a cooperative is and why you are interested in creating one.** Because many people are unfamiliar with cooperative housing, explain the model in simple terms and highlight how it can offer security, shared responsibility, and a sense of belonging in ways not otherwise offered by alternative models.

**Project type, size, and target neighborhoods.** Describe whether the project will be new construction, acquisition and rehabilitation, or conversion of existing occupied building(s); the number and likely unit sizes; and neighborhoods where you expect to look for property.

**Target market of resident owners in the cooperative**, including the income ranges of the residents you anticipate will be living in the apartments and any targets for affordability. (For example, you may be able to provide homes that are affordable to households making as little as 65 percent of the area's median income but expect a mix of residents between 70-80 percent). Also, provide an estimate as to when the units will be filled or shares purchased.

**Potential funding sources.** If the project anticipates the need for subsidies to ensure affordability, include a description of likely funding sources. In addition, the source for pre-development financing (the costs required before construction begins) should also be included.

**Projected timeline.** Identify the estimated number of months or years to:

- Find a site (often up to 2 years)
- Package the financing
- Complete architectural drawings and other requirements to begin construction or rehabilitation
- Complete the construction
- Market and sell the units
- Seek and receive approval for the creation of the cooperative corporation

**Potential partners.** Indicate any potential partners including consultants, other non-profit agencies, homeownership or cooperative counseling agencies, and development team members.

**Contingencies.** Plan for potential constraints in the development process. You need alternatives if a site becomes unavailable or unexpected issues arise. Lenders look for conservation assumptions including extra time in the schedule and financial contingencies in the budget. They also expect the sponsor/developer to understand local regulatory and logistical challenges. A strong plan clearly identifies major risks and how to manage them.

Most experts recommend budgeting a contingency of 5 percent for soft costs and a higher amount for hard costs—7-10 percent for new construction and 10-15 percent for renovations. These contingency funds should be included regardless of any guarantees in the General Contractor's contract. Because some subsidy funders limit contingency levels, their requirements should be reviewed and reflected in the budget.

Renovation projects typically need larger contingencies since older buildings often reveal hidden problems only after work begins.

## Avoiding Pitfalls During the Development Process

**Time:** The vast majority of developers and cooperatives find that projects take longer than originally expected. It is not uncommon for a project to take 3-5 years between concept and completion. Delays are common in several parts of the development process, such as locating an appropriate site, gaining site control, securing financing, addressing environmental issues, obtaining building permits and zoning variances, preparing architectural drawings, completing major construction projects, moving residents if needed, and finishing cosmetic repairs. A well-qualified project manager will help estimate how long design and construction work will take and ensure the proposed timeline is conservative.

**Money:** Verify what sources of funds are available before entering the site selection phase of pre-development. Packaging resources, particularly if subsidy financing is expected, can be time-consuming and difficult. Many subsidy sources are highly competitive, have application cycles only once a year, and/or may require more than one application to be successful.

**Rules & Regulations:** Identify local compliance requirements, including building codes or zoning restrictions. Consult experienced project managers, other cooperatives, architects, developers, contractors, and local officials, keeping in mind that interpretations of rules may vary. Projects needing special permits or variances often face added uncertainty, and final decisions may not be available until inspections or hearings. Anticipating potential issues and working with an experienced team is essential. In some cases, hiring an expeditor can help move the review and approval process forward.

**Need for Professional Assistance:** The development process involves a great deal of technical expertise and significant financial risk. Don't try to go it alone on your first project. Contract with knowledgeable professionals to guide you through various aspects of the process. Be aware that using volunteers can be an excellent way to obtain certain services; however, it can also be problematic due to a lack of commitment or time availability.

### **STEP 2: Site Selection & Evaluation Using Market Demand Study and Feasibility Analysis**

Site selection and evaluation generally includes gathering detailed information about the location, arranging site and environmental evaluations, and estimating the subsidies needed—and available—based on potential buyers' incomes. For rehabilitation or conversion projects, the actual incomes of current residents are used to estimate subsidies. As information is collected, each potential site is assessed for feasibility of cooperative development. Lenders typically require such an analysis for making financing decisions.

**MARKET DEMAND STUDY:**

Evaluate the local housing market to determine potential demand for cooperative housing. Engage current residents to identify rehabilitation needs and assess whether they or their neighbors might become buyers. Most lenders require a formal market study for financing proposal and may need to approve the consultant who conducts it.

A market study for housing cooperatives has several primary components. It should:

- Demonstrate long-term demand for your housing unit type. Assess whether current market activity suggests a sustained pool of buyers and sellers interested in cooperative ownership over its useful life.
- Establish unit pricing. Determine what buyers would pay for carrying charges plus share loan payments.
- Show rental viability. Most lenders, particularly in markets where cooperatives are uncommon, often require proof that the property could succeed as a rental if cooperative sales fall short.

**Demonstrating Long-Term Housing Demand**

Analyze trends in typical apartment sizes, vacancy rates, recent sales, and area rentals to assess pricing and demand for similar unit types. If the homeownership rate or population of the area is falling, determine why. It may be that marketing any type of homeownership might be difficult in an area with high unemployment, or it may be that affordable homeownership is an unfilled niche in the market. In cases where subsidy financing from the government is required, political support for the project is important.

**Establishing Unit Pricing**

Creating permanently affordable housing for neighborhood residents is important. Even market-rate co-ops, if priced in line with the current area's affordable levels, improve area stability. Unit Prices should be comparable to or lower than the typical housing payments in the area. Co-op governance labor should be considered a cost; the savings in charges and increase in stability must balance that cost, or the units will not be competitive. Local brokers, online resources, and housing officials can provide relevant pricing data. If your project targets specific income levels, such as "low-income" or "below 80 percent Area Median Income," HUD's database will give a clear answer to what is affordable in your area. Housing payment levels and potential resident incomes can also be researched online, from local brokers, local housing officials, census data, community surveys or local reports. The Home Mortgage Disclosure Act (HMDA) is typically useful.

### Showing Rental Viability

*In areas where multi-family ownership is not well established, evaluating rental marketability helps identify alternative operating incomes and building uses.* Most potential buyers for your project will likely be current renters, unless the project targets a specialized market such as seniors.

### FEASIBILITY ANALYSIS:

The market demand study provides the income or source side of a feasibility analysis; the expense side outlines how funds will be used. Knowing what buyers will pay for cooperative shares is only half the equation—the developer must also ensure that projected development and operating costs can be supported by the revenue.

Two core tools guide this analysis:

1. **The Sources and Uses Table:** This table details total development costs—developer fees, construction costs, overhead and profit, legal and architectural services, financing and other third-party fees, and all other costs.. These uses are compared to all incoming funds, including share purchase prices, subsidies, and long- and short-term debt. *The Appendix “Cost Allocation Sheet” provides a sample Sources and Uses Table.*
2. **The Operating Budget:** This budget shows whether buyers can cover ongoing project operating and maintenance costs, including debt service on the cooperative’s permanent blanket mortgage, with or without continuing subsidies. *The Appendix “Financial Report—Operating” provides a sample Operations and Maintenance Budget.*

Many professionals update feasibility analyses multiple times—six or seven is common—during the development process as estimates become more precise. Throughout development, the project manager or financial consultant should revise the *pro forma* whenever cost assumptions, market demand, or available subsidies change.

For the purposes of site selection, the Site Feasibility Analysis includes not only the calculations, but the justification for why the assumptions made are reasonable. To analyze a Site, you must show that each of the following is feasible for your development:

- Location
- Site Acquisition Cost
- Construction Cost
- Legal & Environmental Suitability for Construction

Together, these details can support a “back of the envelope” estimate of acquisition, rehabilitation, or construction costs.

**LOCATION:**

When selecting a site from all the infinite possible sites, it can be easier to filter out what would *not* make a good site rather than what *would*. Committing to a specific city, neighborhood or other geographical region greatly speeds this process. Among the things that need to be considered when choosing a location is which sites are available for new construction? What existing buildings have potential for rehabilitation? How much do the sites cost?

A sponsor/developer should also consider:

- accessibility to highways, services, mass transit, and community amenities
- areas targeted by local government for subsidy financing or homebuyer assistance programs
- zoning or density incentives for affordable housing

**SITE ACQUISITION COST:**

Cost should be the first factor considered when evaluating potential sites. Typically, the largest mistake new developers make is overpaying for a site. As the Site Acquisition Cost + the Construction Cost must be covered by the unit sales income, and per-unit construction cost is relatively fixed, you will quickly come to a determination of how much per-unit you can spend on site acquisition. (See Chapter 4.) **Do not purchase land that does not pencil out.**

If a site has a “**density bonus**”, an allowance for affordable homeownership to build more densely than alternative models, you may be able to improve the per-unit site acquisition cost ratio by adding more units than a competing standard developer. Other site-related cost improvements are Opportunity Zones, Enterprise Zones, Community Development Block Grants (CDBG), Redevelopment Census Tracts, and other sources of funding.

Identify owners of desirable properties in the target neighborhoods, assess their interest in selling, and determine their likely sales price. Information on recent local sales is typically available on-line or at the local building department or finance office.

**ESTIMATE COSTS TO BUILD:**

Estimate both hard costs (construction) and soft costs (inspections and reports, architect and attorney fees, taxes and insurance, etc.) to develop the project. Include a **contingency fund** (typically 20 percent of the total construction cost at this phase) for error. Compare these total costs to projected unit sales prices and the anticipated blanket mortgage, including any subsidy funding, to determine whether the project is financially viable.

**SITE SUITABILITY AND ENVIRONMENTAL TESTING:**

For renovation and construction projects, an environmental review is required, especially if seeking government funding. This review is separate from the engineer's assessment of the building's structure and mechanical systems. In existing buildings, an engineer's report may identify environmental concerns such as asbestos and lead paint. For new construction projects, tests typically include:

- soil borings (soil analysis)
- identification of the location of water, sewer, electric, telephone, and cable lines and any costs to extend them to the property
- a zoning analysis by an architect to determine the allowable uses, potential size and number of units that can be in a building
- a review of possible drainage issues

If the environmental analysis identifies any problems, additional testing and a remediation plan may be required before construction or renovation can proceed. It is also important to check for existing violations on the site, the property's last purchase date, and any current liens. Other factors that affect cost should be reviewed, such as whether the site is a Brownfield.

**BUYER/SELLER NEGOTIATION:**

Once the potential sites are narrowed down to one or two, the next step is to begin negotiations with the sellers. One challenge is that packaging subsidy financing can take several months, which may deter sellers in competitive markets who are unwilling to wait. In areas with higher vacancy rates, it may be possible to get an "option to purchase" a property, giving you six months or more to complete the transaction, or a "contract of sale" that allows for an extended closing period. A "letter of intent" can also help by requiring the seller to notify you of any competing offers.

During the option or contract for sale period, the developer typically conducts the environmental, financial, and legal tests to confirm the site can be developed within the expected budget. This period should allow the buyer to cancel the purchase without penalty if results suggest significant unexpected construction costs.

**STEP 3: Preliminary Financing Decisions and Preparation:**

Much of the research and analysis from the first two steps are essential for Step 3. Project development funds come from three sources

**Equity:** Equity includes cash or property used for construction, purchase, or renovation. Initial contributions come from the developer/sponsor and, ultimately, from cooperative buyers.

**Debt:** Debt (borrowed funds) includes construction financing followed by permanent blanket debt borrowed by the cooperative and secured by the land and buildings. Individual buyers take out share loans secured by their cooperative ownership interests. Like corporate stock, **share loans create individual debt but provide equity or cash to the co-op.**

**Social investment:** Social Investment is usually structured as **grants**—funds that do not need to be repaid, and/or “**soft debt**”—borrowed money that may not require full repayment. These borrowed or donated funds come from governmental or charitable sources for lower income households. Grants are typically preferable to loans. Soft loans can be made to the cooperative or to individual shareholders. Soft debt is often deferred and then forgiven over a required affordability period, providing many of the same benefits as a grant. If a borrower sells and moves before the end of that period, or ceases to maintain compliance with the soft debt’s terms, they may have to repay part or all of the loan balance.

#### EARLY FINANCIAL PLANNING

The project type will shape the mix and amount of equity, debt, and social investment needed. Early decisions should address:

- Whether social investment is needed to make the project affordable
- What sources of social investment exist, their timelines, and any requirements that may affect marketability (e.g., resale restrictions, extra income documentation)
- Available construction and permanent blanket financing, including rates and terms
- How to balance share prices with blanket debt in the permanent financing structure

A realistic estimate of development costs, share prices, and blanket mortgage amounts is essential at this stage. Meeting early with lenders and subsidy providers helps gauge interest and refine assumptions. Share your concept paper, site cost evaluations, and preliminary estimates, while making clear that a formal proposal is still months away.

#### DETERMINING SUBSIDY NEEDS

You must also estimate the amount of subsidy required and assess whether it is likely to be available. If market-rate pricing cannot support private financing, social investment will be needed to bridge the gap between what the target population can afford and actual project costs. Subsidies are often available through state and local governments and the regional Federal Home Loan Bank.

This research helps define the income ranges you can serve, since subsidies lower the share price and expand access for lower-income households. Early conversations with state and local housing agencies are valuable. Banks should be contacted early and again when assembling the financing package—especially in markets unfamiliar with cooperative housing. Before applying for govern-

ment or social investment funding, seek a letter of interest from potential lenders outlining preliminary terms. Note that banks typically will not process a full application until social investment commitments are secured.

#### **STEP 4: Finalizing Assembly of the Development Team:**

Once the project concept is outlined, site selection and preliminary financing decisions are underway, you should have identified all of the development team players, including the architects, engineers, and attorneys who will assist with the physical and organizational development.

*Meet with funders even before your development team is fully assembled, since you don't want to spend the time and money to contract with the full development team unless you are sure that the project is likely viable and that funders are interested.*

The sponsor/developer should begin conversations with potential General Contractors early in the process. However, the actual selection of a General Contractor should wait until project financing is nearly or fully secured.

#### **SELECTING THE GENERAL CONTRACTOR:**

The General Contractor is a crucial member of the development team. Involving one early can benefit the development process, but it is often more cost-effective to wait until architectural drawings and specifications are complete. At that point, you can find a General Contractor through a competitive bidding process. If a bidding process is used, an architect typically prepares the bid package, with developer oversight. Contractors are usually given around 30 days to submit bids and for a renovation project, a site walk-through is commonly scheduled for interested contractors. The contract is typically awarded to the lowest-priced, qualified bidder.

Before making a final selection, the developer should:

- Check the contractor's references
- Review the bid with the architect to confirm that cost estimates are reasonable
- Ensure the contractor has the capacity to take on the project alongside their other commitments

Once a contractor is selected, the developer and contractor negotiate specific line items to finalize the scope of work. Because the contractor's bids are typically valid for only 60 to 90 days, the project team must be ready to begin construction soon after the bidding process.

After a contractor has been selected, the next step is to move forward with closing the construction loan with your financiers.

**TIMING IS EVERYTHING: WHEN TO DEVELOP A MANAGEMENT PLAN**

Typically, financiers will not fund a cooperative project without a management plan in place. Therefore, the target date for having a relatively complete management plan with either a bid for management services from a Property Manager, or a clear budget for self-management<sup>2</sup> should typically concur with the project's first official application for financing.

While financiers may provide temporary or construction financing with only a bid for services or an estimate for management, permanent financing (moving from the Development Phase into the final Operating Phase) nearly always requires a finalized plan. Any buyers of resident-member shares will need to know the full costs and expectations of management before buying. A management plan is finalized by executing a contract for services with the Property Manager during the Development Phase. The final management plan will be shared with the financiers and included in the co-op's share offering statements given to potential buyers.

Ideally, a contract for management services includes the Property Manager working as part of the development team. This can be especially valuable when converting existing occupied properties. Management can be effective in marketing cooperative interests to prospective residents and can have valuable input on cost-saving designs and materials that create savings in property upkeep. However, limited funds or other constraints may make this early involvement impossible.

If management cannot get involved early, the financial packager should be able to provide a preliminary annual budget based on research. The management plan is something that may be delayed until the project is further along in the Development Phase, if necessary. However, 3 months prior to permanent financing closing, a management plan ought to be finalized for a smooth transition, as management companies typically require 30-90 days after signing to onboard the co-op and begin to provide services.

**STEP 5: Financial Packaging:**

In addition to putting together the development team, the sponsor and development coordinator or financial packager will reach out early to lenders, community groups, community leaders, local governments, and public and private sources of social investment.

Gathering support is sometimes formalized by creating an advisory committee whose members make a personal commitment to see the development process through, from beginning to end. Advisory committee members should be individuals who can facilitate the mobilization of community resources and/or smooth the process to support development.

<sup>2</sup> Many funders will not accept self-management as a valid strategy, particularly for a developer's first cooperative project, as cooperative share disclosure requirements contain significant legal complexity, and inexperienced management can place the funder's collateral at risk.

Financial packaging begins early in the development process, during the project concept and preliminary financing planning. Contacting appropriate government agencies early in the process serves two purposes. First, it will help government staff better understand cooperative housing and its financing. Second, as government funding regularly changes, it will help to keep abreast of what support is available—public funds are often make-or-break on a project. Relevant government agencies might include the municipal housing department, county health department, city and state housing authorities, bond agencies, and the local office of the U.S. Department of Housing and Urban Development (HUD).

Formal financing applications should be submitted once the development team is assembled, site analysis is completed, construction drawings are prepared, and approval processes are completed or well under way. Government and subsidy applications are typically lengthy, require extensive staff review, may involve elected officials, and often take at least six months.

Many state and local governments are unfamiliar with cooperative housing and may need guidance on how their subsidy programs apply. While homebuyer assistance products can usually be adapted easily, some jurisdictions require additional education and application modifications. Lower-income target markets generally require more subsidy applications, often involving both state and local governments and sometimes foundations.

Developers without sufficient equity may seek pre-development funding to cover early costs such as engineering, architectural work, site control, and updated feasibility analyses. Grants or forgivable loans are common sources. Nonprofit developers that qualify as Community Housing Development Organizations (CHDOs) may access forgivable Federal HOME funds for these costs. Larger requests—such as social investment, construction financing, or permanent financing (including FHA-insured loans)—require more detailed proposals.

The feasibility analysis anchors all financing proposals. Its depth and certainty increase as the project moves from small pre-development requests to larger commitments for construction, permanent financing and long-term social investment.

### **STEP 6: Essential Commitments:**

The sponsor/developer must secure key commitments before financing can be finalized and construction can begin. This includes agreeing on a firm purchase price with the property owner and establishing realistic construction/ or rehabilitation costs based on completed drawings, which are necessary to present a credible loan request.

**CONSTRUCTION DOCUMENTS:**

A complete set of construction documents typically consists of:

**Working Drawings:** Working drawings include the full set of floor plans, elevations, sections, and detailed diagrams that define every aspect of the building. They specify dimensions, materials, layouts, and sometimes construction phasing. These drawings span all disciplines—architectural, structural, mechanical, electrical, plumbing, civil, landscape, interior design, and other specialties—and must be approved by the relevant local agencies.

**Construction Specifications:** Specifications (“specs”) describe the materials and methods to be used, including manufacturer and model numbers for equipment and detailed finishes such as paint colors. Together, the drawings and specifications form the contract documents used by contractors when preparing bids. Because specs determine material quality, the sponsor or developer should review them closely with the architect, considering durability, appearance, maintenance needs, and market expectations.

**BIDDING REQUIREMENTS:**

Bidding requirements provide instructions for contractors interested in submitting a bid. These requirements vary by funding source. Most funders require invitations to be sent to approved contractors, and many also require advertising and outreach to minority-owned or small businesses. Loan commitments: are generally made contingent on commitments for specific kinds and amounts of social investment.

**Social investment** is often contingent on loan commitments.

**Construction and acquisition financing** are generally contingent on a commitment for permanent underlying financing as well as some share pre-sales or documentation of the marketability of the shares.

**PRE-SALES:**

Many lenders require a portion of units to be **pre-sold** to demonstrate buyer interest prior to construction commencing. Pre-sales are signed purchase offers typically backed by down payments held in escrow from buyers who can afford the remaining share price of the cooperative’s projected monthly charges. Pre-sales do not require that the buyers fully close on their purchase prior to construction, just qualify to purchase the share, sign a purchase offer, and make a down payment. (The pre-sale down payment can be a reasonably small amount of \$500-\$1500 dollars—enough to be a substantial commitment, but low enough to not be a burden.) The required pre-sale percentage varies by lender and project scenarios. Higher loan-to-value ratios *may*, or markets with limited familiarity with cooperative housing *often*, require higher pre-sale levels. HUD Section 213 financed loans typically require 60 percent pre-sales for construction funding, but 90 percent is not unheard of for new developers.

## STEP 7: Property Acquisition/Construction or Rehabilitation:

### THE CONSTRUCTION PROCESS

The construction process begins with the bidding process and the selection of a general contractor. It is completed when the building is finished and the government issues a certificate of occupancy that permits individuals to move into the building.

Key Milestones:

1. A contractor is selected
2. The contract and construction timeline are negotiated
3. Construction financing is closed
4. Construction is initiated
5. The construction process is managed and Change orders are monitored before each Draw
6. The certificate of substantial completion is negotiated
7. The certificate of occupancy is obtained

### CONSTRUCTION/RENOVATION PROCESS MONITORING:

Before work begins, a clear construction monitoring process must be in place. The architect typically holds weekly or biweekly on-site meetings attended by the project manager or developer representative, as well as a lender's representative, such as an inspector. The architect's meeting minutes serve as the record of progress and help ensure the contractor follows the agreed timeline.

The contractor usually submits **Draw requests** (payment requests) monthly or every few months, with payment expected within 30 days. These requests typically require the construction lender or grant funder to review the expenses and approve the draw before disbursement. An efficient internal review and approval process is thus essential to avoid delays. Many contractors—especially smaller firms—rely on timely disbursements to pay sub-contractors. Late payments can trigger interest or penalties and may slow construction and increase costs.

### CHANGE ORDERS AND REQUESTS FOR INFORMATION:

**Change Orders** are scope, cost, and/or timeline modifications to the contract with the general contractor. These may be requested by either the contractor or the developer, and are negotiated between the parties. The contractor should request a change order when materials are unavailable, site conditions differ from expectations or other adjustments are needed, which often happens once this phase is underway. The developer should request a change order if the project scope changes. Requests for Information (RFIs) are formal clarifications from the contractor to the developer and/or architect. RFIs ensure that any ambiguities in instruction are clarified in writing. As with draw requests, fast, well-defined review and approval process for these change

orders and RFIs is essential. Each change order request requires prompt evaluation by the developer and architect.

Most development budgets have a contingency line item to cover the cost of change orders. If contingencies are used rapidly in the early part of the project, it may signal future problems and should be monitored closely. If change orders exceed contingencies and reduce the developer's fee/profit additional approvals—such as from senior staff, the board, or the lender—may be required. A structured process ensures timely decisions and avoids project delays.

### **STEP 8: Operations Startup:**

#### ESTABLISHING PERMANENT OWNERSHIP

Once the certificate of occupancy is issued, the cooperative corporation typically assumes ownership of the property by closing on the permanent blanket mortgage. This closing is where the developer/sponsor are paid their developer fee.

When both ownership and certificate requirements are met, the cooperative can schedule closings with initial buyers. At these closings, buyers purchase their shares and sign occupancy agreements, after which they may move into their units.

#### REMAINING UNIT SHARE SALES

If 100 percent of cooperative interests have not been sold, the sponsor/developer remains responsible for carrying charges on unsold units. The development budget usually includes a working-capital line item for these expenses. The financial stability of both the sponsor and the cooperative depends on selling the remaining interests quickly or temporarily leasing units. Permanent lenders generally will not close on the underlying mortgage until a required percentage of units have binding purchase agreements.

#### COOPERATIVE PROPERTY MANAGEMENT:

By the time the certificate of occupancy is issued, the co-op must have management in place—either full-service or outsourced. Management should establish a plan of participation for the board and members, understand the co-op structure, meet with the board monthly, and provide clear and easy-to-understand monthly financial reports.

Effective management protects the building's value and maintains member satisfaction by delivering reliable services and responding promptly to co-owner requests and complaints. Strong management practices include:

- Preparing an annual management plan and operating budget for board approval
- Submitting required reports to lenders and regulatory agencies

- Overseeing daily operations and maintenance, including supplies, equipment, and major repair planning
- Collecting payments and maintaining accurate operational records
- Acting as liaison with lenders, agencies, vendors, professionals, and the co-op
- Hiring, training, and terminating staff
- Presenting monthly financial statements and addressing issues at board meetings
- Assisting with long-term capital planning
- Implementing a clear work-order, request, and complaint process

### To self-manage or not to self-manage?

*One of the earliest—and most consequential—decisions a co-op board makes is whether to self-manage, hire a consultant, or bring in a full management company. Self-management is rarely advisable: even small co-ops struggle to handle the volume of tasks and the internal controls required to run a building responsibly. Many lenders won't even fund a co-op unless professional management is in place at the start.*

*The right choice depends on the co-op's size, population, financing and regulatory obligations, and ultimately the capacity and preferences of its members. But the message is clear: strong management isn't optional—it's foundational to the co-op's stability and long-term success.*

### Types of Management

**Self-Management:** Self-management comes in two forms. In one, the co-op hires its own staff—including a property manager who reports to the board and oversees daily operations. In the other, members themselves take on all maintenance and administrative duties, with no outside help. This second model demands significant time, skill, and discipline from volunteers.

**Management Consultant:** A co-op may hire a management consultant to handle selected tasks—often accounting, collections, or compliance—while members or staff handle maintenance and day-to-day operations. This is typically paired with some level of self-management.

**Management Company:** A full management company takes on the entire operation: financial management, collections, disbursements, staffing, supervision, maintenance, and regulatory reporting. This is the most comprehensive and professionally controlled option.

### Determining the Best Management Model for Your Cooperative

Choosing the right management structure depends on several practical considerations, including:

**Size:** Smaller co-ops—such as a 10-unit building—may not have the budget for a full-time management company. In these cases, members may need to take on a larger share of the work.

**Experience:** If the board is made up of new cooperators with little or no management background, self-management can quickly become overwhelming and inefficient.

**Time:** Member-run management (especially without hired staff) only succeeds when board members can commit steady, ongoing time to daily operations.

**Legal or Contractual Requirements:** Lenders or regulatory agencies—such as HUD—may require professional management as a condition of financing or program participation. Some government investment programs also mandate specific management standards.

## Running the Bases: Organizational Development

The experience of the **Organizational Development process** will be shaped significantly by how actively residents initiate or participate in the cooperative's development. Regardless of their level of involvement, the steps described here provide a consistent description of the overall process.

### The 7 Steps of Organizational Development

Our description of the Organizational Development Process is divided into seven steps. The order of these is largely fixed, though there will be some overlap.

STEP 1: Creating the cooperative corporation

STEP 2: Preparing an owner handbook

STEP 3: Marketing the cooperative

STEP 4: Owner education

STEP 5: Buyers become owners

STEP 6: Transition to owner control

STEP 7: Board of directors' training

### STEP 1: Creating the Cooperative Corporation

The first step in organizational development is forming the cooperative corporation. Once established, the co-op can prepare proposals, seek financing, and adopt articles of incorporation and bylaws that address both the development phase and long-term operations.

In conversions—or in projects where residents help initiate the co-op—resident involvement early in the development phase is essential, even before the corporation is formally created. In conversion projects, the sponsor/developer typically appoints the initial board to represent resident interests while still retaining control of the development process.

All governing documents and long-term contracts created during development must comply with federal and state law.

*Sponsor/developer control of the initial board does not exclude residents or subscribers from meaningful participation. In resident-driven conversions, the initial board may even include resident representatives. Strong resident involvement builds commitment to purchase, sustains engagement through a lengthy development period, improves design decisions, and ultimately strengthens cooperative governance after development.*

### Some Caveats about Resident-Initiated Conversion

A resident-initiated conversion can happen in several ways. For example:

- An owner may have abandoned the building, forcing the residents to assume the responsibilities of paying the bills to maintain services. Those residents may eventually contact a sponsor/developer to help them explore purchasing the property.
- An owner may want to sell the property and will either approach the residents voluntarily or be legally obligated to do so.
- A sponsor/developer may approach an active resident organization to suggest that they jointly explore the group's purchase of the building.

Resident-initiated conversions can look very different from those initiated by the sponsor/developer. When residents take a more active role in the entire development process, they bring energy, insight, and commitment that strengthen the project—both during marketing and later when full operational responsibility shifts to the membership. Engaged residents are often highly informed and deeply invested. They want ownership of the process because the outcome affects their homes, and a home carries real emotional weight.

A strong sponsor/developer recognizes the emotional dimension of the development process and respects residents' desire for meaningful involvement. At the same time, even the most active resident group needs the technical expertise of a seasoned development team. Success depends on a relationship built on trust, transparency, and a shared purpose.

## STEP 2: Preparing the Owner Handbook

The owner handbook, often called Offering Statement or Prospectus, explains exactly what prospective buyers are purchasing. Because state and federal corporate, securities, tax, and consumer protections laws apply, strong legal guidance is essential. In several states, a co-op cannot sell shares until these documents are filed, reviewed, and approved by the state.

At a minimum, the handbook includes the core cooperative documents (articles of incorporation, bylaws, purchase and occupancy agreements, and rules) and a narrative describing ownership, governance, and operations. It typically covers tax considerations, financial operations (often a detailed first-year's budget), financing and management expectations, and the building's condition. For renovations, it usually also details the age and status of major systems.

If the cooperative is subject to regulation by a third party—such as your city or HUD when FHA-insured financing is used—the handbook must also include the relevant regulatory documents and explain the co-op's respective rights and obligations under those rules. The narrative should describe the regulatory structure and how it affects individual owners.

The owner handbook is not a sales pitch. It must avoid uncertain promises or predictions while still being written in clear, accessible language. A typical resident-owner should be able to understand both cooperative ownership in general and the specifics of their cooperative. When well-designed, the handbook also serves as a key resource for future ownership training.

**Structured Communications:** Active resident organizations usually have a small core of engaged members. Others often wait to participate until they have enough substantive information to make informed decisions. That's why communication must be consistent, comprehensive, and fully available to all residents.

A simple system—regular newsletters paired with floor, area, or court captains—ensures all residents receive the same information and have someone available to answer questions. Bringing committed residents into these roles strengthens both communication and the organization as a whole.

**Balancing Opposing Values in a Cooperative Conversion:** Most existing buildings need some level of rehabilitation. The goal is to deliver a sound property that won't require major repairs soon, while also building a replacement reserve for future needs. At the same time, residents—especially in resident-initiated conversions—place a high priority on keeping monthly occupancy charges and share prices affordable so current households can remain.

Well-planned rehab can reduce long-term costs, but substantial repairs inevitably raise overall project costs. Those costs show up either in higher share prices or in a larger blanket mortgage, which increases monthly charges. Building adequate reserves also raises monthly costs, even though it strengthens the co-op's long-term stability.

Social investment can help but rarely covers all rehab needs. Finding a workable balance between necessary improvements and affordability is often challenging, particularly when residents are deeply involved. Clear, structured communication and opportunities for dialogue are essential to move the process forward. Fortunately, cooperative financing offers significant flexibility to help balance the need for rehab with affordability.

### **STEP 3: Marketing the Cooperative**

Projects differ based on when future co-op owners become involved and how the cooperative corporation is structured. In new construction, the corporation may not be formed until after the building receives its certificate of occupancy, but pre-sales are still crucial for securing construction financing. A strong marketing program should target the buyer groups identified in the market study, and in areas where co-ops are unfamiliar, marketing must start early and clearly explain both the benefits and unique features of cooperative homeownership.

Market data should guide whether outreach focuses on the immediate neighborhood or a broader city or regional audience. Subsidy funders may also impose specific marketing requirements, such as waiting lists or lotteries.

Effective marketing includes orientation sessions that explain cooperative ownership and member responsibilities. These sessions help prospective buyers decide whether co-op living is right for them, reducing dropouts during construction and strengthening long-term success.

A common mistake is treating marketing like a landlord's approach to filling rental units—especially in limited-equity co-ops with low share prices. Filling units quickly matters, but filling them with informed, committed owners matters far more. The true measure of a sponsor/developer's success is the co-op's long-term stability, not how fast the project closes. Co-ops serving low-income households or first-time buyers are particularly vulnerable without careful owner selection and strong education.

Useful outreach methods include community meetings, social media, local news coverage, bulletin boards in community spaces, online platforms, and waiting lists maintained by counseling agencies and nonprofit developers. Real estate brokers can be key partners; presenting cooperative housing at their regular meetings and engaging neighborhood brokers can expand the pool of qualified buyers.

**STEP 4: Owner Education**

**Training is essential to a successful housing cooperative**—before, during, and after development—but it should recognize the time and resource needs of resident-owners. Training helps residents understand the core benefits of cooperative ownership and shows how effective management can ultimately save time compared to other forms of homeownership. Prospective buyers need a clear grasp of the cooperative structure and their responsibilities, and they should be encouraged to participate actively in management so the co-op’s benefits are fully realized.

Board members especially need focused training to ensure leadership remains democratic, transparent, and effective. A co-op thrives when residents cultivate responsible leadership and when new people rotate into leadership roles, spreading the workload and strengthening the community. Training should continue after closing, through the transition period, and ultimately become a permanent part of cooperative life.

Finally, trainers with no financial stake in the development are often more trusted and more easily heard than those perceived to have competing interests—even when delivering the same message.

**TRAINING CURRICULUM**

An effective owner-education training teaches owners their shared responsibilities for maintaining the property—from legal, financial, structural, and social perspectives. A basic, introductory training curriculum should cover the following core topics. (*Note: This is only an outline covered in an initial training; ongoing training is essential to a healthy, well-run co-op.*)

**Ownership Basics (for owners)**

- What is co-op/mutual ownership?
- Financing fundamentals
- Rights and obligations as residents
- Rights and obligations as owners
- Regulatory structure
- Property transfers—who can sell what to whom and for how much?
- Budget basics

**Governance—Democracy in Action (for owners)**

- Role of owners
- Role of board
- Bylaws—the structure of governance
- The annual meeting—eligibility, quorum, proxies, agenda
- Elections

- Changes to structure
- Regulatory program impact (where appropriate)

#### **Board Basics (for the board/leadership)**

- Acting on behalf—delegation of authority
- Accountability and standard of care
- Property operations—roles of owners, board of directors, management, vendors, lender(s), regulator(s)
- Officers' roles and duties
- Committees

#### **Financial Management (for the board/leadership)**

- Review—financing fundamentals and budget basics
- Budget process
- The annual cycle
- Estimating fixed and variable costs
- Reserves
- Debt service coverage ratio
- Rehabilitation and improvements
- Planning (estimated useful life)
- Financing options
- Management
  - Oversight—asking the right questions and understanding the answers
    - Accounting principles—cash v. accrual
  - Monthly reports
  - Payables & receivables

#### **Owner Screening and Training (for ownership committee/leadership)**

- Making ownership policy
  - Fair housing issues
  - Financial accountability
  - Effective policymaking
- Designing a screening process
  - Role of the board
  - Delegation of responsibility
  - Role of management
  - Role of ownership committee
  - Appeals
- Owner training (training for trainers)

- Review of owner training curricula
- Effective training techniques

Training resources for cooperative board members come from established co-op support, including local, state, or regional cooperative development organizations. The National Association of Housing Cooperatives (NAHC) and its affiliates provide comprehensive, low-cost training at its annual conferences—an opportunity for board members to gain essential skills while recognizing and reinforcing their leadership. The Urban Homesteading Assistance Board (UHAB) provides extensive, free training materials, cohort training for developers and experienced cooperative lenders and networks—such as NCB, Capital Impact Partners, Rochdale Capital, Shared Capital, LEAF, and CooperationWorks!—often publish valuable guidance and tools online.

For lower-income cooperative buyers, local housing counseling agencies can play a critical role by offering homeownership and financial-readiness training.

Once governance transfers to the owners, the value of a strong training program becomes unmistakable. Most co-op bylaws require the first annual meeting once a certain percentage of shares have closed (for example, within 90 days of reaching 60 percent sold) or within a set period after the first sale. By that point, effective training should have prepared both the membership and the new board for their responsibilities. Continuing training—especially for board members—through the first year of owner control is highly recommended and often essential for long-term success.

### **STEP 5: Buyers Become Owners**

There comes a point in the development process when construction is complete and operations begin. Typically, this aligns with the time when buyers officially become owners. After reviewing the owner handbook, signing purchase agreements, making deposits, completing initial training, and, sometimes participating in development decisions, buyers are ready to purchase their cooperative interests and become owners. The transition is significant—both legally and financially.

#### **What happens at closing?**

- Buyers pay the remaining balance of the ownership price. This may involve closing on a share loan or signing documents that allow subsidy dollars to be applied on their behalf to the cooperative.
- Buyers sign the occupancy agreement, which sets their obligations, including monthly payments. The first payment is typically due at closing.
- The cooperative issues ownership certificates or shares, along with proprietary leases, confirming evidencing each buyer's ownership interest and right to occupy their unit.

Once these steps are complete, the new owners can move into their homes for the first time as cooperative owners.

### STEP 6: Transition to Owner Control

Board control by the sponsor/developer ends at the first annual meeting, when cooperative owners elect their own board. This typically occurs once the building is ready for occupancy and a required percentage of shares have been sold. Critically, at this point, the sponsor/developer must transfer ownership of any and all assets that are to be owned by the cooperative corporation, and the cooperative pays the sponsor/developer for their services. This shift does not exclude residents from participating earlier, nor does it prevent the sponsor/developer from having any role afterward—but it does mark a major transfer of authority and responsibility.

#### All means ALL

100 percent of all collectively-owned assets **MUST** be transferred to the co-op at transition. This includes any passwords, bank accounts, keys, posters, and leftovers from construction. Many states require an audit of the construction period to be performed at this point to ensure that the developer/sponsor has transferred all assets. It is very easy for a sponsor/developer to miss an asset and be accused of embezzlement. Clear accounting prevents this major risk.

After this transition, sponsors/developers may still have a role in two ways:

- **Unsold shares:** If they still hold ownership shares at the first annual meeting, they can vote for directors and may appoint board members until most or all remaining shares are sold.
- **Reserved board seats:** Depending on the bylaws, they may retain one or more board seats, with or without unsold shares. This may be temporary—to provide expertise during the transition—or permanent, as in mutual housing associations.

### STEP 7: Continued Board Training

Most board members do not come in with the expertise needed to understand and oversee financial reports or building-planning documents. This knowledge must be learned, and as board membership changes, new directors will need training. Some states even require board-member training within a set period after election. Beyond that, every board should commit to at least one annual training on board fundamentals, financial statements, and building operations.

Board members should also seek outside training and stay connected with other cooperatives and property owners. These networks often spark ideas for saving on insurance, energy, and contractor costs. Local chambers of commerce and building-owner associations frequently host conferences

and trainings as well. For those who want to deepen their skills or advance to or in cooperative management, courses in cooperative management are available, and organizations such as the Consortium for Housing and Asset Management offer helpful online materials.

## Chapter 4 Keeping Score: *Financing Cooperatives*

In Chapter 1, we introduced the foundational concepts of cooperative financing, focusing on blanket loans and share loans as the primary tools for securing capital. Chapter 3 expanded that foundation by situating financing within the broader Cooperative Development Process, outlining early decisions related to debt, equity, and social investment, as well as the initial steps of financial planning.

This chapter moves from concepts and preliminary decisions into practical application. It explores the range of financing sources available to cooperatives and provides a detailed look at the loan process—from identifying appropriate lenders to preparing a strong loan package. By the end of this chapter, readers will have a clearer understanding of where financing can come from, what lenders expect, and how cooperatives can position themselves for successful borrowing.

### To Swing or Not to Swing: *Pro Forma* Financial Projection

A *pro forma*<sup>3</sup> financial projection (or simply “*pro forma*” for short) is a forward-looking estimate of the financial performance of a business, given stated assumptions. It is the key tool for understanding a cooperative’s financial plan and how the development budget phases fit together. The *pro forma* will be the tool used to decide whether or not pursuing any given building purchase or design choice is feasible.

#### Sometimes the Best Deal Is the One You Let Get Away

It can be very tempting to try to pursue an amazing project design that looks like it just barely doesn’t work on paper. That’s a sure way to lose your shirt and burn tens or hundreds of thousands of dollars and months or years of effort. If you can’t make a building or design work out on paper, it won’t work in real life. Walk away. Try another project.

<sup>3</sup> *Pro forma* is Latin for, “for the form of,” implying that a *pro forma* financial projection gives a reviewer an idea of what the business performance will be like each year, without enumerating all the unplanned or incidental expenses and fluctuations that occur in reality.

A typical *pro forma* includes three interrelated components:

- **Development budget** covers acquisition, construction or rehabilitation costs, and soft costs such as legal, training, and development fees. It also includes reserves for unexpected construction expenses and projected vacancy losses during the post-construction sell-out period. (See Appendix: *Development Flow Chart*.)
- **Sources and uses of funds** shows where development capital comes from—equity, conventional debt, and social investment—and how it will be allocated. This section is often organized by the three financing phases: pre-development, construction, and permanent financing. (See Appendix: *Cost Allocation Sheet*.)
- **The operating statement** details projected income and expenses once the co-op is functioning and shows any resulting surplus or deficit. Typical expenses include utilities, maintenance, property taxes, insurance, administrative costs, reserve contributions, and debt service on the blanket mortgage. Income generally comes from occupancy charges or rental income. *Pro formas* usually project operating performance for 10 years or for the term of the mortgage. (See Appendix: *Financial Report—Operating*.) An operating statement (or budget) should demonstrate that projected Net Operating Income (NOI) is sufficient to cover mortgage payments. Lenders look for a **debt service coverage ratio** (DSCR) to confirm that cash flow after expenses can reliably meet debt obligations. An acceptable DSCR is typically 1.20, meaning that, after paying all its regular operating expenses for every \$1.00 of debt service, the co-op has \$1.20 of free cash to pay it with. Some lenders will allow lower or require higher DSCRs, but 1.20 is a reasonable starting target.

The *pro forma* brings together the findings of the market study and the construction and operating cost analyses to assess the project's financial viability. It helps confirm that share or ownership prices align with local market conditions and that monthly occupancy charges are feasible for buyers. It also guides estimates of the subsidy financing needed to set purchase prices and occupancy charges at levels affordable to low- and moderate-income households.

***Pro Forma* best practices:** When numbers, assumptions, or estimates are used, the source should be identified and justified—for example, insurance quotes from a broker or cost estimates from a property management company. A ten-year operating projection is typically included, with an inflation factor applied to future occupancy charges. An accountant or management company can assist in preparing this budget.

**Purchase Prices and the *Pro Forma*:** For affordable housing projects, subsidy funders often require a chart within the *pro forma* showing that share or ownership costs are affordable for the target population. These funders generally expect that residents spend no more

than **30–33 percent** of their income on total housing costs, including common charges and the share loan, and excluding individual utilities.

## Sticking to the Base Lines: Cash Flow *Pro Forma*

Once the physical development process begins, the developer/sponsor will be committed to many major short turn-around expenses. It is neither reasonable nor prudent to expect to manage cash levels solely by watching the bank balance. Because revenues typically arrive steadily while many expenses are billed annually or quarterly, cash availability may not align with when payments are due. As a result, a cooperative can show an annual operating surplus yet still face a monthly cash-flow shortfall. A monthly ***pro forma* Cash Flow projection**, linked to the *pro forma* development and operating budget, helps the cooperative project and track cash needs throughout the fiscal year.

This report does not only help ensure enough cash is on hand to meet expenses, it also serves as an early-warning system for the board if costs rise or cash management weakens. This also allows the board to respond quickly to changing conditions—such as higher insurance or energy costs—via a mid-year budget adjustment.

A Cash Flow *Pro Forma* should be created that includes *both* the development period *and* the initial operating period to ensure that the project does not suffer costly delays or financing costs due to poor cash flow management.

## The Three Bases: The Phases of the Development Budget

A development budget is essential when creating a new cooperative or undertaking major rehabilitation. A well-prepared preliminary budget::

- Sets the financial parameters for the project
- Supports informed decisions about financing
- Helps secure lender and funder commitment
- Reduces the risk of unexpected costs during the development process

A development budget is typically divided into three phases: pre-development, construction financing, and permanent financing. As in baseball, where you have to run from 1<sup>st</sup>, to 2<sup>nd</sup>, and then 3<sup>rd</sup> base before sliding home, these three financing phases will occur in this same order each time, and indicate how close you are to success.

### 1<sup>st</sup>—Pre-Development Financing

Pre-development funds cover costs incurred before construction or renovation begins. Typical expenses include:

- Architectural, legal, and filing fees
- Environmental testing and soil analysis
- Upfront construction loan fees (appraisals, bank legal costs)
- Building or engineering reports
- Consultant fees
- Site acquisition and/or Site control<sup>4</sup>

Some costs can be deferred until construction financing closes; others require immediate payment. Most pre-development expenses are realized up-front prior to any loan disbursements (and in fact are required for most loans to be issued), and are typically expenses that once incurred, are only useful or recoverable if the project continues successfully. Pre-development funds are thus referred to as “at-risk” funds, and require sources willing to accept this risk of loss. These expenses are usually covered by the developer, the co-op’s cash or credit, or—during occupied building conversions—contributions from residents.

While established for-profit developers often have the required funding resources to cover the pre-development period internally, startup developers or nonprofits without deep pockets may need to seek alternative sources of pre-development funding.

Some Alternative Sources of Pre-development Financing for Nonprofit developers:

- National intermediaries such as Enterprise Communities, or Local Initiatives Support Corporation (LISC), and local intermediaries.
- State and local government programs, often through the Federal HOME program or funded via Community Development Block Grants (CDBG).
- The Federal Home Loan Bank (FHLB) network can and does provide some pre-development funding.

## 2<sup>nd</sup>—Construction Financing

Construction financing is required for a new development or the renovation of a building. During the construction phase, there is higher risk involved than during the permanent financing phase, as there is not a complete building. In case of failure, an in-process construction site could be abandoned. Therefore, construction financing typically has higher rates and more active project supervision than permanent financing. In line with this risk management, construction financing is typically not issued all at once, but instead as-needed throughout the project for specific uses through planned “draws.”

The total amount of financing a bank will provide during construction varies, but is usually based on the building’s value upon completion. The amount financed is typically between 60 and 90 per-

<sup>4</sup> Site control may be an expense incurred during the pre-development period or the construction financing period. For larger projects that require significant time to structure the construction plan, a site could be lost while waiting to secure the required approvals. Site control is often an expense that can be covered by recoverable grants, or municipal land acquisition programs.

cent of the after-built value—called the “**as-built** loan-to-value” **ratio**. Banks will often request that the building be valued both as a cooperative and as a rental building to determine the “**highest and best use**” of the building—the maximum amount the property could be sold on the open market. This assures the lender that it can be repaid by selling the property as a rental building if for some reason the cooperative does not get formed.

Banks may also require that the developer or sponsor provide cash equity during construction, even if the loan-to-value requirements are met otherwise. This assures the bank that the developer or sponsor has a real stake in the project completion. Banks need a substantial review time and often require their own building or engineer’s report, environmental report, and appraisal. Banks will also review the drawings and specifications, as well as the financial statements of the developer. Bank review and approval usually takes at least 90 days.

### In Preparation to Apply for Construction Financing, Have On-hand:

- Appraisals valuing the building as both a cooperative and a rental
- Developer or sponsor cash equity to ensure commitment
- Independent engineering, environmental, and appraisal reports
- Project drawings, specifications, and developer financials

### 3<sup>rd</sup>—Permanent Financing

Permanent financing has two main components: **blanket loans** which are long-term debts that the cooperative takes out to pay for the overall project, and **share (ownership) purchase loans**. Individual buyers typically use a share loan to purchase their cooperative share. While share loans are *debt* to the individual members, these purchases count as *equity* for the cooperative corporation because they provide cash—the sale proceeds—to the co-op.

Permanent Social-investment funding may come as grants, which reduce the project’s permanent debt or equity needs, as junior debt, or as “**soft**” **debt**. “Soft” debt can supplement either the co-op’s blanket loans or the buyers’ share loans and is collateralized against the creditworthiness of the borrower, *not collateralized against the property*. Junior debt is usually structured as a second- or lower-position lien at the investor’s discretion.

### Piece by Piece: Components of a Development Project Budget

The following twelve categories are a part of most development project budgets. Each item may not apply to your specific project, but they have been included to demonstrate the possible scope of project costs:

Category	Expenses
(1) Land or Building Acquisition	<ul style="list-style-type: none"> <li>• Surveys and Site Assessments</li> <li>• Appraisals</li> <li>• Engineering Studies</li> <li>• Environmental Testing</li> <li>• Purchase Price (of land and existing buildings)</li> <li>• Soil Borings</li> <li>• Legal Fees</li> <li>• Demolition Costs of Existing Structure(s) (if appropriate)</li> <li>• Title and Recording Fees</li> </ul>
(2) Professional Fees	<ul style="list-style-type: none"> <li>• Architects and Engineers</li> <li>• Legal Counsel</li> <li>• Project Management</li> <li>• Space Programming</li> <li>• Construction Manager</li> <li>• Cost Estimator</li> <li>• Interior Designer</li> <li>• Technology Consultants (Information Technology, Security)</li> <li>• Equipment Planner</li> <li>• Environmental Consulting Firm (if environment testing indicates remediation is required)</li> <li>• Financial Consultant</li> <li>• Other Professional Consultants</li> </ul>
(3) Construction	<ul style="list-style-type: none"> <li>• General Contractor Contract or separate contracts for various specialties (used only if required by funders or if the developer has substantial construction management experience/skills)</li> </ul>
(4) Site Preparation (Most should be in the General Contractor contract)	<ul style="list-style-type: none"> <li>• Utilities (water, sewage, gas, etc.)</li> <li>• Site Drainage</li> <li>• Landscaping</li> <li>• Parking Lot</li> <li>• Surfacing and Fencing</li> <li>• Outside Lighting</li> <li>• Environmental Remediation</li> <li>• Demolition</li> <li>• Appendix 4: Development Flow Chart Template provides a sample development project budget</li> <li>• Temporary or Permanent Relocation (if renovations make an apartment uninhabitable. For projects receiving federal funds, federal relocation assistance requirements must also be followed)</li> </ul>

Category	Expenses
(5) Furniture, Fixtures & Equipment (FF&E)	<ul style="list-style-type: none"> <li>• All Movable Furnishings</li> <li>• Computers, Telephones, Data Lines</li> <li>• Security Systems</li> <li>• Signage/Artwork</li> <li>• Installation Fees</li> </ul>
(6) Inspection	<ul style="list-style-type: none"> <li>• Inspector to supervise work on owner's and/or lender's behalf</li> </ul>
(7) Administrative & Permitting Costs	<ul style="list-style-type: none"> <li>• Postage &amp; Shipping</li> <li>• Permits, Filing, and License Fees</li> <li>• Moving/Storage Costs</li> <li>• Relocation Costs</li> </ul>
(8) Financing Costs	<ul style="list-style-type: none"> <li>• Commitment Fees</li> <li>• Mortgage Recording Costs</li> <li>• Interest during pre-development and construction</li> <li>• Lender's inspection during construction</li> <li>• Lender's Legal Costs</li> <li>• Letter of Credit Fees</li> <li>• Mortgage Insurance Fees</li> <li>• Interest Reserves</li> </ul>
(9) Insurance	<ul style="list-style-type: none"> <li>• Builder's Risk</li> <li>• Errors &amp; Omissions (Architect)</li> <li>• Property and Liability</li> <li>• Worker's Compensation Insurance</li> <li>• Fire &amp; Theft</li> <li>• Sponsor/Developer Directors and Officers Liability Insurance</li> </ul>
(10) Contingencies for emergencies and unforeseen events and change orders during construction	<ul style="list-style-type: none"> <li>• Soft costs—5 percent</li> <li>• Hard costs—7.5 to 15 percent</li> </ul>
(11) Developer's Fee (Typically 7.5 to 15 percent of total development costs, minus acquisition)	
(12) Up-front Replacement and Operating Reserves	

## Moneyball: Making Sense of and Optimizing Debt, Equity, and Social Investment Sources of Funding

Funds for cooperative development can come in three basic forms: **equity**, **debt**, and **social investment**. Generally, it takes a combination of funding from all three to make affordable housing development happen.

**Equity:** At the beginning of the development process, equity comes from the sponsor. The initial amount may be small to cover the salaries and other costs of pre-development analysis. Most construction lenders will require equity, including actual cash equity during construction. A portion of the (non-cash) equity may be in the form of the value of the land or building to-be developed, if they are owned by the sponsor/developer. This is typically the case when land is acquired below its appraised value, and the appraised value should be added to the project's balance sheet at acquisition. Social investors may provide funding directly to the sponsor, thus providing a portion of the equity. After the cooperative is formed, some of the equity will come from sale of the shares.

**Debt:** At the beginning of the process, debt can take the form of a pre-development loan. Further along, that loan may be refinanced as part of an acquisition or construction loan. Ultimately, most cooperatives will have some form of permanent blanket loan in place. The blanket loan can repay loans that were used to acquire land and/or construct or rehabilitate a building.

**Social Investment:** Creating affordable housing costs the same as creating market-rate or “highest and best use” housing. Making that housing affordable to low and moderate-income individuals and families while still covering those development costs often requires some form of social investment, or “**subsidy**” to bring the cost down. Social Investment sources typically wish to maximize the impact of their dollars, so they rarely fund projects at a ratio of more than a 1:1 [subsidy]:[equity + debt], meaning each dollar of subsidy should be matched by at least one dollar of equity or debt brought by the developer.

### Mobilizing Equity

Every dollar that is available free and clear is extremely valuable to a development. Both Debt and Social Investment financing sources are typically not immediately available in the early stages of the development process, and are often dependent on having a proportion of equity available in the deal. For example: a construction lender may only provide 70 percent of the as-built value in financing. The remaining 30 percent of construction costs will have to be made up of equity. The more equity is available, the more it can be leveraged to build larger projects.

### Debt Financing

Both developers/sponsors and existing cooperatives require debt financing. While no one likes to take on additional debt, there are times when it can be beneficial:

- Depending on interest and developer fee rates, increasing the amount leveraged can produce a larger project, with a commensurately larger developer fee, which may cover the additional construction period interest
- When calculating the balance between an underlying mortgage and share loan, the developer/sponsor might find that raising the underlying mortgage and lowering share prices may make homeownership accessible to residents who might not have the down payment or financing for a larger share loan
- As compared to paying for repair/replacement costs up-front, borrowing can free up the cooperative's cash for other operating needs
- Bridging a long-term capital campaign with borrowed funds allows the capital project to be completed more quickly
- Repaying a loan encourages financial discipline and improves cash flow management
- Establishing a positive lending relationship may lead to additional resources, including access to working capital lines of credit for short-term cash flow needs or more flexible loan requirements for future capital improvement projects

#### LOAN TYPES

The loan type chart below highlights the primary differences between various loans used in a typical development project. When the construction and rehabilitation project is completed, all short-term loans are repaid by the cooperative's blanket and share loans. The loan types are listed in the order they are needed.

Pre-development loans are required first and are typically the smallest loans. These loans carry the highest risk since they are usually needed before a project is fully defined or financed and often before there is a property to provide collateral. Loan types decrease in risk as the process progresses.

Construction lenders have a short-term focus and a unique set of skills that enable them to closely monitor the construction/rehabilitation process. Although a short period (6 to 24 months), it carries substantial risk because of potential scheduling delays, cost overruns, subcontractor non-performance, or a slower market delaying sales of units. Since the amount of the "construction loan" interest and other costs increase the longer the project takes, unpredictable time delays can threaten a project's viability, thus increasing loan risk. The decision to lend on a particular project is normally based primarily on having permanent "take-out" financing to repay the loan at project completion, even if the construction lender and permanent lender are one and the same.

Loan Type	Use Of Loan Funds	Typical Loan Terms	Comments
Pre-Development Loan	Covers initial costs such as down payments and architect, engineer, legal, appraisal, site & environmental testing fees. Also costs associated with applications for grants and other funding sources.	Term is typically 12-24 months at a fixed interest rate that can be relatively low given the short term of the loan. Often underwritten more as a line of credit based on the developer/sponsor's financial assets. Loan can typically be repaid early without penalty.	Usually smaller loan amounts (under \$100,000). Interest may be payable quarterly or deferred until repayment.
Bridge Loan	Covers time gap between end of construction loan term and closing of permanent loan, or to "bridge" other funding that has long processing time.	Higher rates due to the risk that the permanent or government/subsidy loan will not close. Terms range from 3 to 36 months.	More complicated loan structure that involves more sophisticated lenders who command higher fees.
Construction Loan	Covers the costs to acquire land and construct a building or to acquire and renovate an existing building.	Variable interest rate with only interest paid during construction (some government lenders may defer interest payments until permanent closing). Full principal repayment is usually required at permanent loan closing (which also typically requires a certain percentage of units sold). Terms range from 6 to 24 months. Lender will control disbursements, based on inspections, to ensure construction is proceeding as agreed.	Lender will not usually close until a commitment has been issued for a permanent loan to repay the construction loan. Collateralized by property.
Blanket/ Underlying Loan Permanent Loan or Commercial Mortgage Loan	Purchase land or buildings and/or finance a project at the end of the construction period.	Cooperatives may have to provide up to 25 percent equity (in other words, the loan may be limited to 75 percent of the value of the property plus any improvements). May also require a certain number of units be sold or rented before closing. Payments of principal and interest are made monthly based on an amortization of 15+ years.	In conversion of existing cooperative improvement projects, the construction and permanent loan may be the same loan. The loan term is often shorter than the amortization period—requiring a balloon payment or refinancing at maturity. Repayment depends on the ability of the cooperative to fill units, collect occupancy charges, & make payments. Collateralized by real estate.
Share Loan	Covers cost of a co-op share purchase. Finances the borrower's interest in the co-op corporation.	Depending on the share price, these loans can mirror condo loan terms: 75 to 95 percent loan-to-value of the shares, fixed and variable interest rates based on 30-year amortization schedule.	Collateralized by co-op owner's shares. Often shorter terms and higher interest rates v. blanket loans so can limit affordability if too large.

### PERMANENT DEBT FINANCING—BLANKET AND SHARE LOANS

Co-op corporations are financed with a combination of "blanket" debt and equity. Equity is typically derived from the sale of shares or memberships. Ultimately, the total of the initial debt and equity is what finances the development of the cooperative.

#### What's a Share Loan?

The cooperative share of each owner can be financed with a share loan, or an agreement between the co-op member-owner and the share loan lender. The share loan enables the owner to pay for the purchase of a share in the co-op corporation that owns the real estate. The corporation does

not participate in the share loan, though it will need to legally agree to the share lender's ability to foreclose on a shareholder who is unable to pay his/her share loan debt. If an owner has obtained a share loan, only the owner is individually liable to the share lender. The cooperative incurs no financial obligation to the share lender.

#### **Why Is a Share Loan Useful?**

A cooperative typically plans to derive equity from the sale of shares, which usually have significant cash value. (This could be as high as the value of purchasing a market-rate condo). If a prospective member-owner cannot afford this cash outlay outright, the member-owner may be able to acquire a share loan from a lender such as the National Cooperative Bank (NCB) to finance that purchase. Doing so allows the shareholder to finance the share purchase, allowing them to be a full member at outset. A share loan ensures that the co-op immediately is able to access the equity needed for development. However, co-ops need to balance need for equity and affordability as larger size share loans could raise housing costs too high for low income members.”

#### **Share Loan Default and Foreclosure**

In the event of foreclosure by the share lender, the co-op board terminates the individual's ownership and evicts the owner, based on a “recognition agreement” with the individual share lender (see the sidebar “What is a Recognition Agreement?”). The lender becomes the legal owner of the share, and then sells it as outlined in the recognition agreement, subject to a new owner gaining approval by the co-op board.

#### **What's a Blanket Loan?**

A blanket, or “underlying” loan, is the financing used by the cooperative corporation to purchase the land and/or building. Cooperatives also can use a blanket mortgage to refinance existing blanket debt or finance major improvement and rehabilitation projects. The cooperative corporation is liable for the blanket mortgage. The individual owners of the cooperative are not liable to the blanket lender, nor do they need to individually qualify for the blanket loan. The owner occupancy agreement obligates cooperative owners to pay their proportionate share of the monthly blanket loan payment. The cooperative can and will enforce this obligation, but the blanket loan lender cannot. However, should the cooperative be unable to make payments on the blanket loan, the lender may have certain rights in order to be paid.

#### **Why Is a Blanket Loan so Useful?**

The ability of the cooperative to secure long-term blanket debt can be especially advantageous when financing major improvements or rehabilitation. Only cooperatives have the option of using new, long-term blanket debt financing to spread costs over time in affordable monthly payments for which their owners do not need to individually qualify. Like condominiums and homeowners' associations, cooperatives can choose to (and in some states and municipalities are required to)

accumulate reserves at a high enough annual rate to cover anticipated rehab and improvement costs. Additionally, coops can assess individual owners for their share of the total cost of a rehab or improvement project when needed. Blanket lending is more equitable because it casts the financial obligation of improvements over a period of time in the future. Therefore, the individuals who benefit from the improvements pay for them at the time they are needed. In contrast, when improvements are paid through building assessments, the costs are paid by owners who may not remain in the building long enough to enjoy the full benefits of the improvements they paid for.

#### **Blanket Loan Default and Foreclosure**

In the unlikely event of a foreclosure by the blanket lender on the mortgage of the building, the lender could potentially sell the entire building. If there are any proceeds in excess of the sale price following foreclosure on a blanket mortgage loan, this money goes to the cooperative shareholders. However, the termination of the cooperative corporation's ownership of the building would also terminate the share owners' shares in the building and their occupancy rights.

#### **What is a Recognition Agreement?**

A recognition agreement "recognizes" that the cooperative and the share lender have potentially competing interests. In the event of default by a share owner, the collateral is his/her ownership share in the cooperative. Share lenders require a recognition agreement as a condition of each share loan. The recognition agreement establishes the rights and obligations among the share lender, the cooperative corporation and the share owner. Recognition agreements vary according to the share lender. But in a typical agreement:

- the cooperative corporation guarantees that it is the owner of the real estate and that the share owner (borrower) is a member-owner of the cooperative in good standing.
- the cooperative corporation consents to the share owner's pledge of his/her cooperative share as security for the share loan. This can also protect the share owner from predatory lending.
- the cooperative corporation agrees to notify the share lender of any default by the share owner in his occupancy charges or the cooperative corporation's own default on the blanket mortgage or taxes.
- the share lender is given a right to end/repair certain defaults by the share owner or cooperative.
- the cooperative agrees to terminate ownership if the share owner defaults on his/her share loan obligations.
- priorities related to who gets paid first are established between the cooperative, the share lender, and the share owner upon foreclosure and resale of the share owner's cooperative share.

### What is an Aztech Agreement?

The Aztech Agreement is an industry standard recognition agreement. It generally creates a favorable situation for the co-op corporation vis-a-vis the share lender in the event of default by a share owner. Other recognition agreements spell out some of the subjects/issues that are implied by the Aztech Agreement, but may favor the share lender (such as a bank) over the cooperative in certain default or foreclosure matters. A best practice for cooperatives is to negotiate with share lenders for a recognition agreement as close to the Aztech Agreement standard as possible.

### DO YOU HAVE THE RIGHT STUFF? WHAT LENDERS LOOK FOR

When assessing a loan application, lenders typically review the following “5-C’s”: **Credit, Cash flow, Capacity, Collateral, and Competition**. These are used in one form or another to measure risk of default by the cooperative for any potential loan, the risk the loan will not be repaid, or the risk that the agreement will be breached. Different organizations and people will interpret them in different ways, but all lenders will likely have similar questions about the developer/sponsor or cooperative and any future plans. This list can help you look at your proposed cooperative and be prepared to discuss your strengths and weaknesses as a borrower.

#### Credit

- What are the developer and cooperative’s track records, if any, with other creditors such as banks, credit unions, and vendors?
- Do the financial statements of the borrower and developer indicate positive net assets? Do they have an audit without any comments?
- What is the borrower’s previous experience or proposed plan for managing debt?

#### Cash Flow/Operating Income

- What will be the primary source of repayment, such as the proposed division between blanket and share loans?
- Based on the proposed common charges, budget, and financial projections, will there be adequate cash flow available for debt repayment?
- How much debt can the cooperative repay, given its projected common charges and expenses?
- If the building does not become a cooperative or if the cooperative corporation defaults, what would be the operating income of the building as a rental property?

#### Capacity

- Does the sponsor/developer have experience in developing other affordable housing projects, and in particularly affordable homeownership projects?
- What type of oversight or technical assistance is currently being provided to help the cooperative? Are there new or additional plans for the future?

- Who will be the developer/sponsor's key managers or board members? What real life experience do they bring to their roles? What is their commitment to the success of the cooperative?
- What other projects will the developer/sponsor be undertaking in the next couple of years? Does the developer/sponsor have the staffing/financial capacity to take on these projects?
- What is the cooperative's proposed governance structure, such as the board of directors and shareholder/tenant involvement?
- What is the developer/sponsor's plan for managing the proposed development project?
- Does the developer/sponsor have the capacity to manage the development process? If not, who will be hired and what is their previous experience?

#### Collateral

- In the event of a loan default, is there adequate security or guarantee in the real estate to repay the loan? What is the fair market value of the property now? What will the value be upon completion of the development? What would the value be as a rental property should the market become less favorable for ownership?
- Are there any obstacles to properly perfecting the lender's security interest?

#### Competition

- What competing housing options are there in the geographic area?
- Has the developer/sponsor shown that there is a local market for cooperative housing, with the blend of share loan/occupancy charges they project?
- What is the fair market value of other units in the building's location?
- Has the cooperative undertaken an evaluation or market analysis to assure it can fill the units within a reasonable period of time?

#### DOES YOUR LENDER HAVE THE RIGHT STUFF?

All loans have four elements that may be used when comparing terms from lenders: interest rate, fees, term, and amortization.

#### Loan Fees Demystified

Be prepared to pay several types of loan fees and remember to budget for these costs associated with the loan process. Because one lender's fees might be substantially higher than another's, it is best to check with more than one potential lender. A list of common costs follows:

- **Application or Underwriting Fee**—Lenders may charge a fee that must accompany the original loan application package and covers the upfront work lending institutions complete before a loan is funded. This normally ranges from \$500 to \$5,000 and may be credited toward the commitment fee if the loan is approved.

- **Commitment Fee**—Sometimes called an “origination fee,” it covers the cost of the lender reviewing and approving the loan request. The fee is typically 1 to 2 percent of the loan amount. For example, a 1 percent commitment fee on a \$500,000 loan would be \$5,000. This may be negotiable based on the overall strength of the credit application. Normally this fee is non-refundable even if the loan never closes.
- **Appraisal Fee**—The lender will require an appraisal to obtain the fair market value of the real estate offered as collateral. The appraisal is usually ordered once a commitment has been issued. The cost can range from \$2,000 to over \$10,000 based on the complexity of the project. The applicant pays for the appraisal when it is ordered and the fee is non-refundable, even if the loan never closes.
- **Environmental Assessment Fee**—The lender will order an environmental assessment to ensure there are no outstanding issues either with contaminants in the land or in any structures on the property. The cost can be as little as \$1,000 for a basic assessment when there is no concern or apparent issues. This can increase to a range of \$5,000 to well over \$20,000 for Phase 1 and Phase 2 studies when issues are uncovered. These costs are paid by the borrower prior to closing and are not refundable even if the loan does not close.
- **Legal Fees and Closing Costs**—Lenders charge for the preparation of legal documents and other costs of executing the loan. Be sure to ask about them at the beginning of the application process. These fees will vary depending on the complexity of the deal (multiple properties or property owners, for example) and the time spent negotiating loan terms and the related legal documents. Borrowers normally pay for their legal costs and for those of the lender. A deposit for these fees is usually collected at the time of commitment and is typically not refundable, even if the loan never closes.
- **Interest Reserve**—During the construction period, an account is established to pay the estimated interest costs during the construction of the building. Since the borrower is only charged interest on the amount of funds disbursed, an estimate of the average disbursed amount is made.
- **Bank Engineer**—The borrower normally pays the bank’s costs to hire an engineer to review the drawings and specifications, and to have an engineer or construction supervisor review invoices and work completed during construction.

## THE FEAR FACTOR: THE ROLE OF RISK IN RECEIVING LOANS

When approaching an organization for a loan, remember that lenders are risk-averse. Every lender's primary objective is to make sure that the loan will be repaid as agreed. Depending upon the type of financing sought by the developer/sponsor or cooperative, risk will be evaluated differently. Below are some risks that lenders consider.

Risk	Indicators	Ways To Mitigate Risk
Organizational Risk	Limited development track record. In the case of conversion, limited experience of residents in building management.	<ul style="list-style-type: none"> <li>• Partner with experienced developer or hire consultants</li> <li>• Active tenant association formed to prepare for co-op conversion</li> <li>• Contract for professional management</li> </ul>
Construction Risk	The developer/sponsor or cooperative board lacks real estate development experience.	<ul style="list-style-type: none"> <li>• Hire an experienced project manager and/or architect</li> <li>• Provide a detailed project budget with well-researched cost estimates and ample contingency</li> </ul>
Repayment Risk (ability to repay the loan from cash flow without considering collateral)	Cash flow at the early stages of loan repayment may be inadequate to cover payments. This may be caused by unit sales not matching projections, resulting in decreased revenues and initial operating losses.	<ul style="list-style-type: none"> <li>• Demonstrate waiting lists for residents wanting units or pre-sell units (using subscription agreements, which obligate buyers to pay for their shares/memberships when subscriptions are reached for a high percentage of available units)</li> <li>• Show detailed cash flow projections under multiple scenarios (worst case, best case) sometimes called: "Debt Service Coverage Ratio"</li> <li>• Show adequate reserves to offset any cash flow shortfall until enough units are filled to generate sufficient cash flow.</li> </ul>
Collateral Risk	In the case of a payment default, can the property be sold for enough money to repay the loan in full?	<ul style="list-style-type: none"> <li>• Demonstrate the value of the property through an appraisal by a certified appraiser, approved by the lender.</li> <li>• Make an equity contribution to the project, if possible, to reduce the loan balance versus the value of the property (sometimes called "loan-to-value ratio").</li> <li>• Design the construction / renovation so the property could be converted to a different use should the cooperative fail.</li> <li>• Provide information about how the property could be used for other purposes, including rental housing. Include a pro forma indicating viability as a rental building.</li> <li>• Describe a property management plan and reserve funds to be set aside for maintenance and repairs to maintain the property's value.</li> </ul>

## LENDER REPAYMENT ORDER ("WHO'S ON FIRST?")

- Bank financing (or whoever lends the largest amount) typically demands to be repaid first, before any other lenders, if the project fails or defaults. This is called "first lien position". First lien position is "senior" to all other lien positions.
- Government and social-investment lenders typically take a second, third, or lower lien position. These are considered "subordinate" or "junior" liens. Subordinate liens typically

do not count toward the loan-to-value calculation for loans with senior lien position. This helps the project meet the primary lender's loan-to-value requirements and may also satisfy developer equity requirements.<sup>5</sup>

- Lien position is additionally relevant when calculating the DSCR for each lender. DSCR is calculated in order of lien position. So, the first lien position DSCR calculation is able to use all the free cash flow, but the second lien position must use the free cash flow MINUS the debt service of any senior lien position loans.
  - Example: A co-op has \$1,000 of free cash flow after expenses. It has 3 loans. Loan in position 1 has an \$800 payment, Loan 2 has a \$100 payment, and Loan 3 has a \$75 payment. The DSCR for loan 1 is  $(1,000/800) = 1.25$ . For Loan 2, it is  $([1,000 - 800]/100) = 2.00$ . For Loan 3, it is  $([1,000 - 800 - 100]/75) = 1.33$ . Each of these loans has an acceptable DSCR, even in the face of senior liens, and each can be independently approved.

#### LOAN APPLICATION PROCESS

Lenders suggest beginning the loan process once a site is under consideration and the developer knows what resources can be committed. The process that begins during the pre-development site selection phase will continue through development and throughout the life of the loan.

The following steps will guide you through the loan application process:

1. Be prepared. Compile details about your project before you call the lender:
  - Summary of experience of the developer/sponsor and business plan detailing the current state of the cooperative and any future plans.
  - Details of the real estate development project including purchase and sale agreements, realtor listings, real estate appraisals, and environmental studies (although lenders may order their own appraisals or studies instead of accepting those already done). Indicate whether the project meets current zoning and, if not, the process for obtaining zoning.
  - Preliminary plans for the site, schematic drawings, and capital improvement plans
  - Proposed prices for share/ownership and evidence that there is a market for these units.
  - Preliminary sources and uses of funds to complete the project.
  - Audited financial statements or federal income tax returns for the past three years (if applicable).
  - An interim financial statement, if possible.
  - Minimum three years of monthly and annual budget projections, including any impact from the construction/renovation project.

<sup>5</sup> Some senior liens require "subordination agreements" to be signed, stating that any and all future liens taken out against a property must be subordinate to them.

2. Schedule an appointment to meet with the lender to discuss the project. A lending institution's internal process will involve an initial review of your detailed information. There are three possible responses at this point: not interested, need more information, or interested.

3. An interested lender will usually issue a **term sheet or letter of intent**. This document is non-binding, meaning the institution is expressing an interest but not a legal commitment to lend money. This document will outline loan terms and conditions similar to those listed below:

- Loan amount;
- Use of loan proceeds (usually limited to specific items);
- Length of loan and amortization;
- Interest rate that may be fixed or variable (based on some type of index); sometimes the lender will offer a choice;
- Fees for underwriting, application, commitment, and legal;
- Loan pre-payment penalties, if any;
- Collateral for the proposed loan and how it will be secured;
- Maximum loan-to-value (LTV) ratio allowed, which is usually based on the current or as-completed appraised value (both as cooperative housing and often as rental fallback);
- Reporting requirements for the submission of financial statements, rent rolls, etc.;
- Financial covenants (i.e., promises that the borrower will meet certain financial benchmarks in its operations) for indicators of financial condition such as debt service coverage ratio and liquidity ratio;
- Conditions to be met prior to closing, such as revised project costs, unit occupation benchmarks, and letters of commitment from additional sources of funds (i.e., grants);
- Specific date for accepting the offer to proceed with the underwriting process (this is acknowledged by returning a signed copy of the letter of intent to the lender).

It is important to read the letter carefully as it contains details of what the lender expects. Approach your lender with questions and be aware that some items, like fees, may be negotiable.

4. Some lenders will require a completed loan application form that they will provide you. Submit this form along with any additional information requested. This will all be used in the underwriting or “due diligence” performed by the lender.

5. Maintain regular communication with the lender during this process. It is important to promptly provide additional information as it becomes available, such as the following items:

- Finalized project budget
- Purchase, lease, or other official site contracts
- Final architectural drawings
- Contract with developer/general contractor

- Zoning variances or approvals
- Letters of commitment from other funders
- Permits

Upon completion of due diligence, the lender will write a **loan approval memo** that remains an internal document not released to the applicant. The loan approval memo includes an overview of the proposed development project, the cooperative, management structure, financial analysis, and credit risks.

6. Once the approval process is successfully completed, your lender should issue a **commitment letter**. All of a loan's costs—indeed all of its terms—are potentially negotiable with the lender. This is especially true if you have more than one lender interested in providing financing. Use a financing worksheet to compare sources of financing, their terms, and conditions.

#### What the commitment letter means...

*The receipt of a commitment letter will allow you to officially commit to your development project and finalize the contract to purchase and with your contractor. This letter is more specific than the letter of intent, and is a legal commitment by the lender to make a loan under the conditions specified. A signed copy of this letter will be returned to the bank along with a check for any required commitment fee and upfront expenses for appraisals, environmental studies and preliminary legal work related to the loan closing. As these fees are generally not refundable, it is important to be relatively confident that the project will proceed before signing the commitment letter and paying the fees.*

A worksheet for comparing sources of financing can be found in Appendix 6, “Financing Comparison Worksheet.”

7. Once you've signed the commitment letter the actual **loan closing is typically 30 to 90 days** away. Lenders will now begin work on legal documents and complete their due diligence process on the appraisal, environmental report, title, and lien searches. Your project may have other specific items to be completed before closing, such as building permits or subscription agreements.

Prior to closing you should request draft legal documents to review, which usually include a promissory note, mortgage or deed of trust, loan agreement, and a security agreement. The lender will hire a lawyer to represent it and coordinate the loan closing. The cooperative should also hire an attorney to represent the corporation through the closing process. The closing date is typically scheduled about a week ahead of time. At closing, the lender and borrowers will sign the legal documents and transfer funds for all fees and equity contributions.

## The Paper Trail: Summary of Support Documents Required for Construction Lending

*This list is provided for illustration purposes only and pertains only to the construction-specific aspect of the transaction.*

Information about the property might include:

### LENDER-PROCURED DUE DILIGENCE (Lender Must Approve Source):

- Phase I Environmental Report
- Appraisal Report—“as is” and “as built”
- Building Evaluation regarding existing structure(s) if any property condition assessment
- Building Inspection Report

### OWNER SUBMITS:

- Market Study
- Complete Sources and Uses Schedule that outlines each source and use of funds
- Scope of Work Summary
- Development Budget, with subtotals for hard and soft cost items, and a separate line item for contingency, with an industry standard around 10-15 percent contingent reserve for the hard costs and 5-7 percent contingent reserve for soft costs
- Overall project timeline, including at least the following project benchmarks:
  - 50 percent construction completion
  - certificate of occupancy
  - marketing start
  - homeownership counseling
  - cooperative training start
  - timeline for sales
- Summary description of ownership and history of ownership
- Summary of the development team with resumes, describing the relevant experience of the borrower, architect, attorney, general contractor, and project manager, with additional details:
  - Architect—qualification statements, list of current and completed projects, evidence of insurance (professional liability), and financial statements for the past three years
  - General Contractor—qualification statements, list of projects, evidence of insurance (general liability and worker’s compensation), financial statements for

the past three years, and type of lien waivers used

- Construction Schedule—illustrating stages of construction, prepared by general contractor or architect
- Draw Schedule—amounts to be funded with dates and type of work to be done
- Title Insurance
- Final plans and specifications
- Executed agreement between owner and general contractor
- Performance bond of general contractor
- Lists of subcontractors
- Insurance:
  - Flood (if applicable)
  - Builder's risk
  - General liability—third party
  - Worker's compensation insurance
- Executed Agreement between owner and architect
- Soil report (if applicable)—In new construction, the soil must adequately support the proposed improvements
- Utility available letter
- Permits
- If other funding is not closing at the same time, letters of commitment from other funders

## Loan Sources

### TRADITIONAL BANKS/CONVENTIONAL LENDERS

Most cooperatives are financed using some degree of blanket debt obtained from or through a conventional lender. Blanket loans for the co-op corporation are generally substantially bigger than individual share loans taken out by the resident owners. Share loans, when compared to blanket loans, may need a different funding source due to their relative size. Where share ownership prices are reasonably substantial (for example \$20,000 or more), share lending—like blanket lending—usually starts with conventional banks. Where share ownership prices are very low, for example below \$20,000, share financing can be harder. Conventional lenders typically cannot afford, or choose not to make, very small loans. The cost of processing a small share loan is generally the same as the cost of processing a large loan, while the interest and fees generated by the small loan are rarely substantial enough to cover its processing cost.

Therefore, some other sources of funding for small-sized share loans can include:

- Credit unions
- Co-op corporation makes loans from its own reserve funds
- Co-op corporation pools the reserve funds of several local cooperatives
- Sponsor loans
- Local community loan funds
- Owner savings programs created by sponsors and developers (these programs have been used effectively during lengthy development periods to allow subscribers time to put money aside to accumulate some or the entire share purchase price)
- Individual Development Accounts (IDA) available through banks, employers, nonprofit homeownership counseling agencies, and other sources can provide matching funds. In Atlanta, the local United Way launched a successful IDA to encourage savings for home purchases. Programs that write down purchase prices and/or closing costs (for example, FHLBank Affordable Housing Program and HomeFirst programs, HOME, and Community Development Block Grant pass-through programs) can be used to lower or eliminate share costs to incoming cooperative owners.

#### COMMUNITY DEVELOPMENT LENDERS (CDLs)

CDLs are specialized financial institutions that provide a wide range of services and technical assistance, usually targeted to low-income households and businesses located in distressed communities. Some CDLs are called Community Development Financial Institutions (CDFIs) or Community Development Credit Unions (CDCUs). Generally, government or foundation seed money is invested in the CDFI/CDCU/loan fund to support its mission and to generate additional private investment. Such lenders usually work in market niches that are underserved by traditional financial institutions. Community development lenders have successfully broken down credit barriers and demonstrated the creditworthiness of community-based businesses to investors.

### Three Reasons to Look to Community Development Lenders

Community development lenders are an excellent resource for debt financing for cooperatives:

1. Many community development lenders have knowledge of the market and a dedicated interest in affordable housing that is backed by committed loan pools for this purpose.
2. Community development lenders can be considered “flexible” sources of financing. They can structure a loan with a longer amortization schedule, higher loan-to-value ratio, or an interest only period. They also frequently accept non-traditional forms of collateral and real estate located in economically distressed areas. CDLs are typically structured to

take higher risk loans than conventional banks.

3. Some CDLs may offer lower interest rates and simply make available financing that would otherwise not exist.

Beyond these differences, borrowing from a community development lender is much like borrowing from a conventional bank, including the loan closing documentation and process.

## SOCIAL INVESTMENT

Social investment comes from government or charitable sources and can take many forms. A number of the more commonly-used are listed below:

	Subsidy to the Co-op	Subsidy to the Members
Grants	<ul style="list-style-type: none"> <li>Direct grants from governmental or charitable sources to the cooperative itself—Typically restricted to nonprofit, affordable, or limited-equity co-ops.</li> </ul>	<ul style="list-style-type: none"> <li>Direct Grants to individual owners to pay part of the purchase price of individual member shares (Downpayment Assistance)</li> <li>Individual Development Accounts (IDAs) are programs, typically administered by banks or nonprofit agencies, that provide matching funds to low- or moderate-income households for home purchases or education</li> <li>Ongoing payment assistance to owners for their carrying charges or share loan payments in the form of Housing Choice Vouchers (if the local housing authority has a HUD-approved homeownership program) or similar government subsidies See <a href="#">24 CFR 982.635(c)(3) (Feb. 12, 2026)</a></li> </ul>
In-Kind Donations	<ul style="list-style-type: none"> <li>Contributions of products, property, services, or anything of value besides cash, such as free or reduced cost (below market) property and/or free development or legal services</li> </ul>	
Cost Reductions	<ul style="list-style-type: none"> <li>Payment in lieu of taxes (PILOT) programs, or other state and local programs to reduce property taxes</li> <li>501(c)(3) tax-exempt status for the cooperative corporation resulting in exemption from property taxes (Typically subject to IRS Revenue Ruling 1996-32)</li> </ul>	<ul style="list-style-type: none"> <li>Sweat-equity can be used to decrease the total construction costs via volunteer and is a necessary component of HUD's Self-Help Homeownership Program's grants</li> <li>Mortgage Interest tax deductions can help lower the cost of ownership for co-op members</li> </ul>
Forgivable Debt	<ul style="list-style-type: none"> <li>"Soft second" loans to the cooperative (some of these loans may be forgivable over time or remain in place as long as the cooperative or the unit remains affordable)</li> </ul>	<ul style="list-style-type: none"> <li>Governmental homeownership program loans that are forgivable at a set time—typically if the owner remains a resident and was low-income at purchase</li> </ul>

	Subsidy to the Co-op	Subsidy to the Members
Deferred Debt	<ul style="list-style-type: none"> <li>Blanket debt that does not immediately go into repayment improves early cashflow, allowing for tighter project design margins. (May also be forgivable debt if deferred during an affordability period and then forgiven. Many affordable housing departments use this model.)</li> </ul>	<ul style="list-style-type: none"> <li>“Soft second” loans to individual owners that do not need to be repaid until resale</li> </ul>
Below-Market Debt	<ul style="list-style-type: none"> <li>Reduced-interest-rate blanket loans from government or charitable sources—Typically requiring the cooperative to serve low-income members</li> </ul>	<ul style="list-style-type: none"> <li>Reduced-interest-rate share loans from government or charitable sources—Typically requiring the member to be low-income</li> </ul>

#### GOVERNMENT-RELATED PUBLIC INVESTMENT (A.K.A. “PUBLIC SUBSIDY”)

Local, state, and federal programs can provide financing in the form of loans, mortgage subsidies, soft second loans, tax credits, and other funding to ease the cost of developing a cooperative. Many government programs, mortgage subsidies, and other financing support are funneled through the cooperative’s lender. Although such funds are usually accessed through community development lenders, some are available directly through government agencies or in the form of tax credits. While cooperative share lending is eligible under many federal programs, awareness of cooperative ownership varies greatly. It may take some work by local cooperatives and their lenders to move local programs from legal/theoretical eligibility to actuality. Programs that write down purchase prices and/or closing costs can reduce or even virtually eliminate small share costs to incoming cooperative owners.

Many of these programs—HOME, CDBG, Housing Choice Vouchers—are administered by state housing finance agencies, local public housing authorities, and/or city/county community development departments. These agencies have significant discretion in how they run their programs and typically have lengthy application and review processes. Most use formal request for proposal (RFP) processes, typically with annual deadlines posted on their websites.

Funding available varies by program. Some agencies support projects as early as at-risk pre-development costs, while others provide funds only when a low-income household purchases a unit.

Because of this variation, it’s essential to understand how these funds operate in your locality and state during the Project Concept stage, and begin conversations early. These agencies are generally supportive of affordable housing initiatives and bring extensive experience, even if they are less familiar with cooperative housing. Reach out to your local community development agency, state housing finance agency, local housing authority, and local HUD (or USDA in rural areas) to learn about available financing programs and gather their insights on your project.

### State and Local Affordable Housing Trust Funds

A majority of states and large cities provide housing trust funds. Most trust fund money is disbursed through requests for proposals and can take the form of no-interest loans, forgivable loans, below-market loans, and grants. Policies and objectives vary considerably from fund to fund.

Trust funds generally serve low-income households earning below 80 percent of area median income. Eligible units may be single-family or multifamily, and available for purchase or rent, depending on each fund's policies. Awareness of cooperative ownership varies widely across programs. In most cities, these funds do not provide assistance directly to individual homebuyers or cooperative share buyers.

### COUNTING ON FOUNDATIONS

Foundations can be a useful source of **social investment**, particularly when requesting funding for specific small pieces of the total need, such as pre-development or bridge loans. Foundations provide funds as:

- Grants that do not need to be repaid
- Reduced-rate program-related investments that require repayment within a specified time frame
- Forgivable loans whose repayment can be waived upon certain conditions.

The size, focus, and priorities of foundations range widely, as does their awareness of cooperative ownership. It is often useful to present the housing development or rehabilitation as a means to advance specific foundation priorities rather than presenting cooperative development as an end in itself. Such priorities might include:

- community and affordable housing development within a given locale;
- wealth creation or asset building through accumulated home equity for low-income families;
- community stabilization; and/or
- high-quality senior living.

## Use and Care of Funding

### Eligible Uses

During the Pre-development and Development Phases, some funders will have immediate restrictions on how their funds are used. These are usually limitations on whether those funds can be used for soft costs or hard costs. Tracking exactly what funds were used for what uses is necessary throughout the project. An example of how to do this is in the Appendix: "Cost Allocation Sheet."

### **Maintaining Compliance with Funder Restrictions and Regulatory Agreements**

Frequently, funders place restrictions on the uses of their funds (or the use of the improvements purchased by their funds) that extend long after the project is built. This is typical of Social Investment funders, but is often the case with standard lenders as well. These restrictions may be as simple as “continue using the property for housing.” They could be more complex, such as a requirement that the co-op “maintain at least 40 percent of its units as affordable to households making less than 60 percent of the Area Median Income for at least 55 years.” In addition to meeting funder expectations, limited equity co-ops and those that receive government funding, must ensure ongoing compliance with applicable regulatory agreements, which supercede by-laws. See more about this in the Appendix: Overview of Co-op Documents. The co-op must have a plan in place to monitor, document, and enforce compliance with all such restrictions for the full duration of their effective period.

## Conclusion

# The Bottom of the Ninth

## *Additional Resources*

As housing costs continue to climb, the demand for truly affordable homes has never been more urgent. Meeting that need requires policymakers, lenders, developers, and residents to step up to the plate together and craft creative, practical paths to homeownership. Developers and tenant groups, in particular, can shift the game by embracing cooperative housing as a strategy to expand affordability and prevent displacement. With the right teamwork and a willingness to innovate, we just might bring more communities safely across home plate.

The following appendices include examples of templates, such as loan documents, bylaws, and financing worksheets.

### List of Appendices

- App. 1—Aztech Agreement
- App. 2—Cost Allocation Sheet (downloadable, editable template)
- App. 3—Development Flow Chart Example
- App. 4—Development Flow Chart Template (downloadable, editable template)
- App. 5—Financial Report
- App. 6—Financing Comparison Worksheet Example
- App. 7—Financing Comparison Worksheet (downloadable, editable template)
- App. 8—IRC Section 216
- App. 9—IRC Section 42(i)(7)
- App. 10—Overview of Co-op Documents
- App. 11—Sample Sales Price Analysis
- App. 12—Federal Funding Sources for Cooperative Housing
- App. 13—IRS Revenue Procedure 1996-32
- App. 14—Sources and Uses Example

## App. 1—Aztech Agreement

### Aztech Agreement

[This form is not intended for use where the Proprietary Lease already has “financing provisions” which duplicate the substance of this agreement or are at substantial variance with the provisions of this agreement.]

Premises:

Apartment:

To \_\_\_\_\_:

We have been asked by \_\_\_\_\_ (“Lessee”) for a loan of \$ \_\_\_\_\_ to be secured by a pledge, security interest, mortgage and/or assignment (hereinafter sometimes collectively referred to as “the Security”) of shares of your Corporation allocated to the above Apartment and of the Proprietary Lease (the “Lease”) appurtenant thereto (the shares and Lease collectively referred to as “the Apartment”).

1. (a) You are a \_\_\_\_\_ corporation formed for the purpose of cooperative ownership and (owner in fee / ground tenant) of the above premises.

(b) Your records show that the Lessee is the owner of the Apartment.

(c) You have duly approved or consented to the creation by the Lessee of the Security, if and to the extent such approval is required by the Lease.

2. (a) You will not consent to any further encumbrances, subletting, termination, cancellation, surrender or modification of the Apartment by the Lessee without our approval, which we will not unreasonably withhold but this provision shall not apply to any modification or termination which, by the terms of the Lease, may be effective against a Lessee when approved by a fixed percentage of other holders of your shares, or which may be effective in the event of condemnation or casualty.

(b) The Lessee has agreed that, without our written approval, the Lessee will not exercise any right that he may have under the lease to terminate the lease so long as the loan is outstanding.

(c) You will notify us of any notice of intention to terminate the Lease, and

- (1) If the Lessee’s default can be cured by the payment of money, you will also notify us promptly of any default involving an amount equal to or exceeding three months maintenance payments and will take no action to terminate the Lease or cancel the shares if the default be cured either by us for the account of the Lessee or by the Lessee within 15 days after such notice of default or intention to terminate; or
- (2) If the default cannot be so cured, you will institute no action to terminate the Lease or cancel the shares until we have had reasonable notice and opportunity, by action or otherwise, to induce the Lessee to cure the default, such opportunity to be no less than the time provided in the Lease for the Lessee to cure.
- (3) If you shall terminate the Lease and cancel the shares for a default not curable by the payment of money, then, provided we pay you the amounts which are due to you under the Lease (including its deficiency clause) when due, you shall not sell or sublet the apartment without our approval, unless the net proceeds of such sale or subletting

## Aztech Agreement

shall equal or exceed the amount owing to us by Lessee.

(d) You will accept payment from us on behalf of Lessee of any sums due under the Lease (including its deficiency clause), any payments made by us under the terms of this agreement will be deemed so paid, and no payments made in accordance herewith shall be deemed to limit our rights against the Lessee pursuant to law.

(e) You shall recognize our right as lienor against the Apartment pursuant to the Security, and, if the Lease be terminated and/or shares cancelled, against the net proceeds of any sale or subletting of the apartment, after reimbursement to you of all sums due you under the Lease.

3. (a) Before delivery of this letter by you to us, we will have authority from the Lessee to give, and will, on request, give you a copy of the financial and credit information provided by him, but shall be under no duty to advise you of the results of any credit check we may make.

(b) Notwithstanding any apparent authority granted to us under agreements with the Lessee, WE SHALL HAVE NO RIGHT OR POWER TO TRANSFER THE APARTMENT UPON FORECLOSURE OR OTHERWISE EITHER TO US OR ANYONE ELSE WITHOUT YOUR APPROVAL AS REQUIRED BY THE LEASE provided, however, that nothing contained herein shall limit any rights we may have to dispossess the Lessee pursuant to law or realize upon our security in accordance herewith.

(c) If through oversight or negligence you or your agents or employees shall fail to notify us of Lessee's default prior to termination of the Lease, we will not seek to hold you or your agents or employees liable for breach of this agreement, provided that:

- (1) you advise us promptly after discovering your failure, and
- (2) if you have already sold or contracted to sell the Apartment, that you pay us the net proceeds of such sale (after reimbursing yourselves for all sums due you), or such lesser sum as shall equal the amount owing to us by the Lessee (the balance being payable to the Lessee), or
- (3) if you have not contracted to sell the Apartment, that the provisions of paragraphs 2(c)(3) and 2(e) hereof shall apply.

(d) We will indemnify you and your agent against loss, liability or expense incurred in connection with any claim by the Lessee, his successors or assigns against either of you arising out of our representations pursuant hereto or your agreements herein (except as stated in paragraph 3(a) hereof), provided you give us prompt notice of any such claim. We may contest such claim in your name and on your behalf, but at our sole cost and expense, and you will execute such documents and do such things as are reasonably necessary to assist us in such contest.

4. While we have the right but no obligation to cure the Lessee's defaults under the Lease, if we do not do so within the time provided for herein, you shall have no obligation to us, except that in the event of sale or subletting the Apartment, you shall recognize our rights as lienor against the net proceeds of any sale or subletting (after reimbursement to you of all sums which are due to you under the Lease).

Aztech Agreement

Any notice of approval provided for herein shall be deemed valid only if in writing and sent you registered or certified mail, as follows: to you, in care of your Managing Agent, with a copy by regular mail addressed to: \_\_\_\_\_ at \_\_\_\_\_; to us at \_\_\_\_\_.

Either of us may change the address to which notices or approval shall be mailed by notice given as herein provided. This letter and the representations and agreements contained herein shall be deemed made as of the date of the making of the loan.

\_\_\_\_\_ Bank

By: \_\_\_\_\_

Agreed to:

Approved:

\_\_\_\_\_  
Lessor

\_\_\_\_\_  
Lessee

By: \_\_\_\_\_

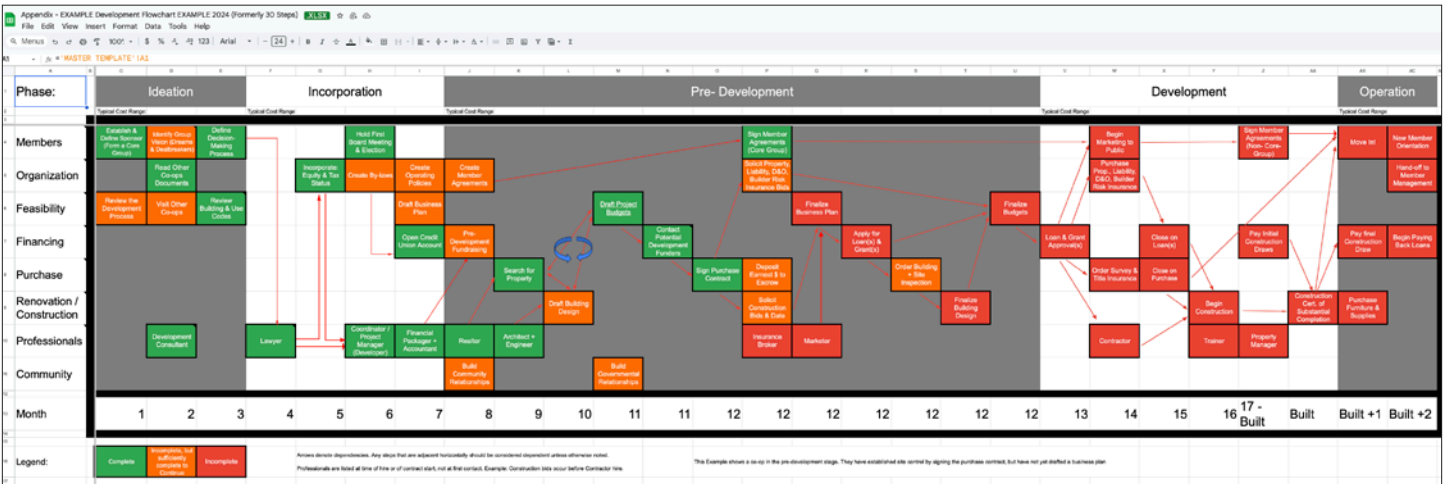
\_\_\_\_\_  
Lessee

## App. 2—Cost Allocation Sheet

Appendix Cost Allocation Sheet (Final)													
File Edit View Insert Format Data Tools Help													
Q Menus 100% 123													
A1 Total Sources													
	A	B	C	D	E	F	G	H	I	J	K	L	M
1	Total Sources	\$ 5,700,000	Total Equity	\$ 1,050,000	Sources ->	Developer Equity	Deferred Developer Fee	CDFI Loan	City Pre-Development Loan	City Land Acquisition Loan	State Solar Grant	Landscaping Grant	Parks & Rec Grant
2	Total Uses	\$ 5,700,000	Total Debt	\$ 4,650,000	Source Type ->	Unrestricted Equity	Unrestricted Equity	Unrestricted Debt	Restricted Debt	Restricted Debt	Restricted Equity	Restricted Equity	Restricted Equity
3	Total Remaining Gap	\$ 0.00	D/E Ratio	4.43	Total Source Amount ->	\$ 369,630	\$ 370,370	\$ 4,500,000	\$ 50,000	\$ 100,000	\$ 75,000	\$ 150,000	\$ 85,000
4	Total Project Surplus	\$ -	Total Restricted Sources	\$ 460,000	% of total Sources ->	6%	6%	79%	1%	2%	1%	3%	1%
5			Total Unrestricted Source	\$ 5,240,000	Unallocated Amount ->	\$ -	\$ 0	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
6					Columns to the right detail how each Source is allocated to each Use.	Amounts Below: Allocations by Use from Developer Equity	Amounts Below: Allocations by Use from Deferred Developer Fee	Amounts Below: Allocations by Use from CDFI Loan	Amounts Below: Allocations by Use from City Pre-Development Loan	Amounts Below: Allocations by Use from City Land Acquisition Loan	Amounts Below: Allocations by Use from State Solar Grant	Amounts Below: Allocations by Use from Landscaping Grant	Amounts Below: Allocations by Use from Parks & Rec Grant
7	Uses	Total Use Cost	Total Sources Allocated	Remaining Gap (Per Use)									
8	Soft Costs	\$ 90,000	\$ 90,000	\$ -	<-- Soft Costs	\$ 90,000							
9	Architecture/Design	\$ 140,000	\$ 140,000	\$ -	<-- Architecture/Design			\$ 140,000					
10	Pre-development	\$ 150,000	\$ 150,000	\$ -	<-- Pre-development			\$ 100,000	\$ 50,000				
11	Land Acquisition	\$ 1,500,000	\$ 1,500,000	\$ -	<-- Land Acquisition			\$ 1,400,000		\$ 100,000			
12	Construction - General	\$ 2,500,000	\$ 2,500,000	\$ -	<-- Construction - General			\$ 2,500,000					
13	Construction - Playground, ball field, Tennis Courts	\$ 130,000	\$ 130,000	\$ -	<-- Construction - Playground, ball field, Tennis Courts	\$ 4,000		\$ 41,000					\$ 85,000
14	Landscaping	\$ 150,000	\$ 150,000	\$ -	<-- Landscaping						\$ 75,000	\$ 150,000	
15	Solar Installation	\$ 150,000	\$ 150,000	\$ -	<-- Solar Installation	\$ 75,000							
16	Contingency	\$ 481,000	\$ 481,000	\$ -	<-- Contingency	\$ 200,630		\$ 280,370					
17	Developer Fee	\$ 370,370	\$ 370,370	\$ 0	<-- Developer Fee	\$ 370,370							
18	Reserve Contribution	\$ 38,630	\$ 38,630	\$ -	<-- Reserve Contribution			\$ 38,630					

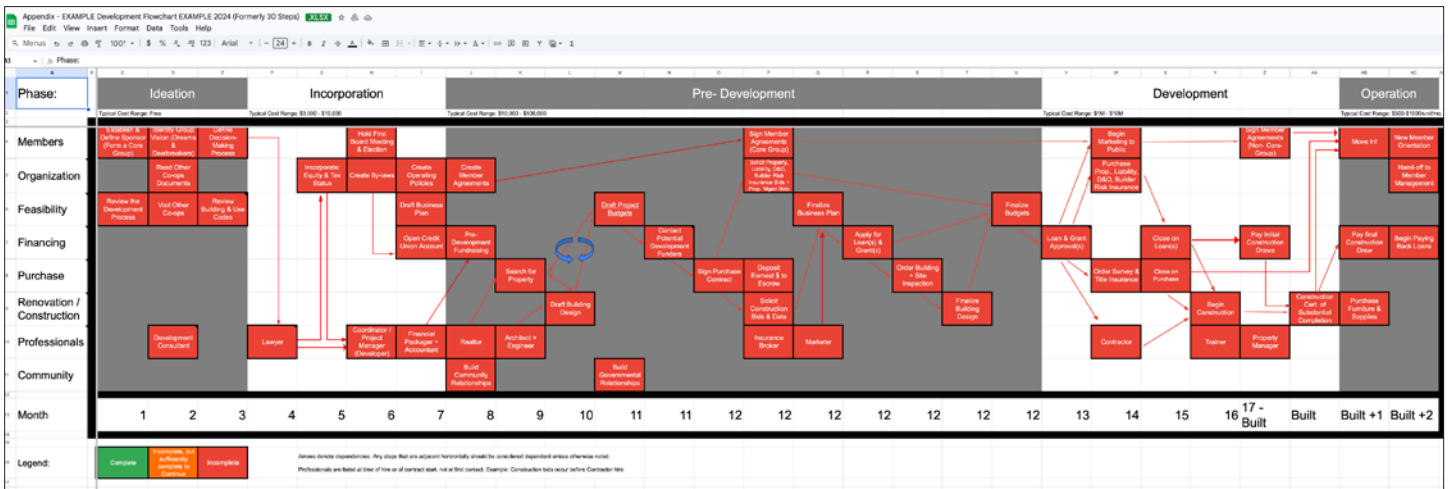
Located here: [https://docs.google.com/spreadsheets/d/14cSrmlnu\\_3qthzBIFHpiNjwcYq4noqC/edit?usp=sharing&ouid=107413769446516837147&rtpof=true&sd=true](https://docs.google.com/spreadsheets/d/14cSrmlnu_3qthzBIFHpiNjwcYq4noqC/edit?usp=sharing&ouid=107413769446516837147&rtpof=true&sd=true)

## App. 3—Development Flow Chart EXAMPLE



Located here: [https://docs.google.com/spreadsheets/d/14cSrmlnu\\_3qthzBIFHpiNjwcYq4noqC/edit?gid=1110521480#gid=1110521480](https://docs.google.com/spreadsheets/d/14cSrmlnu_3qthzBIFHpiNjwcYq4noqC/edit?gid=1110521480#gid=1110521480)

## App. 4—Development Flow Chart TEMPLATE



Located here: [https://docs.google.com/spreadsheets/d/14cSrmlnu\\_3qthzBIFHpiNjwcyYq4noqC/edit?gid=1110521480#gid=1110521480](https://docs.google.com/spreadsheets/d/14cSrmlnu_3qthzBIFHpiNjwcyYq4noqC/edit?gid=1110521480#gid=1110521480)

## App. 5—Financial Report—Operating

Appendix Copy of Financial Report (substitute for operating budget example) (final?) .XLSX ☆

File Edit View Insert Format Data Tools Help

Q Menus 100% \$ % .00 .00 123 Defaul... - 10 + B I A

Z84

	A	B	C	D	E	F	G	H	I	J	K
1	<b>FINANCIAL REPORT - Operating</b>										
2											
3		Month	1								
4											
5											
6		<b>INCOME</b>				<b>Annual Budget</b>	<b>Monthly Budget</b>	<b>Expenses</b>	<b>Expenses</b>	<b>Budget</b>	<b>Over (Under)</b>
7							<b>(1/12 Annual)</b>	<b>This Month</b>	<b>To Date</b>	<b>To Date</b>	<b>To Date</b>
8		Carrying Charges				\$593,000	\$49,417			\$49,417	(\$49,417)
9		Non-Member Rents				\$36,000	\$3,000			\$3,000	(\$3,000)
10		Parking				\$25,000	\$2,083			\$2,083	(\$2,083)
11		Late Charges				\$500	\$42			\$42	(\$42)
12		Interest Income				\$12,900	\$1,075			\$1,075	(\$1,075)
13		Legal Recovery				\$0	\$0			\$0	\$0
14		Other				\$0	\$0			\$0	\$0
15											
16		<b>Total Income</b>				<b>\$667,400</b>	<b>\$55,617</b>	<b>\$0</b>	<b>\$0</b>	<b>\$55,617</b>	<b>(\$55,617)</b>
17											
18		<b>EXPENSES</b>									
19											
20		Vacancy & Collection Loss				\$31,450	\$2,621			\$2,621	(\$2,621)
21		Employee Apartment Rent				\$36,000	\$3,000			\$3,000	(\$3,000)
22		Apartment Resale Expense				\$1,000	\$83			\$83	(\$83)
23		Management Fee				\$14,900	\$1,242			\$1,242	(\$1,242)
24		Legal Expense				\$3,000	\$250			\$250	(\$250)
25		Audit Expense				\$2,750	\$229			\$229	(\$229)
26		Telephone				\$900	\$75			\$75	(\$75)
27		Office & Administrative Salaries				\$1,500	\$125			\$125	(\$125)
28		Office Expenses				\$1,000	\$83			\$83	(\$83)
29		Misc. Administrative Expense				\$5,000	\$417			\$417	(\$417)
30		Resident Manager				\$36,500	\$3,042			\$3,042	(\$3,042)
31		Association Dues				\$600	\$50			\$50	(\$50)
32							\$0			\$0	\$0
33		Fuel				\$0	\$0			\$0	\$0
34		Electricity				\$39,500	\$3,292			\$3,292	(\$3,292)
35		Water & Sewer				\$18,650	\$1,554			\$1,554	(\$1,554)
36		Veh. & Equip. Oper. Expense				\$0	\$0			\$0	\$0
37		Janitor's Payroll				\$12,500	\$1,042			\$1,042	(\$1,042)
38		Janitor's Supplies				\$0	\$0			\$0	\$0
39		Exterminating				\$950	\$79			\$79	(\$79)
40		Rubbish Removal				\$7,500	\$625			\$625	(\$625)
41		Parking Area Expense				\$1,200	\$100			\$100	(\$100)
42		Uniforms				\$0	\$0			\$0	\$0
43											
44		Rehabilitation				\$500	\$42			\$42	(\$42)
45		Grounds Maintenance				\$18,000	\$1,500			\$1,500	(\$1,500)
46		Painting & Decorating				\$3,000	\$250			\$250	(\$250)
47		Structural Repairs				\$3,000	\$250			\$250	(\$250)
48		Heating & Air Conditioning Maint				\$5,000	\$417			\$417	(\$417)
49		Plumbing Maintenance				\$5,000	\$417			\$417	(\$417)
50		Electrical Maintenance				\$5,000	\$417			\$417	(\$417)
51		Elevator Maintenance				\$9,500	\$792			\$792	(\$792)
52		Pool Maintenance				\$0	\$0			\$0	\$0
53		Maintenance Supplies				\$5,000	\$417			\$417	(\$417)
54		Maintenance Payroll				\$0	\$0			\$0	\$0
55		Misc. Maintenance Repair				\$0	\$0			\$0	\$0
56											
57		Real Estate Taxes				\$19,500	\$1,625			\$1,625	(\$1,625)
58		Employer's Payroll Taxes				\$3,600	\$300			\$300	(\$300)
59		Misc. Taxes				\$2,500	\$208			\$208	(\$208)
60		Property & Liability Insurance				\$14,500	\$1,208			\$1,208	(\$1,208)
61		Workers' Compensation				\$1,750	\$146			\$146	(\$146)
62		Fidelity Bonds				\$0	\$0			\$0	\$0
63		Misc. Insurance				\$0	\$0			\$0	\$0
64		Employee Health Ins.				\$0	\$0			\$0	\$0
65											
66											
67		Ground Rent				\$0	\$0			\$0	\$0
68		FHA Mortgage Ins. Premium				\$0	\$0			\$0	\$0
69		Mortgage Interest				\$11,590	\$966			\$966	(\$966)
70		Mortgage Principal				\$55,432	\$4,619			\$4,619	(\$4,619)
71		Replacement Reserve				\$194,500	\$16,208			\$16,208	(\$16,208)
72		General Operating Reserve				\$36,000	\$3,000			\$3,000	(\$3,000)
73		Painting Reserve				\$20,000	\$1,667			\$1,667	(\$1,667)
74		Project Equipment Purch.				\$2,000	\$167			\$167	(\$167)
75		Capital Improvements				\$37,000	\$3,083			\$3,083	(\$3,083)
76											
77		<b>Total Expense</b>				<b>\$667,272</b>	<b>\$55,606</b>	<b>\$0</b>	<b>\$0</b>	<b>\$55,606</b>	<b>(\$55,606)</b>
78											
79		<b>Income Over (Under) Expense</b>				<b>\$128</b>	<b>\$11</b>	<b>\$0</b>	<b>\$0</b>	<b>\$11</b>	<b>(\$11)</b>
80											

Located here: [https://docs.google.com/spreadsheets/d/1-i\]r2cqpkpYRKOH\\_K9pC26c\\_YE8U8Ua/edit?gid=1838924917#gid=1838924917](https://docs.google.com/spreadsheets/d/1-i]r2cqpkpYRKOH_K9pC26c_YE8U8Ua/edit?gid=1838924917#gid=1838924917)

## App. 6—Financing Comparison Worksheet—Example

**APPENDIX 6: FINANCING COMPARISON WORKSHEET**

The following worksheet can be adapted to your cooperative's financing needs. Use it to compare sources of financing, as well as their terms and conditions.

	Financial Institution #1	Financial Institution #2	Financial Institution #3
Name	NiceFund	FunFund	FriendFund
Loan Amount	1,500,000	1,980,000	1,500,000
Equity required?	10%	20%	15%
Term (in months or years)	60mo/5Y	60mo/5Y	360mo/30Y
Amortization (in months or years)	360mo/30Y	300mo/25Y	360mo/30Y
Balloon Payment	Yes	Yes	No
Interest Rate	6.25%	6.0%	6.3%
Fixed or variable?	Fixed	Variable	Fixed
Collateral Required	Yes - 70% LTV	No	Yes - 70%LTV
Mortgage/Assignment of Contracts/Leasehold			
Application Deadline			
Application Fee			
Estimated time to approval/rejection	5 days	10 days	15 days
Estimated time from approval to closing	60 days	90 days	100 days
Origination Fees	1% of total proceeds	1.5% of total proceeds	\$1,500
Legal Fees			
Other Closing Costs			
Prepayment Penalties (if any)			
Loan Disbursement Schedule			
When and how will you get the loan proceeds?	At closing - wire to account(s)	At closing - wire to account(s)	At closing - wire to account(s)
Billing Schedule	Monthly, on first of the month	Quarterly, on first of the quarter	Monthly, on first of the month
How often will you be billed for loan payments?			
Other Loan Conditions			

Located here: <https://docs.google.com/document/d/1rqjNTOQL6HUm-Fngsg5I9eooNylcpvgL9s7PGlqxV4/edit?tab=t.o>

## App. 7—Financing Comparison Worksheet—Template

**APPENDIX 7: FINANCING COMPARISON WORKSHEET**

The following worksheet can be adapted to your cooperative's financing needs. Use it to compare sources of financing, as well as their terms and conditions.

	Financial Institution #1	Financial Institution #2	Financial Institution #3
Name			
Loan Amount			
Equity required?			
Term (in months or years)			
Amortization (in months or years)			
Balloon Payment			
Interest Rate			
Fixed or variable?			
Collateral Required			
Mortgage/Assignment of Contracts/Leasehold			
Application Deadline			
Application Fee			
Estimated time to approval/rejection			
Estimated time from approval to closing			
Origination Fees			
Legal Fees			
Other Closing Costs			
Prepayment Penalties (if any)			
Loan Disbursement Schedule			
When and how will you get the loan proceeds?			
Billing Schedule			
How often will you be billed for loan payments?			
Other Loan Conditions			

Located Here: <https://docs.google.com/document/d/iizmIeXKLnR7AGwIUyB4No6T6nrOqPT1pxKfivlGUZrc/edit?usp=sharing>

## App. 8—IRC Section 216

Retrieved from Cornell Law School Legal Information Institute. 2026.

**(a) ALLOWANCE OF DEDUCTION** In the case of a [tenant-stockholder](#) (as defined in subsection (b)(2)), there shall be allowed as a deduction amounts (not otherwise deductible) paid or accrued to a [cooperative housing corporation](#) within the taxable year, but only to the extent that such amounts represent the [tenant-stockholder's proportionate share](#) of—

(1) the real estate taxes allowable as a deduction to the corporation under [section 164](#) which are paid or incurred by the corporation on the houses or apartment building and on the land on which such houses (or building) are situated, or

(2) the interest allowable as a deduction to the corporation under [section 163](#) which is paid or incurred by the corporation on its indebtedness contracted—

(A) in the acquisition, construction, alteration, rehabilitation, or maintenance of the houses or apartment building, or

(B) in the acquisition of the land on which the houses (or apartment building) are situated.

**(b) DEFINITIONS** For purposes of this section—

**(1) COOPERATIVE HOUSING CORPORATION**

The term “[cooperative housing corporation](#)” means a corporation—

(A) having one and only one class of stock outstanding,

(B) each of the stockholders of which is entitled, solely by reason of his ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by such corporation,

(C) no stockholder of which is entitled (either conditionally or unconditionally) to receive any distribution not out of earnings and profits of the corporation except on a complete or partial liquidation of the corporation, and

(D) meeting 1 or more of the following requirements for the taxable year in which the taxes and interest described in subsection (a) are paid or incurred:

(i) 80 percent or more of the corporation's gross income for such taxable year is derived from [tenant-stockholders](#).

(ii) At all times during such taxable year, 80 percent or more of the total square footage of the corporation's property is used or available for use by the [tenant-stockholders](#) for residential purposes or purposes ancillary to such residential use.

(iii) 90 percent or more of the expenditures of the corporation paid or incurred during such taxable year are paid or incurred for the acquisition, construction, management, maintenance, or care of the corporation's property for the benefit of the [tenant-stockholders](#).

**(2) TENANT-STOCKHOLDER**

The term “[tenant-stockholder](#)” means a person who is a stockholder in a [cooperative housing corporation](#), and whose stock is fully paid-up in an amount not less than an amount shown to the satisfaction of the Secretary as bearing a reasonable relationship to the portion of the value of the corporation's equity in the houses or apartment building and the land on which situated which is attributable to the house or apartment which such person is entitled to occupy.

**(3) TENANT-STOCKHOLDER'S PROPORTIONATE SHARE****(A) In general**

Except as provided in subparagraph (B), the term "[tenant-stockholder's proportionate share](#)" means that proportion which the stock of the [cooperative housing corporation](#) owned by the [tenant-stockholder](#) is of the total outstanding stock of the corporation (including any stock held by the corporation).

**(B) Special rule where allocation of taxes or interest reflect cost to corporation of stockholder's unit****(i) In general** If, for any taxable year—

**(I)** each dwelling unit owned or leased by a [cooperative housing corporation](#) is separately allocated a share of such corporation's real estate taxes described in subsection (a) (1) or a share of such corporation's interest described in subsection (a) (2), and

**(II)** such allocations reasonably reflect the cost to such corporation of such taxes, or of such interest, attributable to the [tenant-stockholder's](#) dwelling unit (and such unit's share of the common areas),

then the term "[tenant-stockholder's proportionate share](#)" means the shares determined in accordance with the allocations described in subclause (II).

**(ii) Election by corporation required**

Clause (i) shall apply with respect to any [cooperative housing corporation](#) only if such corporation elects its application. Such an election, once made, may be revoked only with the consent of the Secretary.

**(4) STOCK OWNED BY GOVERNMENTAL UNITS**

For purposes of this subsection, in determining whether a corporation is a [cooperative housing corporation](#), stock owned and apartments leased by the United States or any of its possessions, a State or any political subdivision thereof, or any agency or instrumentality of the foregoing empowered to acquire shares in a [cooperative housing corporation](#) for the purpose of providing housing facilities, shall not be taken into account.

**(5) PRIOR APPROVAL OF OCCUPANCY**

For purposes of this section, in the following cases there shall not be taken into account the fact that (by agreement with the [cooperative housing corporation](#)) the person or his nominee may not occupy the house or apartment without the prior approval of such corporation:

**(A)** In any case where a person acquires stock of a [cooperative housing corporation](#) by operation of law.

**(B)** In any case where a person other than an individual acquires stock of a [cooperative housing corporation](#).

**(C)** In any case where the [original seller](#) acquires any stock of the [cooperative housing corporation](#) from the corporation not later than 1 year after the date on which the apartments or houses (or leaseholds therein) are transferred by the [original seller](#) to the corporation.

**(6) ORIGINAL SELLER DEFINED**

For purposes of paragraph (5), the term “[original seller](#)” means the person from whom the corporation has acquired the apartments or houses (or leaseholds therein).

**(c) TREATMENT AS PROPERTY SUBJECT TO DEPRECIATION****(1) IN GENERAL**

So much of the stock of a [tenant-stockholder](#) in a [cooperative housing corporation](#) as is allocable, under regulations prescribed by the Secretary, to a proprietary lease or right of tenancy in property subject to the allowance for depreciation under [section 167\(a\)](#) shall, to the extent such proprietary lease or right of tenancy is used by such [tenant-stockholder](#) in a trade or business or for the production of income, be treated as property subject to the allowance for depreciation under section 167(a). The preceding sentence shall not be construed to limit or deny a deduction for depreciation under section 167(a) by a [cooperative housing corporation](#) with respect to property owned by such a corporation and leased to [tenant-stockholders](#).

**(2) DEDUCTION LIMITED TO ADJUSTED BASIS IN STOCK****(A) In general**

The amount of any deduction for depreciation allowable under section 167(a) to a [tenant-stockholder](#) with respect to any stock for any taxable year by reason of paragraph (1) shall not exceed the adjusted basis of such stock as of the close of the taxable year of the [tenant-stockholder](#) in which such deduction was incurred.

**(B) Carryforward of disallowed amount**

The amount of any deduction which is not allowed by reason of subparagraph (A) shall, subject to the provisions of subparagraph (A), be treated as a deduction allowable under [section 167\(a\)](#) in the succeeding taxable year.

**(d) DISALLOWANCE OF DEDUCTION FOR CERTAIN PAYMENTS TO THE CORPORATION**

No deduction shall be allowed to a stockholder in a [cooperative housing corporation](#) for any amount paid or accrued to such corporation during any taxable year (in excess of the stockholder’s proportionate share of the items described in subsections (a)(1) and (a)(2)) to the extent that, under regulations prescribed by the Secretary, such amount is properly allocable to amounts paid or incurred at any time by the corporation which are chargeable to the corporation’s capital account. The stockholder’s adjusted basis in the stock in the corporation shall be increased by the amount of such disallowance.

**(e) DISTRIBUTIONS BY COOPERATIVE HOUSING CORPORATIONS**

Except as provided in regulations no gain or loss shall be recognized on the distribution by a [cooperative housing corporation](#) of a dwelling unit to a stockholder in such corporation if such distribution is in exchange for the stockholder’s stock in such corporation and such dwelling unit is used as his principal residence (within the meaning of [section 121](#)).

## App. 9—IRC Section 42(i)(7)

Retrieved from Cornell Law School Legal Information Institute. 2026.

### **42(i)(7) Impact of tenant's right of 1st refusal to acquire property**

#### **(A) In general**

No Federal income tax benefit shall fail to be allowable to the taxpayer with respect to any qualified low-income building merely by reason of a right of 1st refusal held by the tenants (in cooperative form or otherwise) or resident management corporation of such building or by a qualified nonprofit organization (as defined in subsection (h)(5)(C)) or government agency to purchase the property after the close of the compliance period for a price which is not less than the minimum purchase price determined under subparagraph (B).

#### **(B) Minimum purchase price**

For purposes of subparagraph (A), the minimum purchase price under this subparagraph is an amount equal to the sum of-

- (i) the principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred within the 5-year period ending on the date of the sale to the tenants), and
- (ii) all Federal, State, and local taxes attributable to such sale.

Except in the case of Federal income taxes, there shall not be taken into account under clause (ii) any additional tax attributable to the application of clause (ii).

## App. 10—Overview of Co-op Documents

Document	Purpose	Effects
Articles of Incorporation	Establish the existence of the cooperative.	<ol style="list-style-type: none"> <li>1. Makes the organization (as opposed to the individual members) the operative entity vis-a-vis the rest of the world.</li> <li>2. Limits the purposes for which the organization can act.</li> <li>3. Defines the basic structure of the cooperative.</li> </ol>
By-Laws	Regulate the internal workings of the cooperative.	<ol style="list-style-type: none"> <li>1. Defines membership (eligibility, rights, terminations, transfers).</li> <li>2. Delineates powers, operations, and officers of the Board of Directors.</li> <li>3. Provides for Annual Meeting of Members and elections of Directors.</li> <li>4. <i>Establishes maximum transfer value.</i></li> <li>5. <i>Subordinates all of the above to the Regulatory Agreement.</i></li> </ol>
Subscription Agreement (designed to operate during start-up period)	Create a conditional agreement to purchase and sell a membership.	<ol style="list-style-type: none"> <li>1. Gives prospective members a limited right to buy a membership from the cooperative in exchange for a down payment which secures the cooperative against default.</li> </ol>
Occupancy Agreement	Define the rights and duties of the member as tenant and the cooperative as landlord.	<ol style="list-style-type: none"> <li>1. Same as any residential lease, except that the term is, essentially, perpetual.</li> </ol>
Regulatory Agreement	<i>Control the operations of the cooperative so that they meet the purposes of the (federal) government program under which the cooperative was financed/insured/subsidized.</i>	<ol style="list-style-type: none"> <li>1. <i>Restricts the (initial) membership of the cooperative to members of the target population.</i></li> <li>2. <i>Regulates the resale of memberships as to both price and membership in the target population.</i></li> <li>3. <i>Regulates the financial operations of the cooperative (occupancy charges, reserves, contracts, borrowing, investments).</i></li> <li>4. <i>Regulates the maintenance and repair of the structures and grounds.</i></li> <li>5. <i>Provides means for enforcement.</i></li> </ol>
Recognition Agreement	Set forth obligations of share lender and cooperative vis-a-vis each other.	<ol style="list-style-type: none"> <li>1. Cooperative guarantees the truth of certain statements regarding the status of the cooperative as owner of the real estate and the borrower as a member of the cooperative.</li> <li>2. Cooperative consents to member's pledge of cooperative interest (membership certificate plus occupancy agreement) as security for loan.</li> <li>3. Cooperative agrees to notify lender of any threat to the borrower's status as a member in good standing of the cooperative or of any impairment in the cooperative's financial status.</li> <li>4. Gives lender rights to cure certain defaults by member or by cooperative.</li> <li>5. Requires cooperative to terminate membership if borrower defaults on share loan obligations.</li> <li>6. Sets out priorities between cooperative, lender, and borrower upon foreclosure and resale of borrower's cooperative interest.</li> </ol>

Note: Items in italics are applicable only to limited equity and/or government-related cooperatives.

## App. 11—Sample Sales Price Analysis

Example Project													
Area Median Income (AMI)		\$70,900											
Interest Rate		7.50%											
Down Payment		10%											
Discount Factor*		95%											
	% Area Median Income Target	# of Units	Average Total Monthly Payment	Average Monthly Maintenance	Estimated Mortgage Payment	Estimated Mortgage Amount	Down Payment Assistance	Cash Down Payment	Estimated Sales Price	Total Sales Price	Actual Income @ 33%	Actual Income's % of AMI	Common Charge
Efficiency	130%	2	\$1,686	\$575.00	\$1,111	\$158,829	\$0	\$17,648	\$176,477	\$352,954	\$61,293	124%	\$1,150
Efficiency	100%	0	\$1,297	\$575.00	\$722	\$103,199	\$0	\$11,467	\$114,666	\$0	\$47,149	95%	\$0
Efficiency	80%	2	\$1,037	\$575.00	\$462	\$66,112	\$0	\$7,346	\$73,458	\$146,916	\$37,719	76%	\$1,150
One Bedroom	130%	7	\$1,806	\$650.00	\$1,156	\$165,322	\$0	\$18,369	\$183,691	\$1,285,838	\$65,671	124%	\$4,550
One Bedroom	100%	0	\$1,389	\$650.00	\$739	\$105,718	\$0	\$11,246	\$117,465	\$0	\$50,516	95%	\$0
One Bedroom	80%	3	\$1,111	\$650.00	\$461	\$65,982	\$0	\$7,331	\$73,314	\$219,941	\$40,413	76%	\$1,950
Two Bedroom	165%	0	\$2,751	\$800.00	\$1,951	\$278,972	\$0	\$30,997	\$309,968	\$0	\$100,022	157%	\$0
Two Bedroom	130%	20	\$2,167	\$800.00	\$1,367	\$195,526	\$0	\$21,725	\$217,251	\$4,345,025	\$78,805	124%	\$16,000
Two Bedroom	100%	0	\$1,667	\$800.00	\$867	\$124,001	\$0	\$13,778	\$137,779	\$0	\$60,620	95%	\$0
Two Bedroom	80%	4	\$1,334	\$800.00	\$534	\$76,318	\$0	\$8,480	\$84,798	\$339,193	\$48,496	76%	\$3,200
Three Bedroom	130%	2	\$2,480	\$925.00	\$1,555	\$222,418	\$0	\$24,713	\$247,131	\$494,262	\$90,188	124%	\$1,850
Three Bedroom	100%	0	\$1,908	\$925.00	\$983	\$140,562	\$0	\$15,618	\$156,180	\$0	\$69,376	95%	\$0
Three Bedroom	80%	0	\$1,526	\$925.00	\$601	\$85,991	\$0	\$9,555	\$95,546	\$0	\$55,501	76%	\$0
Total Residential Sales		40								\$6,684,260			\$29,850
Parking Spaces										\$0			
<b>TOTAL SALES</b>										<b>\$6,684,260</b>			
Efficiency Rooms	1.0	4											
One Bedroom Rooms	3.0	30											
Two Bedroom Rooms	4.0	96											
Three Bedroom Rooms	5.0	10											

Dear Reader—Please note this very important tip!

What is the discount factor? Funders often require that incomes of buyers do not exceed a certain amount. As an example, assume the limit is 80 percent of area median income (AMI). Most applicants will not have incomes exactly at 80 percent, however, if they have incomes slightly above, then they are not eligible. When the maximum income is set at 80 percent, qualified applicants will have incomes between 70 percent and 80 percent of median—an average of about 95 percent of 80 percent of AMI. This is why a discount factor of 95 percent is used to calculate average monthly payment.

Located here: [https://drive.google.com/file/d/1Pzw\\_nmt8dyKbYGjrvNwXo7AeF4IpIJZ/view?usp=drive\\_link](https://drive.google.com/file/d/1Pzw_nmt8dyKbYGjrvNwXo7AeF4IpIJZ/view?usp=drive_link)

## App. 12—Federal Funding for Cooperative Housing

### Federal Housing Programs Summary

Program	Agency	Description
Section 515	USDA	Rural rental housing program that can be used to finance co-op housing.
Housing Choice Vouchers (formerly Section 8)	HUD	Supplements the amount that households pay towards total monthly housing costs. While considered a rental subsidy, it can be used to cover monthly carrying charges. Housing Choice Vouchers funds may be used for homeownership if the local Housing Authority creates such a program.
Section 202	HUD	Subsidies for elderly housing. Can be used for co-ops.
Section 811	HUD	Subsidies for supportive housing for persons with disabilities. Can be used for co-ops.
Community Development Block Grant (CDBG)	HUD	Provides Federal funds to local governments. Local governments determine how to best use the funds to create affordable housing.
HOME Funds	HUD	Like CDBG, HOME provides Federal funds to state and local governments for affordable housing, including direct rental assistance. Largest block grant program specifically for affordable housing for low-income households.
FHA Section 213	HUD	If used, could provide 40-year fixed-rate, federally insured co-op blanket loans.
Section 223(f)	HUD	Long-term, fixed rate multifamily rental housing program can be used to refinance or create housing cooperative.
Rural Housing and Economic Development	HUD	Grant for improving distressed rural areas. Can be used to build affordable cooperatives or to create revolving loan funds for underlying or share loans.
Brownfield Economic Development Initiative (BEDI)	HUD, though City or State must be the applicant	Grant to make a Section 108 loan (a loan guaranteed by CDBG funding) viable, when used in conjunction with cleaning a Brownfield site, including for affordable housing.

Rev. Proc. 96-32, 1996-1 C.B. 717, 1996-20 I.R.B. 14.

## INTERNAL REVENUE SERVICE

### Revenue Procedure

#### LOW-INCOME HOUSING GUIDELINES

Released: May 1, 1996

Published: May 13, 1996

#### **26 CFR 601.201: Rulings and determination letters.**

Low-income housing guidelines. Guidance on qualification for tax-exemption under section 501(c)(3) is provided for organizations that provide low-income housing. The guidance includes a safe-harbor procedure to determine qualification.

#### **SECTION 1. PURPOSE**

**.01** This revenue procedure sets forth a safe harbor under which organizations that provide low-income housing will be considered charitable as described in § 501(c)(3) of the Internal Revenue Code because they relieve the poor and distressed as described in § 1.501(c)(3)-1(d)(2) of the Income Tax Regulations. This revenue procedure also describes the facts and circumstances test that will apply to determine whether organizations that fall outside the safe harbor relieve the poor and distressed such that they will be considered charitable organizations described in § 501(c)(3). It also clarifies that housing organizations may rely on other charitable purposes to qualify for recognition of exemption from federal income tax as organizations described in § 501(c)(3). These other charitable purposes are described in § 1.501(c)(3)-1(d)(2). This revenue procedure supersedes the application referral described in Notice 93-1, 1993-1 C.B. 290.

**.02** This revenue procedure does not alter the standards that have long been applied to determine whether low-income housing organizations qualify for tax-exempt status under § 501(c)(3). Rather, it is intended to expedite the consideration of applications for tax-exempt status filed by such organizations by providing a safe harbor and by accumulating relevant information on the existing standards for exemption in a single document. Low-income housing organizations that have ruling or determination letters and have not materially changed their organizations or operations from how they were described in their applications can continue to rely on those letters.

## SECTION 2. BACKGROUND OF SAFE HARBOR

.01 Rev. Rul. 67-138, 1967-1 C.B. 129, Rev. Rul. 70-585, 1970-2 C.B. 115, and Rev. Rul. 76-408, 1976-2 C.B. 145, hold that the provision of housing for low-income persons accomplishes charitable purposes by relieving the poor and distressed. The Service has long held that poor and distressed beneficiaries must be needy in the sense that they cannot afford the necessities of life. Rev. Ruls. 67-138, 70-585, and 76-408 refer to the needs of housing recipients and to their inability to secure adequate housing under all the facts and circumstances to determine whether they are poor and distressed.

.02 The existence of a national housing policy to maintain a commitment to provide decent, safe, and sanitary housing for every American family is reflected in several federal housing acts. See, for example, § 2 of the United States Housing Act of 1937, 42 U.S.C. § 1437; § 2 of the Housing Act of 1949, 42 U.S.C. § 1441; § 2 of the Housing and Urban Development Act of 1968, 12 U.S.C. § 1701t; and §§ 101, 102, and 202 of the Cranton-Gonzalez National Affordable Housing Act, 42 U.S.C. §§ 12701, 12702, and 12721. Not all beneficiaries of these housing acts, however, are necessarily poor and distressed within the meaning of § 1.501(c)(3)-1(d)(2).

.03 In order to support national housing policy, the safe harbor contained in this revenue procedure identifies those low-income housing organizations that will, with certainty, be considered to relieve the poor and distressed. The safe harbor permits a limited number of units occupied by residents with incomes above the low-income limits in order to assist in the social and economic integration of the poorer residents and, thereby, further the organization's charitable purposes. To avoid giving undue assistance to those who can otherwise afford safe, decent, and sanitary housing, the safe harbor requires occupancy by significant levels of both very low-income and low-income families.

.04 Low-income housing organizations that fall outside the safe harbor may still be considered organizations that offer relief to the poor and distressed based on all the surrounding facts and circumstances. Some of the facts and circumstances that will be taken into consideration in determining whether a low-income housing organization will be so considered are set forth in section 4.

.05 Low-income housing organizations may also qualify for tax-exempt status because they serve a charitable purpose described in § 501(c)(3) other than relief of the poor and distressed. Exempt purposes other than relief of the poor and distressed are discussed in section 6.

.06 To be recognized as exempt from income tax under § 501(c)(3), a low-income housing organization must not only serve a charitable purpose but also meet the other requirements of that section, including the prohibitions against inurement and private benefit. Specific concerns with respect to these prohibitions are set forth in section 7.<sup>1</sup>

<sup>1</sup> Only Permanently limited-equity or group-equity co-ops would be eligible for this. Any resale price or rental amount must be permanently limited to levels that are affordable to a new member with the target percentage of the AMI.

A market-rate co-op would not qualify here, as the structure of the organization is to improve the members' equity position regardless of affordability/safe harbor constraints.

**SECTION 3. SAFE HARBOR FOR RELIEVING THE POOR AND DISTRESSED**

.01 An organization will be considered charitable as described in § 501(c)(3) if it satisfies the following requirements:

(1) The organization establishes for each project that

(a) at least 75 percent of the units are occupied by residents that qualify as low-income: **and**

(b) **either**

at least 20 percent of the units are occupied by residents that *also* meet the very low-income limit for the area<sup>2</sup>

**or**

40 percent of the units are occupied by residents that *also* do not exceed 120 percent of the area's very low-income limit.<sup>3 4</sup>

Up to 25 percent of the units may be provided at market rates to persons who have incomes in excess of the low-income limit.

(2) The project is actually occupied by poor and distressed residents. For projects requiring construction or rehabilitation, a reasonable transition period is allowed for an organization to place the project in service. Whether an organization's transition period is reasonable is determined by reference to all relevant facts and circumstances. For projects that do not require substantial construction or substantial rehabilitation, a one-year transition period to satisfy the actual occupancy requirement will generally be considered to be reasonable. If a project operates under a government program that allows a longer transition period, this longer period will be used to determine reasonableness.

(3) The housing is affordable to the charitable beneficiaries. In the case of rental housing, this requirement will ordinarily be satisfied by the adoption of a rental policy that complies with government-imposed rental restrictions or otherwise provides for the limitation of the tenant's portion of the rent charged to ensure that the housing is affordable to low-income and very low-income residents. In the case of homeownership programs, this requirement will ordinarily be satisfied by the adoption of a mortgage policy that complies with government-imposed mortgage limitations or otherwise makes the initial and continuing costs of purchasing a home affordable to low and very low-income residents.

<sup>2</sup> The "very low-income limit for the area" is typically 50% of the Area Median Income. If 20% of residents are below 50% AMI, this requirement is met.

<sup>3</sup> As "very low-income" is typically 50% AMI, 120% of that income will be 60% AMI. So, as long as 40% of residents are below 60% AMI, this requirement is met. Only one of these two criteria in section (b) needs to be met to qualify.

<sup>4</sup> Critically and strategically, the permanent affordability targets should not be set to exactly the 80% and 50%/60% limits. If members can only afford the units if they are right at the limit, there will be few eligible members. Targeting ranges of 70%-80% and 50-60% is the way to price.

(4) If a project consists of multiple buildings and each building does not separately meet the requirements of sections 3.01(1), (2), and (3), then the buildings must share the same grounds. This requirement does not apply to organizations that provide individual homes or individual apartment units located at scattered sites in the community exclusively to families with incomes at or below 80 percent of the area's median income.

.02 In applying this safe harbor, the Service will follow the provisions listed below:

(1) Low-income families and very low-income families will be identified in accordance with the income limits computed and published by the Department of Housing and Urban Development ("HUD") in *Income Limits for Low and Very Low-Income Families Under the Housing Act of 1937*. The term "very low-income" is defined by the relevant housing statute as 50 percent of an area's median income. The term "low-income" is defined by the same statute as 80 percent of an area's median income. However, these income limits may be adjusted by HUD to reflect economic differences, such as high housing costs, in each area. The income limits are then tailored to reflect different family sizes. If HUD's program terminates, the Service will use income limits computed under such program as is in effect immediately before such termination. Copies of all or part of HUD's publication may be obtained by calling HUD at (800) 245-2691 (HUD charges a small fee to cover costs of reproduction).

(2) The retention of the right to evict tenants for failure to pay rent or other misconduct, or the right to foreclose on homeowners for defaulting on loans will not, in and of itself, cause the organization to fail to meet the safe harbor.

(3) An organization originally meeting the safe harbor will continue to satisfy the requirements of the safe harbor if a resident's income increases and causes the organization to fail the safe harbor, provided that the resident's income does not exceed 140 percent of the applicable income limit under the safe harbor. If the resident's income exceeds 140 percent of the qualifying income limit, the organization will not fail to meet the safe harbor if it rents the next comparable non-qualifying unit to someone under the income limits.

(4) To be considered charitable, an organization that provides assistance to the aged or physically handicapped who are not poor must satisfy the requirements set forth in Rev. Rul. 72124, 1972-1 C.B. 145, Rev. Rul. 79-18, 1979-1 C.B. 194, and Rev. Rul. 79-19, 1979-1 C.B. 195. If an organization meets the safe harbor, then it does not need to meet the requirements of these rulings even if all of its residents are elderly or handicapped residents. However, an organization may not use a combination of elderly or handicapped persons and low-income persons to establish the 75-percent occupancy requirement of the safe harbor. An organization with a mix of elderly or handicapped residents and low-income residents may still qualify for tax-exempt status under the facts and circumstances test set forth in section 4.

**SECTION 4. FACTS AND CIRCUMSTANCES TEST FOR RELIEVING THE POOR AND DISTRESSED**

.01 If the safe harbor contained in section 3 is not satisfied, an organization may demonstrate that it relieves the poor and distressed by reference to all the surrounding facts and circumstances.

.02 Facts and circumstances that demonstrate relief of the poor may include, but are not limited to, the following:

- (1) A substantially greater percentage of residents than required by the safe harbor with incomes up to 120 percent of the area's very low-income limit.
- (2) Limited degree of deviation from the safe harbor percentages.
- (3) Limitation of a resident's portion of rent or mortgage payment to ensure that the housing is affordable to low-income and very low-income residents.
- (4) Participation in a government housing program designed to provide affordable housing.
- (5) Operation through a community-based board of directors, particularly if the selection process demonstrates that community groups have input into the organization's operations.
- (6) The provision of additional social services affordable to the poor residents.
- (7) Relationship with an existing 501(c)(3) organization active in low-income housing for at least five years if the existing organization demonstrates control.
- (8) Acceptance of residents who, when considered individually, have unusual burdens such as extremely high medical costs which cause them to be in a condition similar to persons within the qualifying income limits in spite of their higher incomes.
- (9) Participation in a homeownership program designed to provide homeownership opportunities for families that cannot otherwise afford to purchase safe and decent housing.
- (10) Existence of affordability covenants or restrictions running with the property.

**SECTION 5. EXAMPLES**

.01 Application of the safe harbor and the facts and circumstances test is illustrated by the following examples:

- (1) Organization N operates pursuant to a government program to provide low and moderate income housing projects. Seventy percent of N's residents have incomes that do not exceed the area's low-income limit. Fifty percent of N's residents have incomes that are at or below the area's very

low-income limit. Under the program, N restricts rents charged to residents below the income limits to no more than 30 percent of the applicable low or very low-income limits for N's area. N is close to meeting the safe harbor. N has a substantially greater percentage of very low-income residents than required by the safe harbor; it participates in a federal housing program; and it restricts its rents pursuant to an established government program. Although N does not meet the safe harbor, the facts and circumstances demonstrate that N relieves the poor and distressed.

(2) Organization O will finance a housing project using tax-exempt bonds pursuant to § 145(d). O will meet the 20-50 test under § 142(d)(1)(A). Another 45 percent of the residents will have incomes at or below 80 percent of the area's median income. The final 35 percent of the residents will have incomes above 80 percent of the area's median income. O will restrict rents charged to residents below the income limits to no more than 30 percent of the residents' incomes. O will provide social services to project residents and to other low-income residents in the neighborhood. Also, O will purchase its project through a government program designed to retain low-income housing stock. O does not meet the safe harbor. However, the facts and circumstances demonstrate that O relieves the poor and distressed.

(3) Organization R provides affordable homeownership opportunities to purchasers determined to be low-income under a federal housing program. The homes are scattered throughout a section of R's community. Beneficiaries under the program cannot afford to purchase housing without assistance. R's program makes the initial and continuing costs of mortgages affordable to the home buyers by providing assistance with down payments and closing costs. Homeowners assisted by R will have the following composition: 40 percent will not exceed 140 percent of the very low-income limit for the area, 25 percent will not exceed the low-income limit, and 35 percent will exceed the low-income limit but will not exceed 115 percent of the area's median income. R does not satisfy the safe harbor. However, the facts and circumstances demonstrate that R relieves the poor and distressed.

(4) Organization U will purchase existing residential rental housing financed using tax-exempt bonds issued in accordance with § 145(d). U will meet the minimum requirements of the 40-60 test of § 142(d)(1)(B). It will provide the balance of its units to residents with incomes at or above area median income levels. U has a community-based board of directors. U does not satisfy the safe harbor. Moreover, the facts and circumstances do not demonstrate that U relieves the poor and distressed.

(5) Organization V provides rental housing in a section of the city where income levels are well below the other parts of the city. All of V's residents are below the very low-income limits for the area, yet they pay rents that are above 50 percent of the area's very low-income limits. V has not otherwise demonstrated that the housing is affordable to its residents. Although the residents are all considered poor and distressed under the safe harbor, V does not relieve the poverty of the residents.

(6) Organization W provides homeownership opportunities to purchasers with incomes up to 115 percent of the area's median income. W does not meet the income levels required under the safe

harbor. W's board of directors is representative of community interests, and W provides classes and counseling services for its residents. The facts and circumstances do not demonstrate that W relieves the poor and distressed.

## SECTION 6. EXEMPT PURPOSES OTHER THAN RELIEVING THE POOR AND DISTRESSED

.01 Relief of the poor and distressed, whether demonstrated by satisfaction of the safe harbor described in section 3 of this Revenue Procedure or by reference to the facts and circumstances test described in section 4, does not constitute the only exempt purpose that a housing organization may have. Such organizations may qualify for exemption without having to satisfy the standards for relief of the poor and distressed by providing housing in a way that accomplishes any of the purposes set forth in § 501(c)(3) or § 1.501(c)(3)-1(d)(2). Those purposes include, but are not limited to, the following:

(1) Combatting community deterioration is an exempt purpose, as illustrated by Rev. Rul. 68-17, 1968-1 C.B. 247, Rev. Rul. 68-655, 1968-2 C.B. 213, Rev. Rul. 70-585, 1970-2 C.B. 115 (Situation 3), and Rev. Rul. 76-147, 1976-1 C.B. 151. An organization that combats community deterioration must (1) operate in an area with actual or potential deterioration, and (2) directly prevent or relieve that deterioration. Constructing or rehabilitating housing has the potential to combat community deterioration.

(2) Lessening the burdens of government is an exempt purpose, as illustrated by Rev. Ruls. 85-1 and 85-2, 1985-1 C.B. 178. An organization lessens the burdens of government if (a) there is an objective manifestation by the governmental unit that it considers the activities of the organization to be the government's burdens, and (b) the organization actually lessens the government's burdens.

(3) Elimination of discrimination and prejudice is an exempt purpose, as illustrated by Rev. Rul. 68-655, 1968-2 C.B. 213, and Rev. Rul. 70-585, 1970-2 C.B. 115 (Situation 2). These rulings describe organizations that further charitable purposes by assisting persons in specific racial groups to acquire housing for the purpose of stabilizing neighborhoods or reducing racial imbalances.

(4) Lessening neighborhood tensions is an exempt purpose, as illustrated by Rev. Rul. 68-655, 1968-2 C.B. 213, and Rev. Rul. 70-585, 1970-2 C.B. 115 (Situation 2). It is generally identified as an additional charitable purpose by organizations that fight poverty and community deterioration associated with overcrowding in lower income areas in which ethnic or racial tensions are high.

(5) Relief of the distress of the elderly or physically handicapped is an exempt purpose, as illustrated by Rev. Rul. 72-124, 1972-1 C.B. 145, Rev. Rul. 79-18, 1979-1 C.B. 194, and Rev. Rul. 79-19, 1979-1 C.B. 195. An organization may further a charitable purpose by meeting the special needs of the elderly or physically handicapped.

**SECTION 7. OTHER CONSIDERATIONS**

If an organization furthers a charitable purpose such as relieving the poor and distressed, it nevertheless may fail to qualify for exemption because private interests of individuals with a financial stake in the project are furthered. For example, the role of a private developer or management company in the organization's activities must be carefully scrutinized to ensure the absence of inurement or impermissible private benefit resulting from real property sales, development fees, or management contracts.

**SECTION 8. EFFECT ON OTHER DOCUMENTS**

Notice 93-1 is superseded.

**SECTION 9. EFFECTIVE DATE**

This revenue procedure is effective on [date of publication].

## App. 13—IRS Revenue Procedure 1996-32

<i>Example Project</i>			
	Per unit	Entire Project	Percentage
<b>CONSTRUCTION SOURCES</b>			
Construction Loan	\$175,519	\$5,967,634	64.64%
Second Mortgage	\$47,059	\$1,600,000	17.33%
Third Mortgage	\$11,765	\$400,000	4.33%
Developer Equity	\$13,576	\$461,577	5.00%
Deferred Developer's Fee	\$23,598	\$802,321	8.69%
TOTAL SOURCES	\$271,516	\$9,231,531	100.00%
<b>PERMANENT SOURCES</b>			
Gross Sale Proceeds	\$196,596	\$6,684,260	72.41%
Bank Blanket/Underlying Mortgage	\$16,096	\$547,272	5.93%
Second Mortgage	\$47,059	\$1,600,000	17.33%
Third Mortgage	\$11,765	\$400,000	4.33%
Surplus	\$0	\$0	0.00%
TOTAL SOURCES	\$271,516	\$9,231,531	100.00%
<b>USES</b>			
Acquisition Costs	\$11,941	\$406,000	4.40%
Construction Costs	\$185,294	\$6,300,000	68.24%
Soft Costs	\$13,300	\$452,200	4.90%
Financing Fees	\$6,418	\$218,203	2.36%
Carrying Costs	\$30,965	\$1,052,807	11.40%
Developer's Fee	\$23,598	\$802,321	8.69%
TOTAL USES	\$271,516	\$9,231,531	100.00%
Please note that Total Sources should always equal Total Uses			

## App. 14—Sources and Uses Example

### Glossary of Terms

#### A

**Affordable Housing Trust Funds** provide developers, local units of government, housing authorities, and other service providers the funds to address the needs of low-income households. Most housing trust funds derive their revenue from the National Housing Trust Fund along with local real estate transfer taxes, document recordation fees, or developer fees. There are over 255 local housing trust funds nationwide that in 2024 provided \$1.6 billion to create affordable housing units.

**ALTA Survey** is a boundary survey prepared to a set of standards that have been prepared and adopted by the American Land Title Association and the American Congress on Surveying and Mapping. The ALTA Survey shows improvements, easements (which are defined rights to use the property in a particular way), and other elements impacting the ownership of land.

**Amortization** is the payment of an obligation in a series of equal installments. The amortization period is the length of time it would take for a loan to be paid off in equal periodic (usually monthly) payments. For any given loan amount, the longer the amortization period, the smaller the monthly payment. When the amortization period of a loan is longer than its loan term (the time within which the loan must be paid off), the loan will have a balloon payment. This is usually a single, substantial payment of the remaining principal balance due at the end of the loan term.

**Appraisal** is a professional judgment or assessment of a property's price or value.

**Area Median Income (AMI)** is a measure of the middle-income level within a geographic region. The measure divides households into two equal segments, the first half of households earning less than the median household income and the other half earning more. It is often used to determine which households in a particular area are eligible for government subsidies to help them access rental or home ownership opportunities.

**Assessment** is a review of the rehabilitation needs and costs of a building. The physical needs assessment is done in order to determine how much money each resident must contribute toward the renovations.

**Aztech Agreement** is an industry standard type of recognition agreement, between a share lender and the cooperative. Share lenders require a recognition agreement as a condition of each share loan. The recognition agreement establishes the rights and obligations of the share lender, the

cooperative corporation, and the share owner. It “recognizes” that the cooperative and the share lender have potentially competing interests in the event of a default by a share owner because the defaulting share owner’s collateral is an ownership interest in the cooperative. A best practice for cooperatives is to negotiate with share lenders for a recognition agreement as close to the Aztech Agreement standard as possible.

## B

**Balloon Payment** is a single substantial payment of the remaining principal balance of the loan due at the end of the loan term. (See Amortization)

**Blanket Loan (Blanket Debt/Mortgage)** is usually the loan that finances the co-op corporation’s ownership of its land and building(s). This can be used to pay for initial acquisition of the real estate, to refinance existing blanket debt or to pay for major improvement and rehabilitation projects. Cooperative members are not individually liable to the blanket lender nor do they need to individually qualify for the blanket loan. The cooperative’s occupancy agreement obligates members to pay their proportionate share of the monthly blanket loan payment to the cooperative.

**Brownfield Sites** are locations where environmental cleanup is necessary to make the site safe for reuse.

## C

**Capital Impact Partners** is a leading nonprofit Community Development Financial Institution (CDFI). CIP provides a variety of services to support communities including: Community development real estate and working capital lending to community facilities delivering key social services, training and mentorship programs that break down barriers to professional growth, and impact investments for growth-stage businesses creating social impact. Capital Impact has disbursed more than \$3.0 billion since 1982. The organization’s leadership in delivering financial and social impact has resulted in Capital Impact being rated by S&P Global and Fitch Ratings, and recognized by Aeris.

**Carrying Charges, Common Charges, or Occupancy Charges** are monthly payments made by members to the cooperative corporation for common expenses such as operating costs, blanket debt service, insurance, property taxes, and capital reserves. Carrying charges include the same sorts of expenses covered by condominium association fees plus the expenses individual condominium members pay directly, rather than through their association. In this manual, the term Occupancy Charges is used.

**Certificate of Occupancy** is a document issued by the government that gives individuals written authorization to move in to a newly completed or substantially completed building.

**Closing Costs** are expenses incurred by the purchaser or seller of a property in addition to the purchase price paid. These costs typically include fees and points paid to the buyer's lender, proration of prepaid expenses (e.g. taxes), funding of escrow accounts for property taxes and insurance, title insurance costs, transfer taxes, and recording fees. Many closing costs that usually accompany single-family home or condominium purchases are avoided when purchasing a cooperative membership.

**Closing** is the meeting at which the legal documents are signed to consummate a transaction and cause a property to change hands from buyer to seller.

**Collateral** is a form of security to the lender in case the borrower fails to pay back the loan.

**Community Development Block Grants (CDBG)** provide federal funds to local governments to enable them to craft affordable housing programs (within wide program parameters) to meet local needs. Federal HOME funds fuel first-time homebuyer programs.

**Community Development Financial Institutions (CDFIs)** are organizations that work to provide credit, capital, and financial services to underserved populations and communities in the United States. (See e.g., Rochdale Capital)

**Community Land Trusts (CLTs)** are nonprofits that hold property on behalf of a place-based community and manage that land over the long term on behalf of that community, generally to preserve long-term affordability or to prevent changes in land use.

**Cooperative Interest** describes the ownership interest a cooperative member/shareholder owns in the cooperative corporation.

## D

**Debt Service Coverage Ratio** is calculated by dividing net operating income by the total debt service (such as the loans or mortgages on the property). This ratio is used by lenders to verify that there will be enough operating income to cover annual payments due on debt, without having to liquidate the collateral.

**Due Diligence** is a process of checking carefully the accuracy of information gathered. For example, a bank's review of a loan application requires due diligence to assure they are lending to a borrower that will be able to repay the loan.

## E

**Enterprise Foundation** is a national non-profit intermediary that works with non-profit groups in a variety of locales to facilitate affordable housing development. Through its subsidiaries, Enterprise is an active syndicator of Low-income Housing tax credits (LIHTC).

**Enterprise Zone or Community** is an area where the federal government, aided by local government, attempts to stimulate economic development.

**Environmental Phase I** is a written report issued by an engineering firm describing certain environmental conditions of the property being inspected—such as lead paint, asbestos, underground storage tank leakage, etc.—that might influence construction costs. Lenders require this report to help evaluate whether costs might be incurred that are not yet factored into a construction budget.

**Equity** is the value of a property that is beyond the total amount owed on mortgages, liens, or other borrowed funds. It can also be used to describe the funds or property provided to pay for the new construction, purchase, or renovation of a building.

## F

**Fair Market Value** is the price a typical buyer would pay to a typical seller for a property in a transaction on the open market. The fair market value of housing will change with time, fluctuations in the desirability of a given location, the supply of and demand for similar housing, and changes in the overall economy.

**Fannie Mae and Freddie Mac** are the major secondary market conduits for non-luxury housing financing. These agencies purchase residential loans originated by banks, package them with other loans, and sell the loan packages to groups of investors. This provides liquidity to the banks so that the banks can make more housing loans. The terms that Fannie and Freddie set for buying both multi-family (e.g., blanket) and single-family (e.g., share) loans greatly influence the terms that banks are willing to offer to borrowers.

**Federal Home Loan Banks (FHLBanks)** are 12 regional wholesale banks operating as a system that are each owned by their lender member banks. The system works to enhance the financial strength of member-banks by providing them with liquidity to meet the needs of the member-banks' borrowers. Every year since 1989, the 12 FHLBanks have each used 10 percent of their net income to fund their own Community Investment (CIP) and Affordable Housing Programs (AHP). Each FHLBank shapes its own CIP and AHP priorities within certain guidelines and the overall program goal of making housing affordable for low- and moderate-income families.

**Federal Housing Administration (FHA)** is a federal government entity within the U.S. Department of Housing and Urban Development that administers a variety of multi-family mortgage insurance programs that can be accessed by qualified multi-family lenders. FHA-insured mortgages are backed by the U.S. Government. Federal mortgage insurance enables lenders to make long-term, fixed-rate, high loan-to-value loans to borrowers, including housing cooperatives. Borrowers pay a mortgage premium to their lender, which is then passed through to FHA, which uses the premium to cover losses from FHA's pools of insured loans.

**Federal Housing Administration (FHA) 213 Program** insures mortgage loans to facilitate the construction, substantial rehabilitation, and/or purchase of cooperative housing projects. Cooperative Housing (Section 213) insures lenders against loss on mortgage defaults, enabling non-profit cooperative housing corporations or trusts to develop or sponsor the development of housing projects to be operated as cooperatives.

**Fiscal Year** is the financial year, usually 12 months, which marks the time when accounts are settled. It typically matches the calendar year, but can sometimes begin and end on a different month. For example, the federal government's fiscal year ends on September 30.

**Foreclosure** is a legal procedure that may occur when a borrower defaults, or stops making payments on their loan to the lender. During foreclosure the lender usually gets their claim against a property satisfied, often by getting the proceeds from the sale of the property.

**Forgivable Loans** have no repayment obligation if program requirements are met for a specified period of time. In other words, the loan may be "forgiven" or absolved instead of being fully repaid to the lender.

## G

**General Contractor** commits to construct a building or project, rather than for a portion of the work. The general contractor hires subcontractors, such as plumbing or electrical contractors, and coordinates all work. They are responsible for paying the subcontractors.

## H

**Hard Cost** is the cost of actual land acquisition, renovation, or construction of a building. In contrast, soft costs are the portion other than the cost of the improvements themselves. Examples of soft costs are professional fees such as those charged by architects and engineers.

**Home Mortgage Disclosure Act Data (HMDA)** is information collected by lenders about their lending activity for the government to make public reports on various demographic characteristics of home mortgage borrowers. HMDA data collected includes home purchase and home improvement loans, refinancing, and denied, incomplete, and withdrawn applications.

**Housing Cooperative** is a legal entity, usually a corporation that owns real estate. Each shareholder of the legal entity is granted the right to occupy one housing unit.

**Housing Finance Agencies (HFAs)** are sources of low-interest financing from tax-exempt mortgage revenue bonds for single—and multi-family housing. State and local HFAs are active in shaping a variety of programs to disburse federal funds for affordable homeownership.

**Housing and Urban Development, Department of (HUD)** is the United States Federal Government's Department primarily responsible for funding and administering housing programs. While funding does often come from other departments, such as USDA and Treasury, those departments typically follow the definitions, standards, and practices set by HUD.

## I

**Interest Rate** is a means of expressing the cost charged for borrowing money as a percentage of the amount borrowed. Interest rates are usually quoted as annual percentage rates. For example, to borrow \$100 at an annual interest rate of 8 percent would cost \$8 in interest for one year. Interest rates can be fixed or variable. Fixed interest rates will not vary over the life of the loan. Variable interest rates will change weekly, monthly, annually, or at the end of multiyear intervals, depending on the terms of a given variable interest loan. Variable rate loans may have interest rate caps, upper and lower limits on rate changes over the life of the loan.

## L

**Liability Insurance for Directors and Officers** offers the cooperative Board of Directors protection they need from personal liability and financial loss arising out of decisions or acts committed in their leadership capacity.

**Liens** are created when, in addition to promising to repay a loan, a borrower agrees that, if timely payments on the loan are not made, the lender can sell a pledged item (often whatever is bought with the loan proceeds) and credit the proceeds of the sale against the balance due on the loan. The lender is said to have a lien on (or a "security interest" in) the pledged item. A specific item can be pledged as security for more than one obligation, which can have equal or different priorities. When obligations have equal priorities, the proceeds of the sale of property are distributed to the equal lien holders. When obligations have different priorities, the proceeds of the sale are distributed in order—the first lien must be fully satisfied before any amount is distributed to pay for the second lien, and so on.

**Loan Term** is simply the length of the loan. A five-year loan term means the loan must be fully repaid by the end of five years. Low Income Housing Tax Credit (LIHTC) was created in 1986 by the federal government as its primary means of producing affordable low-income housing. Investors provide equity in exchange for credits against their federal income tax obligations. Tax credits are allocated by state Housing Finance Agencies (HFAs).

## M

**Mortgage Escrow** is a dedicated account that collects money monthly, often as part of the mortgage

payment, and is held by mortgage lenders to pay the borrower's property taxes, fire hazard insurance premiums, and mortgage insurance premiums throughout the year. The account is set up during the financing process and may be a lender requirement.

**Mutual Housing Associations** is a term used to describe a wide variety of situations. It may denote a situation in which a non-profit organization owns one or more sets of lands and buildings that are operated by their residents on a cooperative basis. It may denote a situation in which one or more fee-simple cooperatives come together to create a non-profit organization that provides professional management or other services to its member cooperatives on a mutual basis. It may denote some permutation or combination of the two situations. In the first situation, the nonprofit organization may have a governance structure composed solely of representatives of cooperative residents, composed of a mixture of cooperative residents and representatives of the communities in which the cooperatives are situated, or composed solely of community representatives. In the second situation, the governance structure of the non-profit is likely to be composed largely or exclusively of representatives of the cooperative residents. Mutual housing associations are generally created to provide strength and stability to small cooperatives or as an alternative method of assuring long-term housing affordability.

## N

**NCB** is an acronym for National Cooperative Bank, a corporation chartered by the federal government under the National Consumer Cooperative Bank Act in 1978 and privatized in 1981 as a cooperative financial services company. NCB is dedicated to strengthening communities nationwide through the delivery of banking and financial services, complimented by a special focus on cooperative expansion and economic development. NCB is owned by its member-borrowers, who elect its Board of Directors and receive the benefits of its financial services through lower-cost loans and patronage rebates.

## O

**Occupancy Agreement/Proprietary Lease** is the agreement between a cooperative and each of its members setting forth the terms whereby a member may have exclusive occupancy of a specific dwelling unit owned by the cooperative corporation until they sell their cooperative interest.

**Operating Costs** are expenses incurred by the owner (e.g., a cooperative corporation or the landlord of a rental building) to operate the property. Operating costs include the cost of management, building maintenance, grounds maintenance, common utilities, etc.

**Origination** is the term used to describe the process of creating a loan. Through this process, the terms of the mortgage agreement (such as the amount of loan, interest rate, compounding frequency, etc.) are established and the parties involved agree to the transaction.

## P

**Perfection (Perfection of a Security Interest)** is the establishment of a particular creditor's lien position, giving the creditor priority access to the collateral over other claimants in case of default. In a cooperative, a creditor with a perfected security interest may have certain priority rights to the building. This may help repay the loan if the cooperative corporation can't repay the loan according to the agreed terms. (See Lien for more information.)

**Performance Bond** is a written "promise" issued by an insurance company to guarantee satisfactory completion of a project by a contractor.

**Position (First, Second, or Third)** is used to describe the order in which creditors or lenders get paid back in the event that a borrower is not paying as expected. For example, the courts or a contractual agreement may determine that the bank (in first position) must be paid back before the cooperative is paid back (in second position), in a case where the borrower owes money to both the bank and the cooperative.

**Pre-Payment Penalty** is a charge the lender makes when a mortgage is repaid early, before a certain period of time elapses. In effect, the borrower is penalized for paying off the mortgage early.

**Principal** is the amount borrowed, exclusive of interest or any other costs of borrowing.

**Pro forma** is a detailed breakdown of financial assumptions or projections.

**Public Housing Authority (PHA)** is a local governmental body that administers either public housing or Section 8 vouchers, or both, for the federal government.

## R

**Recognition Agreement** "recognizes" that the cooperative and the share lender have potentially competing interests in the event of a default by a share owner because the defaulting share owner's collateral is an ownership interest in the cooperative. Share lenders require a recognition agreement as a condition of each share loan. The recognition agreement establishes the rights and obligations among the share lender, the cooperative corporation and the share owner.

**Remediation Plan** is created to resolve environmental issues related to site construction or rehabilitation.

**Rent Roll** is a list of lease fees, which includes the names of tenants and the amount of rent they pay.

**Reserves** are funds set aside by a cooperative or a condo association to cover unanticipated expenses. This type of reserve is usually called operating reserves. Rehabilitation/improvement or replacement reserves are collected and saved to cover future, anticipated costs of building repairs.

**Rochdale Capital** is a community development loan fund that promotes cooperative and community ownership and provides capital access in low wealth communities, working to broaden access to capital by offering flexible, affordable financing not currently available through its strategic partner NCB.

## S

**Scope of Work** is a term used to describe the job to be accomplished by a hired professional.

**Secondary Market** is made up of a variety of conduits that link lenders to investors and provide liquidity for banks to make loans. Fannie Mae and Freddie Mac are examples of such conduits. They attract investment capital into mortgage lending by annually buying billions of dollars worth of mortgages from lenders, bundling the mortgages, and re-selling the mortgages to investors. Secondary market criteria for loan purchases shape the type of loan products banks can offer their borrowers.

**Security Interest** (see **Lien**)

**Share Loan** is a loan made to a cooperative co-owner that is secured by a pledge of the co-owner's ownership interest in the cooperative (his/her "shares"). If a cooperative co-owner has obtained a share loan, only that person is individually liable to the share lender. The cooperative itself incurs no financial obligation to the share lender.

**Soft Costs** are the portion of development costs other than the cost of the improvements themselves. Examples of soft costs are professional fees such as those charged by architects and engineers. In contrast, hard costs are the cost of actual land acquisition, renovation, or construction of a building.

**Soft Debt** is debt that is not collateralized against the borrower's assets (usually the building) and instead simply relies on the creditworthiness of the borrower. If soft debts are not repaid, the borrower's assets are not likely to be at risk, but the borrower is unlikely to be able to access such funding again. The term includes debt that is forgiven over time or that is due usually if certain terms and conditions are not met by the borrower. Soft debt is frequently extended by a government to achieve a policy objective.

## T

**Title Insurance** is protection against loss arising from problems connected to the title to the property owned. The cooperative corporation usually takes out title insurance on the building whereas that share owners do not need title insurance on their shares.

## U

**United States Department of Agriculture (USDA)** includes the Rural Housing Service (RHS). RHS provides loan guarantees for multi-family mortgages in rural areas under the 515 program, among its other affordable housing programs.