CITY OF CAMBRIDGE
Community Development Department

BRIAN P. MURPHY
Assistant City Manager for Community Development

To: Richard C. Rossi, City Manager

From: Brian Murphy, Assistant City Manager for Community Development

Date: July 15, 2014

Re: Policy Order #8 dated June 2, 2014, regarding limited equity cooperative housing

A housing cooperative is a legal structure for housing ownership where multiple units are collectively owned by a corporation. The corporation is made up solely of resident households who own shares in the corporation, and enter into an occupancy agreement that grants them the right to live in their unit. The corporation arranges for management, maintenance, insurance, and common utilities, and obtains any needed mortgage financing under the terms of each corporations by-laws. Coop residents pay a monthly "carrying charge", similar to rent or a condominium fee. The carrying charge generally includes costs of all common expenses and payments on any bank mortgages on the property.

Limited equity cooperatives are coops in which resident shareholders are subject to share price appreciation limits as well as requirements that shares can only be transferred to income-qualified households. There are currently eight limited-equity cooperatives in Cambridge which include a total of 102 units. Seven of the coops received some financial or technical assistance from the City and now have some oversight by the City. These seven coops contain a total of 46 units. In most cases, City involvement is limited to a requirement that the Community Development Department approve by-law changes and approve transfers of shares to new shareholders. Coop by-laws contain limited equity provisions and restrictions on the sale of the building, while the City also holds additional affordability restrictions on some buildings.

City-assisted limited equity coops

CDD staff work with City-assisted coops when units become available. These limited equity coops see very little turnover. In the past seven years, only five units have turned over. When a unit becomes vacant, the coop selects a new shareholder according to its by-laws which specify marketing and selection requirements. CDD generally assists coops with a vacancy by sending out materials to potential applicants on the City's affordable housing mailing list and publicizing the opportunity.

344 Broadway
Cambridge, MA 02139
Voice: 617 349-4600
Fax: 617 349-4669
TTY: 617 349-4621
www.cambridgema.gov

When a new shareholder has been selected by the coop, CDD reviews the applicant's eligibility based on each coop's specific selection requirements, and signs off on the share transfer. There is a "buy-in price" for each new shareholder. This price is determined by a process outlined in each coop's by-laws. The specifics differ for each coop. Recent share transfer prices have been between $20,000 and $33,000.

Financing for Share Transfer "Buy-In"

A share loan for a coop is different than a mortgage loan on a condominium in that there is no real estate pledged as collateral to secure the repayment of the loan. While loans made to assist buyers purchasing condominium units are secured by mortgages, loans to assist shareholders buying into a cooperative typically have only the member's share as collateral.

Coops are therefore very different than condominiums for lenders. In the case of a loan default, a lender would have to look to the value of shares that are often difficult to sell quickly and may require approval from other shareholders. Therefore, banks do not offer loans similar to traditional home mortgages that are secured by coop shares. New shareholders can get a personal loan, which is unsecured and generally has a higher interest rate than a secured mortgage loan.

In some cases, the cooperative corporation may have access to a bank line of credit that allows them to provide loans for a portion of the share buy-in price. The shareholder then makes monthly payments to the coop to both repay the share loan and cover regular carrying charges. This has been the most effective mechanism to finance share purchases in recent years.

The Community Development Department has discussed share loans with lenders and some limited equity coops where shareholders have wanted to offer share loans through the coop. We will remain available to work with coops and lenders to explore how best to assist new shareholders in buying into limited equity coops.

Creation of New Limited Equity Cooperatives

Existing limited equity coops were created using different mechanisms, with most created during the 1980's as a means of allowing tenants to purchase their buildings in compliance with rent controls requirements which made condominium conversion difficult. That was the rationale for using the cooperative ownership structure as a strategy to create affordable resident-controlled housing during rent control. Since the end of rent control, City affordable housing programs have focused on creating affordable homeownership units in limited equity condominiums instead of limited equity cooperatives. There are several reasons for this.

While the monthly carrying charges for existing limited equity coop units are very low, this is mainly due to the low cost of creating these coops. Property values were much lower when these coops were created, and in some cases were created without the need for subsidy funding. Carrying charges include the payment on shared mortgages, which are also now very low for many coops as they approach 30 years of age.

Developing new limited equity coops today would require a combination of subsidy funding and mortgage debt held by the coop. Overall development costs would be similar to current costs for the creation of other new affordable ownership and rental housing. In ownership projects, the proceeds from the sale of the units are used to cover a significant portion of the costs to create the affordable units. In a new coop with a modest buy-in price, sales proceeds would need to be replaced by a significant mortgage held by the corporation, which would be then be repaid over time through monthly carrying charge payments.

A mortgage carried by a multi-family coop building is more costly than a mortgage loan a first-time condominium buyer would receive. A cooperative corporation might receive a commercial loan with a 20- or 25-year term at approximately 5.5% today. Income-eligible first time homebuyers have access to many special loan products, most notably the state's OneMortgage program, which provides a below-market interest rate, currently approximately 3.75%. Further, while the share transfer buy-in can be prohibitive for new shareholders, the buyers of limited equity condominium units are generally required to put down a minimum of 3% of the purchase price, which is less than $10,000.

To assist the comparison between developing new limited equity coops vs. new limited equity condominiums, we compared the estimated costs of owning a new limited equity coop versus a new limited equity condominium using costs from a recently completed affordable condominium development. This comparison assumes both the coop and condominium are newly constructed buildings containing ten units with identical development costs. It also assumes that both buildings receive identical amounts of public subsidy. In this model, the condominiums sell for $180,000 and each coop shareholder makes a $10,000 "buy-in" contribution:

	Condominium	Cooperative
Total Development Cost	$4,500,000	$4,500,000
Public Subsidy Sources	$2,500,000	$2,500,000

Unit Sales Proceeds	$2,000,000	$0
Coop "Buy In" Proceeds	$0	$ 100,000
Permanent Mortgage	$0	$1,900,000

As you can see, the coop is carrying a $1,900,000 mortgage that will require monthly payments. In the condominium, each unit owner will be also have a mortgage. This comparison assumes that each condominium owner makes the minimum down payment of 3%. With these assumptions, the monthly costs can be compared:

	Condominium	Cooperative
Monthly Mortgage	$898.00	$0
Monthly Coop Mortgage	$0	$1,167.00
Condo Fee/Carrying Charge (excluding mortgage)/ Taxes	$312.00	$ 400.00
Total Monthly Cost	$1,210.00	$1,567.00

With these monthly costs, an income of approximately $48,400, or 57% AMI for a family of three, is needed to afford the condominium. An income of approximately $62,700, or 74% AMI is needed to afford the coop unit. When developing new housing, coops would require more subsidy to create the same affordability as condominiums. It is also not clear if a new cooperative development would be able to obtain subsidy funds; we have not seen new limited equity cooperative developments funded with subsidy funds in many years.

Limited equity resident-controlled housing

The Community Development Department works with residents in limited equity coops and in affordable homeownership units. We assist coop shareholders with calculating share values, marketing units, shareholder selection, assessing and undertaking rehab, and referral to other available programs and assistance. We will continue to support these units to ensure their successful operation and long-term affordability.

The creation of limited equity coops was an important strategy to create affordable resident-controlled housing under rent control, and the existing limited equity coop units are an important component of the City's affordable housing stock. These coops were created in an environment where rent-controlled multi-family buildings were sold at prices well below the current market for similar buildings. Because these buildings were removed from the private market before the significant market increases in the 1990s and 2000s, they remain a uniquely affordable option in the city.

As market prices have escalated and costs to create new affordable communities have increased significantly, the financial burden for shareholders in any new coops would also have to increase, decreasing the affordability of the units. The limited equity cooperative model is not the best strategy to create new resident-controlled affordable housing in today's environment. New coop units, if feasible to finance and create, would be significantly more costly for shareholders than older, existing units.

We appreciate the City Council's interest in limited equity coops and desire to expand the stock of limited equity affordable housing. We will continue to work with existing cooperatives and residents, and will pay particular attention to financing issues encountered by new shareholders. CDD will also continue to explore opportunities for new affordable housing, however given the advantages of the limited equity condominium model, we recommend we continue to use this strategy for expanding the stock of resident-owned affordable housing.