Limited-Equity Cooperatives:
A Primer on Sustainable Affordability and Wealth Building

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Preface

This report is part of the CLiME's continued interest in exploring and detailing remedial approaches to an affordability crisis that severely impacts both renters and homeowners across U.S. communities. At bottom, low- and moderate-income people face disproportionate housing instability, displacement and a lack of wealth. All three conditions are reflected in statistics such as the racial wealth gap. Remedies for this gap often sound in homeownership. This is understandable since a majority of household wealth in the U.S. is contained in homeowner equity. Yet gains from homeownership are also racially disparate, as is access to financing—especially now in an era of historically high prices, tight markets and high interest rates. Over all, it is harder for people of color to accumulate wealth and housing stability through traditional fee simple homeownership. Are there other means to achieve these two important goals?

That is the question that motivated this research. Shared-equity cooperatives offer the possibility of collective homeownership under a governing structure more like a corporation than a castle—voting shares vs. total control. Owners still retain marketable equity. But they technically own shares in the corporation, which often has an underlying mortgage on the cooperative (usually a building or collection of properties). Tenant-shareholders vote their shares at meetings to manage operations.

Cooperatives are popular across the country—about 75% of New York City apartments are co-ops, not condos. What's distinct about shared-equity cooperatives (sometimes referred to as limited-equity cooperatives) is their affordability restrictions. First, they are subsidized with public funds. This makes possible to sell units at below-market prices to people within a certain income range each time they're sold. While tenant-shareholders typically receive capital gains on their investment, they give up market-rates of return in exchange for the initial ability to get into the property at a rate subsidized to meet their means. This is the sharing of equity. It also, as the report shows, provides an intergenerational asset that can stabilize a household's housing options for the foreseeable future.

For the many interested policymakers, activists, developers, students and prospective tenant-shareholders, we hope this report is a resource that answers most, if not all, of your questions.

--David D. Troutt, CLiME Director

Section 1: What is Cooperative Housing?

1.1 Overview of Cooperative Housing

Cooperative housing is a form of tenure where multifamily housing is collectively owned and operated by its residents. The cooperative corporation holds title to the property and is directly responsible for financing and operating the building. Members purchase a share in the corporation in return for the right to occupy their unit and the responsibility to participate in cooperative governance. Members pay a monthly "carrying charge" to cover prorated costs assumed by the cooperative corporation, including mortgage payments, property taxes, operating expenses, and fees allocated to reserve funds for building and social capital investments (Davis, 2006).

1.2 Shared Equity Cooperatives: An Affordable Housing Opportunity

Cooperative housing is not in and of itself a form of affordable housing. A large segment of the cooperative housing stock in the United States operates as market-rate real estate. In contrast to market-rate coops, shared equity cooperatives (hereafter abbreviated "SEC") institute limits on share prices and monthly carrying charges to provide affordable housing for low- and moderate-income households (NeighborWorks America, 2021, p. 4). SECs are a distinct form of affordable housing because resale restrictions retain public subsidies in the units rather than allow households to exit with equity generated by their subsidized share.

In practice, SECs have varying degrees of permanence depending on how resale restrictions are embedded in the cooperative's governing structure or tied to the terms of development financing (see Section 3.2). Indeed, numerous policy initiatives have produced SECs that eventually converted to market-rate cooperatives due to expiring affordability provisions and insufficient public oversight. For the purposes of this research project, CLiME recognizes affordability in perpetuity as the desired policy goal of developing SECs for urban communities in New Jersey.

1.3 Where are Shared Equity Cooperatives Located?

The geographic distribution of the SEC stock reflects the legacies of joint local and federal initiatives to advance SEC housing development. According to research from Urban Homesteading Assistance Board (UHAB), the number of SEC units across the nation underwent a 56 percent decline from 1990 to 2015 (UHAB, 2015; UHAB, 2016). The reduction of the stock can largely be attributed to the conversion of SECs to market-rate cooperatives upon the expiration of affordability provisions linked to financing terms (ibid).

The State of New York and New York City host the largest concentration of SEC housing in the United States. Cooperatives developed under the Mitchell-Lama program represent the largest pool of cooperatives in New York. In 2022, the New York State Division of Housing and Community Renewal reported 90 Mitchell-Lama cooperative projects composed of about 63,000 units in New York City and

across New York State (New York State Division of Housing and Community Renewal, 2022). In addition, there are approximately 1,100 Housing Development Fund Corporations (HDFC) representing approximately 29,000 units in New York City (NYC Housing Preservation & Development, n.d.; UHAB, 2015).

Beyond New York, the District of Columbia has the second largest concentration of shared equity cooperatives. Washington DC's 4,300 SEC units across 96 buildings stem from tenant conversions under the District's right of first refusal legislation since the 1980s (District of Columbia, 2023). Apart from five SECs developed on District-owned land, all SECs in Washington were converted through the Tenant Opportunity to Purchase Act (TOPA) and the First Right Purchase Program (Howell et al, 2020, p. 47). About two-thirds of SEC units created since the enactment of TOPA in 1980 retained a shared equity ownership structure as of 2016 (Gallaher, 2016, p. 28).

Official documentation on the total number of SECs in other jurisdictions is more limited. UHAB's 2015 report estimates that there are approximately 7,000 units in Massachusetts and 6,000 units in Connecticut that stem from initiatives driven by each state's respective housing finance agency. Another 10,000 SEC units are located throughout California. These cooperatives consist of tenant conversions, HUD-financed development, and senior living cooperatives (UHAB, 2015). Additionally, UHAB reports about 10,000 units in resident-owned communities (ROCs) located across more than 20 states (UHAB, 2015; ROC USA, n.d.). ROCs are mobile and manufactured homes converted to shared equity cooperatives. ROCs represent the fastest growing segment of the SEC stock (UHAB, 2015).

Table 1: Summary of Shared-Equity Coops by Geography & Program

Geography	Program(s)	Projects	Units
New York State	Mitchell Lama (Coops)	12	8,788
New York City	Mitchell Lama (Coops)	78	54,297
	HDFC	1,100	29,000
DC	Tenant Opportunity to Purchase and First Right Purchase Program	96	4,300
Massachusetts	State Finance Agency	-	7,000
Connecticut	State Finance Agency	-	6,000
California	Various programs: HUD-financed development, tenant conversions, senior living cooperatives	-	10,000

Section 2: Why Consider Shared-Equity Cooperatives as an Alternative to Fee Simple Housing?

This section provides an overview of the case for shared equity cooperative housing as an alternative to fee simple affordable housing.

2.1 Racially disparate outcomes of fee simple homeownership should recast our understanding about the relationship between housing and wealth-building.

Scholarship on the racially disparate outcomes of homeownership undermines the national myth that fee simple homeownership is a wealth-building vehicle for all. Public and private action – and inaction – have generated racially segregated urban housing markets whereby homes in predominantly Black neighborhoods do not experience nearly the same gains of home appreciation as predominately white neighborhoods. Low-income, minority households who have owned their homes for ten years or more experienced appreciation at a rate lower than the "riskless" return on U.S. Treasury bills, effectively amounting to depreciation (Reid, 2005, p. 28).[1] Another study examined how neighborhood segregation shapes housing appreciation, finding that the average Black homeowner's home is valued 39 percent lower than a comparable white household's home in a predominately white neighborhood (Flippen, 2004)

Another thread of research demonstrates how homeownership is more likely to become a form of financial harm for low- and moderate-income communities of color. Decade after decade, state and private institutions have advanced policies and organized market action in ways that target Black homeowners for wealth extraction from blockbusting in the mid-twentieth century to predatory lending and institutional investment in the leadup and aftermath of the 2008 financial crisis. Multiple studies of contemporary minority homeownership have demonstrated that minority households are more likely than white households to exit homeownership only five years after purchasing a home (Haurin and Rosenthal, 2005; Reid, 2005; Herbert and Belskey, 2008). Haurin and Rosenthal (2005) found that Black households exited homeownership at a rate 240 percent greater than white households. Hispanic households terminated homeownership at a rate 168 percent greater than white households (p. 49). Scholars conclude that Black and other minority households who do not hold their asset for a short period of time not only forgo the gains of housing appreciation (Carlsson, 2019), but also may become worse off and experience greater financial insecurity.

In contrast, shared equity cooperative housing can protect households against the potential risks of ownership by making housing a shared asset (Carlsson, 2019, p. 4). For example, if one household in a 30-unit building falls behind on their carrying charge for a few months, the cooperative will be able to stay afloat and make monthly payments to the blanket mortgage because 29 other households are making payments and, with sound financial planning, a reserve fund is available in emergencies (Papoutsis, 2019). Program stewards and shareholders have shared

responsibility to preserve housing as a source of shelter rather than optimize a financial asset. Households partaking in shared equity cooperative housing are not banking on the market value of their asset, but rather, reap benefits from stable and reliably priced housing as the market inevitably ebbs and flows.

Additionally, shared equity cooperatives can create avenues for modest wealth building. Limited equity does not mean there is no financial gain to purchasing a share in a shared equity cooperative. Numerous studies of shared equity programs[2] found that upon resale, households recovered their down payment and made additional gains in equity ranging from 7 percent to 60 percent depending on the terms of the program (Acolin et al, 2021; Davis, 2017). Additionally, SEC households can use their shares as an asset for collateral to secure financing for business, educational, or other opportunities. Unlike rental housing, when a household owns shares in a cooperative, they can transfer their shares to a family member to pass down an asset and stable housing to the next generation. Although SEC housing does not come with the high rewards (and risks) of fee simple ownership, it does create more attractive financial benefits than renting.

Later, in section four we discuss some of the reasons why SECs can be more cost effective than fee simple homeownership.

Section 3: How Are Shared-Equity Cooperatives Developed and Sustained?

This section offers more detailed information on creating and sustaining limited-equity cooperatives. We review academic research and grey literature from practitioners to describe:

1. Formation of the corporate shell
2. Required legal documentation
3. The technical assistance network
4. Resale
5. Lender restrictions
6. Land acquisition
7. Governing and managing
8. Property taxes

3.1 Formation of the Corporate Shell

The formation of a cooperative generally follows one of several paths depending on the staging of the cooperative's legal formation and the acquisition of the property (Centennial Mortgage, 2022):

- "**Pre-Sale Management Approach**": A preliminary cooperative corporation is formed prior to development and pre-sells shares to members. The "preliminary" cooperative functions as management and will need to establish a provisional governance system and leadership. Once shares are sold, control is turned over to the membership and development ensues.
- "**Investor-Sponsor Approach**": A sponsor (developer) develops the property and sells membership shares to households. After a sufficient number of shares are sold, the cooperative corporation is established and the property is sold to the cooperative. The cooperative uses a blanket mortgage to purchase the property.
- "**Conversion Approach**": A cooperative is formed to acquire an existing rental building and convert it to a cooperative. Similar to the pre-sale approach, shares are sold to the cooperative prior to the completion of development.

Centennial Mortgage, one of two brokers for FHA federally-insured cooperative blanket mortgages, argues that the "pre-sale management approach" is the most financially advantageous route of establishing a cooperative from a financial standpoint. A pre-sold cooperative demonstrates lower risk to lenders and can help the cooperative secure a loan with more flexible terms (Centennial Mortgage, 2022). The success of this approach is also contingent upon establishing an effective governance system and leadership structure prior to selling shares and establishing a membership.

3.1.2 Legal Documents

Several legal documents are central to structuring a limited-equity cooperative as an organizational entity.

1. **Articles of Incorporation**
   The Articles of Corporation establish the LEC as an entity subject to state law. The Articles should establish the cooperative as a "subchapter T entity" under the Internal Revenue Code to minimize the cost to members through a single level of taxation. The Articles of Incorporation should also adhere to Section 216 of the Internal Revenue Code to allow members to list mortgage interest and real estate taxes as tax deductions (Northcounty Cooperative Development Fund, 2003).
2. **Cooperative Bylaws**
   Bylaws establish a cooperative corporation's governance structure and define core operational procedures. The bylaws define rules for meetings (when, how often, terms for special meetings) and voting (e.g., number of votes based household size or shares, defining a quorum, etc.). Additionally, the bylaws establish a governing framework for the board of directors, including qualifications, the election process, and a schedule of regular meetings. Key operational procedures established in the bylaws are the fiscal management of the cooperative. UHAB provides a sample bylaws for HDFCs as a template. (See: https://www.uhab.org/resource/sample-by-laws/).
3. **Occupancy Agreement or Proprietary Lease**
   The proprietary lease is an agreement between shareholders (households) and the cooperative corporation that establishes rights and responsibilities between both parties. The term of the lease is typically 99 years to establish long-term occupancy. The proprietary lease establishes the right of the shareholder to sell their share in accordance with resale restriction procedures and the approval of the board of directors. The lease will also specify the shareholder's right to sublet, use their shares as collateral, and make capital improvements on their unit. (UHAB, 2023). See a sample proprietary lease from UHAB here: https://www.uhab.org/resource/sample-proprietary-lease/

3.1.3 The Central Role of the Technical Assistance Network

Establishing a cooperative requires a coordinated and well-resourced technical assistance infrastructure. Tenants rely on technical assistance organizations for legal, financial, and organizational support because they are understandably not experts in these areas of real estate. Developing a SEC in a way that puts the cooperative on the path of self-sustainability is very labor-intensive and is substantially aided by professional expertise (Howell et al, 2023). National Cooperative Bank (NCB)'s "Cooperative Playbook" describes the technical assistance providers that make up a development team (NCB, 2006). Members of the team include:

1. **The sponsor** is the entity that spearheads the creation of the cooperative. A sponsor may be a non-profit, Community Land Trust, faith organization, or sometimes a tenant's association. The sponsor is the chief decision-maker and has the greatest financial or reputational investment in getting the cooperative off the ground (NCB, 2006). Having a sponsor with a credible track-record is key to unlocking financial resources and buy-in from other professional technical assistance organizations, particularly for CLTs and other entities that may have a less familiar organizational form. A representative from Self-Help Credit Union commented that the financial institution was confident in making a $9 million senior debt loan to San Francisco CLT because the organization had numerous successful smaller projects under their belt (Author's Interview).
2. The "**financial packager**" is charged with performing pro forma analysis and securing financing from multiple sources. The financial packager should be well-versed in the financial landscape of capital sources, from philanthropic and public grant programs, community development finance, federal and state loan programs, and conventional bank financing (NCB, 2006).
3. The **attorney** develops documents that establish the legal foundation of the cooperative. Additionally, they negotiate land acquisition, review loan documents, and file applications to establish the cooperative, among other tasks (NCB, 2006).
4. **Architects and engineers** analyze the building site, assess rehabilitation and environmental remediation requirements, and make recommendations on improvements for the building where relevant (NCB, 2006).
5. "**Trainers**" educate participating households about the responsibilities of being a cooperative owner as it relates to maintaining their home as an asset and participating in cooperative governance. Trainers should also provide leadership training geared toward the board of directors. While other professionals on the team should have general experience with affordable housing development, the trainers may be the only members of the development team with a specialization in working with housing cooperatives (NCB, 2006). Though initial training is important to educate participating households newly embarking on the development process, education should be seen as an ongoing form of support. UHAB

emphasized that SECs should have a budget line item for shareholder and board ongoing education (author's interview).

6. **Property managers** are often part of the development team for mid-sized to larger cooperatives. Property managers support the operation the building and are charged with services such as collecting rent and managing repairs that are not capital improvements. Unlike a rental apartment building, property managers are working for the cooperative. They do not make decisions about how to operate the building, but rather execute on plans developed by board leadership (NCB, 2006).

While each professional plays a crucial role in the development process for a SEC, coordination and collaboration among the development team can make or break a project. The director of a CDC in Washington, DC that supported the Tenant Opportunity to Purchase Act (TOPA) conversion of 500 units to shared equity coops emphasized that coordination among technical assistance organizations and local government was critical to success: "TOPA will be most successful in communities that already have engaged and built networks of residents with a variety of community groups active in housing policy, community organizing, and affordable housing development" (Meima, 2020, n.p). A local CDC in the District of Columbia hosts a working group of technical assistance organization to facilitate collaboration (ibid). Places such as Washington, DC and New York City are unique in having a network of consultants, attorneys, and community-based organizations that are familiar with the goals and needs of SECs (Howell et al, 2020). Sustained initiatives for SEC development will need to take stock of local professional resources and determine how to facilitate inter-organizational coordination before embarking on the development process.

3.2 Mechanisms for Structuring Limited-Equity Affordability

SECs have devised various mechanisms to establish restrictions or conditions to structure affordability.

3.2.1 Resale Formulas

Shared-equity cooperatives establish a resale formula in the bylaws to maintain the affordability of the cooperative. The resale formula restricts the amount of equity a member can take after selling their shares or ownership interest in the coop. Below are variations on the resale formula from NeighborWorks America (2021, p. 15-16). Share prices stem from the resale formula.

- Under a "**zero equity**" or "**no equity**" resale formula, a member receives the original share price without appreciation.
- A "**constant dollar**" resale formula will return a member's original share price adjusted by the price of inflation.

- The "**limited percentage**" resale formula establishes a maximum resale price that increases each year. The annual increase is often tied to paying down the cooperative's blanket mortgage.
- A "**shared equity**" resale formula equally splits the profit from the sale between the member and the cooperative cooperation.
- Resale formulas based on "**credit for amortization without appreciation**" return the member's original share price plus a portion of the mortgage principal that the member contributed to paying down through monthly carrying charges.
- There are also variations of "**hybrid**" resale formulas. As one example, a member's share appreciates by 1 percent per year plus contributions to mortgage principal payments for the first five years. Beginning in the sixth year, the member can sell their share at market value.

While zero equity and constant dollar resale formulas restrict resale prices to protect the future affordability of the cooperative, other variations enable members to potentially create moderate wealth-building opportunities depending on the market circumstances.

3.2.2 Lender Restrictions

Lender covenants condition limited equity status through financing terms (NeighborWorks America, 2021). For programs where lender covenants are the key mechanism that structures shared-equity ownership, affordability provisions of SEC housing produced under lender covenants are subject to expire. Shared equity status may only hold as a requirement during the duration of a loan. Other programs permit the conversion of SECs to market-rate cooperatives after a sunset period. HUD-financed cooperatives are examples of SECs structured through lender covenants.

Although the New York State legislation in 1955 that established the Mitchell-Lama program did not create pathways to privatize the cooperatives, in 1957 amendments to the legislation that sought to incentivize development created provisions for buy-outs at the expiration of 35- or 20-year subsidized mortgages (Mitchell-Lama Residents Coalition, n.d.). The New York City Office of the Comptroller reported that at least 59 developments including 27,133 cooperative units and 13,168 rental units had a scheduled mortgage pay-off year between 2005 and 2015 (Thompson, 2004, p. 14). Technical assistance organizations committed to preserving the affordability of shared-equity coops conclude that lender covenants alone are insufficient:

> "HUD co-ops and New York State Mitchell-Lama co-ops have shown us that equity restrictions which are tied to loan documents do not succeed in securing the cooperatives as affordable in perpetuity. Strong limited-equity and other affordability provisions need to be built into the underlying documents of co-op corporations." (UHAB, 2015, p. 5)

3.3 Land Acquisition & Locational Implications

This section outlines several avenues for below-market land acquisition. Depending on the place and time, a certain mode of land acquisition may be most viable based on the dynamics of the property market. Therefore, there are varying degrees of applicability to Newark.

1. ***Development on city-owned land***

   The disposition of city-owned property at a nominal fee has great relevancy to Newark, particularly Newark's West and South Wards that have the highest concentrations of available city-owned property. The development of Housing Development Finance Corporations (HDFCs) in New York City is an example of a municipality conveying property it had previously acquired through tax foreclosure. Numerous other legacy cities have established programs to convey city-owned property for market-rate and affordable housing development, though few outside of New York City have intentionally targeted the creation of shared-equity cooperatives through development on city-owned land.

   Sponsors looking to city-owned property as the avenue for land acquisition must navigate the challenges of developing housing in distressed areas subject to public and private disinvestment. SEC development can promote stability in disinvested neighborhoods if affordable housing development is part of a comprehensive community development approach to create healthy, livable places. Ramillier et al (2022) found that households entering shared equity programs[3] tend to relocate to "lower opportunity neighborhoods" with higher poverty rates, poorer quality schools, and lower access to transportation. The authors maintain that tenure stability and modest wealth-building afforded by shared equity made shared-equity housing programs a net benefit in the long-run.

2. ***Tenant conversion via right of first refusal legislation***

   The right of first refusal creates opportunities for sponsors to develop shared-equity cooperatives through the conversion of an existing rental building. Localities such as Washington, DC and San Francisco have adopted right of first refusal legislation. Additional cities including Oakland and Berkely in California and Somerville, Massachusetts are in the process of drafting and debating right of first refusal legislation (Gilgoff, 2020). Other cities, such as San Francisco, have seen cooperatives alongside affordable rentals with ground leases from a Community Land Trust (San Francisco CLT, 2023).

   When localities establish the right of first refusal, they effectively create an intervention in the real estate market. That intervention can be structured in a number of ways, some of which are more or less financially and logistically conducive to the conversion of rental buildings to affordable housing or shared-equity cooperatives. Local Housing Solutions (2023) summarizes different ways that localities have structured the right of first refusal:

- Certain multifamily buildings are required to give advance notice to local government. The locality has the non-exclusive right to identify a buyer for a certain time period after notification;
- Certain eligible purchasers can match another offer made to purchase a building;
- Eligible purchasers are granted the exclusive right to make an offer for a certain time period;
- Certain properties are prohibited from making a private sale and must sell at a "fair market value" to a designated purchaser. The property value is determined by an independent appraisal (Local Housing Solutions, 2023).

Washington's Tenant Opportunity to Purchase Act (TOPA) is unique in the number of limited equity cooperatives that emerged from the right of first refusal process. The District Council passed TOPA in 1978 in response to condo conversion in the central business district. The purpose of the legislation is to prevent gentrification-induced displacement as reflected in the legislation's stated goals to "discourage the displacement of tenants through conversion or sale of rental property" (DC Code 42-3401.01). The District's TOPA requires landlords of rental buildings with five or more units to notify tenants of their intent to sell. The tenants must establish a tenant's organization and register with the city and submit a letter of interest within 45 days of receiving the landlord's notification. Tenants have a minimum of 120 days to negotiate a sale with the landlord and another 120 days to secure financing if an offer of sale is made (District of Columbia Office of the Tenant Advocate, 2013).

The District of Columbia provides gap financing for TOPA projects. The Department of Housing and Community Development's First Right Purchase Assistance Program provides low-interest loans for eligible low- and moderate-income applicants. Funds can be used for acquisition costs, soft costs (architecture and engineering studies), or for a down payment (District of Columbia Department of Housing and Community Development, 2018). However, the District's program has fallen short: "Over the past 20 years the District has struggled with how to deploy acquisition funding quickly enough to respond to the TOPA timeline, while also doing it affordably enough to minimize borrowing costs for tenant associations." (Howell et al, 2020, p. 9)

One shortcoming of DC's right of first refusal legislation is that permanent affordability is not a requirement of TOPA but of the capital source for financing (Meima, 2022). Cooperatives that receive public funding from the District's Trust Fund will have a 40-year resale restriction. Affordability requirements also stem from other capital sources leveraged to finance an affordable conversion project, such as place-based Section 8 contracts, Housing Choice Vouchers, and CDBG funds (Howell et al, 2020). This raises the question as to why the

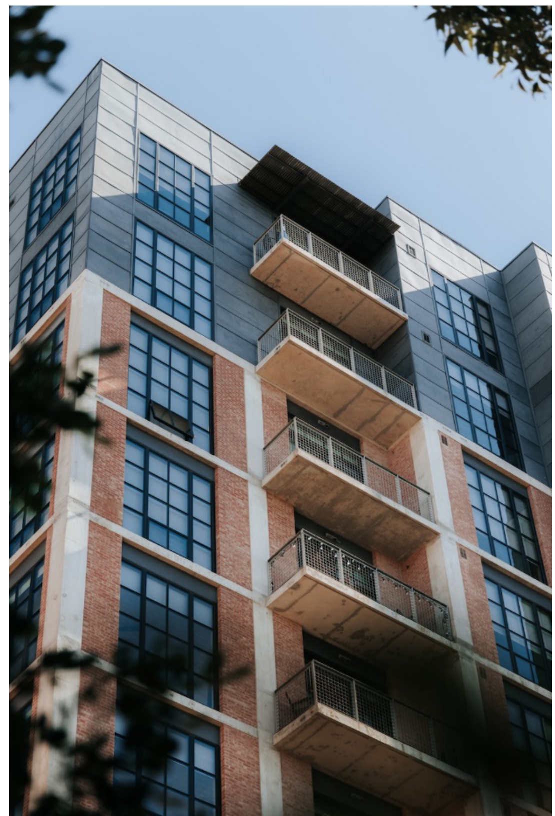
District has not seen high rates of market-rate conversions for SECs with expiring lender covenants.

With the exception of five buildings acquired from the District of Columbia, all limited equity cooperatives in Washington, DC were developed out of the TOPA process (Howell et al, 2020). In Washington, DC, researchers found that limited-equity cooperatives were concentrated in neighborhoods undergoing gentrification. In 2020, 45 percent of buildings were located in census tracts that had a greater median household income than the District-level. Another 18 percent of buildings were in tracts just below the District median (Howell et al, 2020, p. 16; District of Columbia, 2019).

Right of first refusal legislation can play a powerful role in both "hot" and "soft" housing markets. For the latter, the right of first refusal can stabilize neighborhoods undergoing high rates of development and prevent gentrification or development-induced displacement. In the case of the former, right of first refusal legislation can stabilize neighborhoods facing a downturn in the housing market by enabling sponsors to acquire property before predatory actors (Local Housing Solutions, 2023). Both cases presume the presence of a proactive sponsor ready and equipped to intervene in the local housing market.

3. *Inclusionary Zoning*

Though we did not identify localities that use inclusionary zoning as a mechanism to create shared equity cooperatives, the District of Columbia Task Force (2019) recommended using their inclusionary zoning ordinance as an avenue to generate new limited equity cooperative units (p. 15). The Task Force raised inclusionary zoning as a tool to create new SECs to overcome financing hurdles faced by buildings composed entirely of cooperative shareholder units. The Task Force claimed that some SECs have difficulty obtaining private financing and District financing can be insufficient in size to fill the gap. New development composed of a mix of limited equity cooperative and market-rate rental or condo units could support the development of new SECs (ibid).



3.4 Sustaining Shared Equity Cooperatives

This section explores what governance and operational systems are required to preserve and sustain shared equity cooperatives. The mechanisms outlined here aim to prevent the dissolution of cooperatives through financial decline or through conversion to market-rate housing.

3.4.1 Cooperative Governance

There is a need for long-term financial and technical assistance to keep SECs operational. According to UHAB, in the aftermath of the pandemic 262 affordable cooperatives are considered "distressed" with high levels of debt, putting them at risk of foreclosure (UHAB, 2023). The long-term success of shared-equity cooperatives requires investments in organizational governance: "fiscal and organizational capacity from members [is required] to implement and sustain the coop structure; many [limited-equity cooperatives] risk dissolution over the long term..." (Ehlnez, 2018, p. 287). Though the initial training of shareholders is important to educate participating households newly embarking on the development process, education should be seen as an ongoing form of support. UHAB emphasized that SECs should have a budget line item for shareholder and board ongoing education (author's interview). It is crucial that there are technical assistance organizations in Newark that are equipped to provide ongoing education and training to cooperatives.

The National Association of Housing Cooperatives, a non-profit association, offers multiple forms of trainings for SECs. A one-day training for ten participants teaches board members about financial planning, board member duties, and cooperative legal documents (Howell et al, 2020; National Association of Housing Cooperatives, 2023). UHAB hosts a Co-Op Improvement Program targeted at HDFCs that are in financial distress (defined by NYCHPD as $3,000 of debt per unit). UHAB works closely with HDFCs to address code violations, refinance or apply for a loan for critical repairs, and navigate the process of applying for property tax exemption and other local government relief options (UHAB, 2023).

Research suggests that the scale of a shared equity development also facilitates effective governance. Larger buildings can draw from a larger pool of households to participate in cooperative governance and rotate board leadership responsibilities (NeighborWorks America, 2021; National Cooperative Bank, 2006). Additionally, National Cooperative Bank suggests that proximity among households in multifamily buildings can help households cultivate relationships and advance cooperative governance (2006, p. 3).

3.4.2 Property Management

Medium and large cooperatives with 30 or more units tend to rely on property management companies (Northcounty Cooperative Development Fund, 2003). "Managing property management" is a task for cooperative members in and of itself, particularly for SECs that require property managers to comply with their bylaws and operational procedures unique to cooperatives (Howell et al, 2020). According to UHAB, SECs should hold property managers responsible for time-consuming

administrative work that does not involve control of the building. Other duties should be shared between cooperative members and the property manager, i.e., final decisions on maintaining a wait list, making contracts with external parties, taking any legal action, set guidelines for making repairs (UHAB, 2023).

National Association of Housing Cooperatives provides a two-day certification for property management companies. (Howell et al, National Association of Housing Cooperatives). The City of New York has contracted with the technical assistance provider Neighborhood Housing Services of NYC to provide free advisory services to SECs. Services include financial reporting, elections and governance, and compliance (Howell et al, 2020).

3.4.3 Property Tax Policy Frameworks for Shared-Equity Cooperatives

Several local jurisdictions have created property tax classifications that allow shared equity housing to pay reduced property taxes. (Local Housing Solutions, n.d.) Rather than base assessment on market value, assessment value is based on "estimated value of the interests of the association, a pre-determined share of the estimated market value (e.g., 70 percent), or another below-market value. This method more accurately reflects the actual use of the property, and the savings enable the LEC to keep member fees low" (Local Housing Solutions, n.d.).

Other localities, such as New York City, offer a property tax abatement for shared-equity cooperatives. The City's 420-a tax incentive is a 100 percent exemption from city real estate tax for HDFCs with low-income residents (NYCHPD, 2023).

Section 4: What is more cost-effective? Shared equity cooperatives or fee simple housing?

This final section examines the financial advantages of cooperatives as a form of affordable housing in comparison to fee simple housing. For the purpose of comparison, the hypothetical cases put to the test are a multifamily building structured as a shared equity cooperative or an affordable condominium. We assume that the affordable condominium does not have deed restrictions on resale price because this would create a comparison between two different modes of shared-equity housing. There are a few permutations to this comparison to consider when evaluating the cost-effectiveness of either form of tenure. First is the size of the building (30 units, 50 units, or more) to consider the advantages of economies of scale for each form of tenure. The second permutation considers a scenario where a Community Land Trust owns the land and establishes a ground lease with either the cooperative or condominium. For the purposes of comparison, we assume that building features and land conditions are identical.

4.1 Development Costs

Regardless of the form of tenure, a multifamily building will have a very similar set of pre-development and development expenditures. Development costs can be understood in terms of three categories: land acquisition, soft costs, and hard costs (Linneman, 2016). Land costs may range from a nominal fee or represent fair market value depending on the avenue for acquisition (*see section 3.3 for common forms of land acquisition for cooperatives*). Since we are making a one-to-one comparison between the SEC and condo, **there are no differences in land acquisition costs.**

Soft costs typically emerge in the pre-development planning phase and involve expenditures for a range of professional services: architecture and engineering, legal, environmental site analysis, accounting, insurance, and permits, among other costs. There may be a difference in soft costs between cooperatives and condominiums. As discussed in section 3.1 on the formation of the corporate shell, cooperatives require an engaged and well-coordinated development team to work closely with the sponsor. **Soft costs for the development of SEC may be slightly higher given the need for additional legal services to establish the cooperative and specialized training to educate shareholders and the board of directors**. However, these additional soft costs likely represent a small proportion of total development expenditures.

Hard costs represent expenses for construction, including labor and materials. Development of an affordable SEC or condominium may involve new development on a greenfield site or the rehabilitation of an existing building that has been acquired or will be converted from a rental. In the case of the former, insights from interviews with UHAB and Lower East Side People's Free Credit Union indicate that rehabilitation projects are substantial because landlords seeking exit tend to have pulled investment from the building years prior to sale. **There should not be differences in hard costs when comparing cooperative and condominium multifamily building development.**

Multifamily development is typically financed by an interest-only loan or line of credit for acquisition, pre-development, and construction. After construction is complete, pre-development loans are refinanced to a permanent amortized loan (Linneman, 2016). **The development of either a SEC or condo unit would require significant public or private subsidy to make the shares or down payment affordable to a low- or moderate-income household.**

A key difference in financial viability between the two cases is the credibility of the project in the eyes of lenders. CDFIs and commercial banks are regulated financial institutions incentivized to lower their risk by lending to familiar entities with a reputable development track record. Shared-equity cooperatives are unfamiliar to most commercial lenders. Ehlenz and Taylor (2018) comment on the challenges that shared equity projects face when seeking development financing from private sources: "While there are some lenders who believe SEH [shared-equity housing] models are a credit enhancement, owing to active stewardship embedded in the program structure, the broader perception is that SEH buyers are significantly riskier than they are" (p. 13). An interview with a representative from a national CDFI credit union echoed this sentiment when contextualizing the conditions that enabled the credit union to make a $6 million senior loan to a Community Land Trust serving as the sponsor for a development project (author's interview with Self-Help Credit Union). Though CDFIs receive public and private grant support to mitigate risk in community development finance, "CDFIs all across the country have still been hesitant to work with CLTs" (Perry Abello, 2022). Whether a CLT or another organization serves as the sponsor, shared-equity cooperatives are a novel form of tenure in New Jersey. **Lenders may perceive cooperatives as higher risk than a familiar form of fee simple homeownership.**

Another key difference between the two cases that may impact the cost of development is eligibility for capital sources. There is one federal program specifically geared toward blanket mortgages for cooperatives. FHA Section 213 offers a federally insured 40-year fixed-rate loan program for new cooperatives or cooperatives formed through a conversion. Currently, Wells Fargo and Centennial Mortgage are the two main brokers participating in the program. The program interest rates are only slightly lower than market-rate interest rates from commercial banks (author's interview with UHAB). SECs are not eligible for other FHA loan programs due to a misalignment between SEC income thresholds with FHA programs and resale restriction requirements (Ehlnez and Taylor, 2018). Neither cooperatives nor condominiums are eligible for LIHTC financing because only rental projects are eligible for the program.

Otherwise, **SECs and affordable condo units are eligible for similar public funding sources at the federal and state level**. Funding sources include the following:

- Federal sources providing grant capital to subsidize development:
    - Community Development Block Grant (CDBG) program, administered by the U.S. Department of Housing and Urban Development (HUD);
    - HOME Funds, administered by HUD;

- State sources for debt capital in New Jersey:
  - New Jersey Housing and Mortgage Finance Agency (NJHMFA) tax and tax-exempt multifamily loan program (NJHMFA, 2023);
  - New Jersey Redevelopment Authority (NJRA)'s Urban Site Acquisition Fund. The $20 million fund provides financing for acquisition and pre-development costs (NJRA, 2023).
  - New Jersey Department of Community Affairs (NJDCA) administers several programs offering a second amortizing loan at a one percent interest rate with capital from the New Jersey National Housing Trust Fund. Programs include the Municipal Settlement Fund, Neighborhood Partnership Fund, and the Innovation Fund. Projects located in municipalities with court-approved fair share housing obligations are eligible for these programs (NJ Department of Community Affairs, 2023).
- Private sources
  - CDFI Loan Funds and CDFI Credit Unions have loan products for acquisition, pre-development, construction, and permanent financing.
  - Commercial banks with Reinvestment Act obligations have loan products for predevelopment, construction, and permanent financing.
  - Philanthropy offers grants to subsidize the share for cooperatives or offer down payment assistance for condominiums.

4.2 Purchasing shares versus financing a mortgage

SECs create a cost advantage for participating households because a cooperative does not require a member to qualify for a mortgage to become a member-owner. After construction, a SEC will refinance with a "blanket mortgage" held by the cooperative. Subsidy is required for the SEC to issue shares at an affordable price for participating households (NeighborWorks America, 2021). In contrast, the sponsor of an affordable building will sell the unit directly to households who will require a mortgage. Low- and moderate-income households eligible for an affordable condo unit will need to work extensively with community development lenders to qualify for a mortgage and apply for down payment assistance. Households with low or no credit will face significant hurdles in acquiring a mortgage at amenable terms. **Collective ownership over housing enables SECs to create shared ownership opportunities for low- and moderate-income households who may be unable to access mortgage financing** (NeighborWorks America, 2021).

Another key difference in financial structure is related to closing costs. **Closing costs are minimal for cooperatives because selling the share is often not considered a real estate transaction** (NeighborWorks America, 2021, p. 16). Table 2 below compares the cost of selling a share to closing costs for selling a single-family home (Northcounty, 2004). According to Northcounty, a SEC share priced at $110,000 had about $2,900 in closing costs relative to a $130,000 subsidized single-family home with about $4,700 in closing costs. Additional real estate fees for fee simple housing

include appraisal fees, title insurance, a title search, mortgage filing fees, and additional transaction fees (ibid).

Table 2

Comparison of Closing Costs: Shared Equity Cooperative vs. Fee Simple Housing Source: Northcounty, 2004		
	Shared Equity Cooperative	**Fee Simple Housing**
Appraisal fee	No	Yes
Closing fee	Yes	Yes
Loan origination fee	Applicable only if household applies for personal (share) loan to finance purchase of share	Yes (mortgage)
Filing fee and credit report	Yes	Yes
Real estate fee: - **Title search** - **Title insurance** - **Mortgage filing fee** - **Tax escrow account** - **Additional fees for transaction costs**	No	Yes

4.3 Ongoing operations

There are several factors that suggest operating a SEC would be moderately more cost-effective than operating a comparable affordable condo unit.

- Taxes: In circumstances where the SEC and affordable condo owners are not receiving a tax abatement or exemption, shareholders of a SEC may end up paying lower taxes. The cooperative corporation assumes taxes as an entity, which is then distributed to households on a pro rata basis through the monthly carrying charge. In contrast, condo owners are taxed individually. A scenario where SEC prorated taxes is less than a comparable condo unit depends on the context and local tax policy. (Author's interview with Lower East Side People's Credit Union).
- Group purchasing may offer modest operational savings for members of a cooperatives. Savings will depend on the size of the coop (see section 4.4 on economies of scale). Examples of group purchasing include accounting, insurance, babysitting services, and at-home health care (Northcounty, 2004, p. 9)
- "Operation at cost": Cooperatives do not have a third-party managing building operations. Therefore, there is no profit motive to raise monthly carrying charges beyond actual costs (Ibid, p. 8).

4.4 Other considerations: physical building structure and economies of scale

Shared-equity cooperatives can take various physical forms, including rowhouses on contiguous lots or single-family homes on separate parcels across a city (Davis, 2006). Multifamily buildings are the most common physical form for shared-equity cooperatives and arguably provide the greatest cost- and management-related advantages. According to the National Cooperative Bank, a cooperative conversion of a multifamily building with 25 units may be feasible but would be optimal with 50 units or more (National Cooperative Bank, 2006, p. 11).

Fixed costs related to financing and ongoing management grant larger cooperatives a cost-advantage. Examples of fixed costs include financing and professional fees during the development process. Other ongoing costs for services such as accounting and professional property management are also more financially feasible for larger cooperative developments (NeighborWorks America, 2021; National Cooperative Bank, 2006; Northcounty Cooperative Foundation, 2004).

A study of limited equity developments developed under Washington DC's Tenant Opportunity to Purchase Act and the First Right Purchase program found that smaller cooperatives had higher per unit costs for rehabilitation and maintenance compared to larger buildings (Howell et al, 2020, p. 13).

4.5 Ground Lease from a Community Land Trust

A scenario where a CLT owns the land and issues a ground lease to the SEC or condominium would generate comparable cost savings by eliminating land acquisition costs and introducing a ground lease. The SEC or condominium would own the building and have a long-term lease on the land owned by the CLT. There would not be additional financial benefits unique to the SEC or condominium under this scenario.

However, there are substantial benefits in terms of oversight and governance for both forms of tenure. CLTs introduce another layer of governance that reinforces the long-term affordability of housing (Ehlenz, 2018). CLTs abide by a community-based governance system that can hold leadership accountable to stewarding land for the public interest. CLTs have a tripartite board structure that includes three stakeholder groups: (a) leaseholders that occupy buildings on the land, whether that is tenants of affordable housing or below-market commercial space; (b) residents from the surrounding community who are not tenants; and (c) other representatives from civic organizations or city government (Thaden & Lowe, 2014). The tripartite board structure ensures that multiple stakeholders groups have decision-making power, establishing a community-based system of "checks and balances" to ensure that the interests of tenants are not overlooked and do not grow to overpower public interests.

4.6 Immense Long-Term Savings for SECs

SECs are an immensely more efficient vehicle to create affordable housing because, if governance systems and resale restrictions are designed adequately, SECs are perpetually affordable

by retaining subsidy in the unit. Upon selling an affordable condo unit, the housing could be converted to a market-rate unit through the sale. The selling household exits with the subsidy and additional public or private resources are required to add new affordable units to the housing stock.

Lubell (2013) shows that shared equity housing can create affordable housing that serves two to three times the number of households than fee simple ownership using the same set of initial resources. If a grant provides funding for the creation of 10,000 affordable homes per year over 30 years, a shared equity cooperative could serve between 662,500 and 1,025,500 households over 30 years.[4] If the grant program subsidized fee simple housing that allowed the household to sell on the private market, that same grant would serve just 300,000 households. Various forms of shared equity housing (e.g., limited equity coops, deed restricted housing, housing built on a CLT) would provide the same benefit of extended reach over time by nature of retaining subsidy in the housing.

Section 5: Takeaways for CLiME Analysis

1. **Shared equity cooperatives provide two key financial advantages relative to comparable affordable fee simple housing.** First, SECs expand access to ownership opportunities because participating households do not have to qualify for a mortgage. Second, SECs use public and private subsidy much more efficiently because resources are retained in housing to serve future households after the unit is resold.
2. **To ensure SECs remain permanently affordable and financially solvent, create multiple layers of oversight**. Layers of oversight should include organizational oversight within the cooperative (terms in bylaws and resale restrictions in proprietary leases) and public oversight by the municipality or state. UHAB representatives stressed that Community Land Trusts offer the strongest form of inter-organizational oversight. CLTs should issue a ground lease to the cooperative corporation. Since CLTs are governed by a tripartite board that includes tenants, community representatives, and public officials, the interests of the tenants are put in "check" by community representatives who should speak to the public interest in preserving long-term affordability. Relying on loan terms and lender covenants alone puts an expiration date on SEC affordability.
3. **The credibility and organizational capacity of the sponsor is key to getting a SEC project off the ground.** Sponsors should be able to demonstrate a successful track record of affordable development projects to be perceived as reliable in the eyes of lenders. Sponsors should also have excellent organizational capacity for project management and inter-organizational collaboration because they are charged with coordinating the development team.
4. **Developing SECs at scale requires a robust and well-coordinated local network of technical assistance organizations.** Not all members of the development team need to be experts at working with shared-equity cooperatives, but should be willing to build an understanding of their particular needs with the support of "cooperative experts" on the development team (e.g., the sponsoring organization and "trainers/educators").
5. **Establishing a governance system for a cooperative is intensive and requires significant up-front and ongoing costs.** Effective governance can make or break a shared-equity cooperative. SECs should have a line item in the operating budget for ongoing education to ensure that the cooperative has outside support from experts on effective governance practices and leadership development.
6. **Local government plays an important role in the development and preservation of shared-equity cooperatives.** Local government plays a central role in opening avenues for below-market land acquisition through the disposition of city-owned property or creating interventions in the market through right of first refusal legislation. Local government can also provide oversight, coordinate and vet technical assistance providers, allocate public funds toward a gap financing fund, and reform property tax policy to subsidize shared equity cooperatives.

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Endnotes

[1] Note that Reid's study compares white and "minority" households and does not disaggregate "minority" by race and ethnicity.

[2] These studies examined "shared equity housing," which includes limited equity cooperatives, deed restricted housing, and housing built on Community Land Trusts.

[3] This study of shared equity housing programs included various types of housing: limited equity cooperatives, Community Land Trusts, and deed restricted housing.

[4] The range in the number of households served over the 30-year time period depends on the frequency that households move and resell the unit. Lubell (2013) models the cumulative number of households served if households move every 6, 9, or 12 years.