
CHAPTER 1. PROCEDURES

- 1-1. MANAGEMENT TYPE COOPERATIVES (GENERAL). In all approaches to the development of a cooperative the ultimate objective is for the project to become a Management Type cooperative in the Sales Type approach, except for community facilities, the entire area is subdivided into individual freehold estates. The land area, set aside for community facilities, will continue to be owned and operated by a Management Type cooperative.
- a. Management Type cooperatives are organized to purchase (or acquire by a transfer of physical assets) existing projects from their prior owners, from Investor-Sponsors and from Nonprofit Sponsors.
 - b. A presale requirement must be met, except as set forth under the definition "Presale of Units" before the title to any project can be conveyed to a cooperative which utilizes HUD-FHA mortgage insurance. There is, however, a "Presale Management Type" approach used in proposed construction, wherein, the Management Type cooperative comes into existence at the inception of the proposed project and HUD-FHA will initially endorse a mortgage for the insurance of advances upon satisfaction of the presale and certain other commitment requirements. The Presale approach is more fully described in the following paragraphs.
- 1-2. APPLICATION OF THIS HANDBOOK TO ALL COOPERATIVES. While this Handbook covers many of the requirements of a Presale Management Type cooperative, much of it is applicable to any management type cooperative. Only the difference in approach will be covered in the handbooks concerning the investor-sponsor and nonprofit sponsor cases and in the conversion cases.
- 1-3. PRESALE MANAGEMENT TYPE COOPERATIVES. In this approach, a cooperative corporation is chartered into existence and becomes the mortgagor at the inception of the project. HUD-FHA, however, will not permit the cooperative corporation to become the mortgagor of an insured mortgage until a specified percentage of "unit memberships" has been subscribed for in the cooperative corporation and the balance of unsubscribed "unit memberships" is covered by certain guaranties (set forth in paragraph 1-7. of this Chapter) from the sponsorship organization or the builder.

-
- a. The presale cooperative corporation will be organized and go

to initial endorsement under the auspices of a Provisional Board of Directors, the names of which are stated in the Articles of Incorporation.

- b. The Provisional Board has the responsibility and duty to negotiate all contracts necessary to acquire the land, construct the dwelling units and make other improvements to the land, develop the organizational framework through proper documentation, supervise the overall development of the project and cause the unit memberships in the cooperative corporation to be sold. It must administer all of the affairs of the corporation from its inception through initial and final endorsement of the mortgage transaction and until such time as the first annual meeting is held pursuant to the By-Laws and a Board of Directors is elected by and from the membership.
- c. The Provisional Board normally negotiates one or more contracts (called Cooperative Agency Agreements) with a professional team comprising attorneys and cooperative housing specialists, skilled in administration and sales. (See Reference (1) of the Foreword (Chapter 1, Section 2).)

1-4. UNIQUE CHARACTERISTICS OF THE PRESALE COOPERATIVE. Although 90% of the unit memberships will have been sold (or some lesser amount coupled with guarantees on the remainder if approved by the local HUD-FHA office) before initial endorsement, all of the initial payment (sometimes called downpayment) will be placed in escrow to be returned to the subscribers if the project fails to materialize. The Provisional Board and its professional team, therefore, must make arrangements to meet the construction period working capital requirement imposed on the mortgagor by the HUD-FHA Commitment. This is normally negotiated by the Provisional Board by bargaining with the Builder/Land Seller. The Builder/Land Seller must agree to meet all "over and above" costs until the construction is completed and the mortgage note is finally endorsed. If all unit memberships are not sold at final endorsement, the Builder, in consideration of having the mortgage transaction closed by the Provisional Board, will normally agree to guarantee the initial payments on the unsold unit memberships and the monthly payments attributable to those units for a period of three years as required by HUD-FHA. Because the Builder is exposed to a great deal more risk as a result of the agreements he must make to cover the cooperative until it is complete and 100% occupied, he is entitled to a lump sum contract.

1-5. AGREEMENT FOR SALE OF LAND AND DEVELOPMENT OF PROJECT (No MODEL FORM). This is a title frequently used for the agreement between

the Provisional Board and the Builder/Landowner (seller). It reflects the results of the Provisional Board's bargaining efforts for the purchase of the land and the development of the project. The agreement, for instance, has language that is used in lieu of the Liquidated Damage clause in the Lump Sum Construction Contract so as to impose greater requirements for indemnification of the cooperative for all "over and above" costs. It may also contain an agreement for purchase of the land at less than the HUD appraisal so as to generate cash from mortgage proceeds for use by the cooperative prior to the time that all down payments and full occupancy income can be obtained to stabilize the operations.

- 1-6. COOPERATIVE AGENCY AGREEMENT (NO MODEL FORM). This is an agreement(s) which delegates certain ancillary responsibilities to professionals such as attorneys and cooperative housing specialists and establishes the amount of legal, organizational, development services and marketing fees that will be paid to one agency, if performing all the contractual duties or to different parties if separate agreements are used. (See Reference (1) of the Foreword, Chapter 1, Section 2.)
- 1-7. PRESALE OF UNITS. Presale requirements for cooperatives vary according to the type of cooperative proposed. The presale requirement makes it possible to accept a cooperative proposal when the market conditions are such that it would be unwise to commit HUD-FHA to a rental proposal because the presale requirement must be met before a cooperative commitment is satisfied. Therefore it is generally desirable from the standpoint of both HUD-FHA and the consumer to require that the total proposed membership be procured by the cooperative prior to initial endorsement. However, circumstances of an individual case may warrant an initial closing with less than 100% sales required by the commitment. The HUD-FHA Director may, in his discretion, agree to an initial closing under such circumstances, provided that the interests of both the subscribers and HUD-FHA are protected or furthered by the action he takes. The guarantees set forth below will be required to take the place of the financial support that would, otherwise, have been available to the cooperative from the down payments and "signed" three-year occupancy agreements, had all the unit memberships been sold.

-
- (1-7) a. Insurance of Advances. Normally management type cooperative members for at least 90% of the units in a project involving insurance of advances must be obtained by the cooperative and approved by HUD prior to initial endorsement. In all insurance of advances case where construction has been undertaken by the builder at his risk and a substantial number

of subscribers (50%) has been obtained, the sponsor or servicing organization may request an initial closing. Such closing may be permitted only if the cash requirements for closing can be met. Unless the subscribers supply 100% of the equity, the cash deficiency must be overcome by the builder or sponsor by means of an agreement whereby one or the other will in effect stand by for a portion of the amount otherwise due it and be entitled to interest-free payment covering such amount only out of the sales of the remaining units when, as and if made. The builder or sponsor must also agree to pay the carrying charges for a period of three years (or until sold whichever is less) on these units should they remain vacant after final endorsement. Performance of this undertaking shall be assured in a manner satisfactory to the HUD-FHA Director.

- b. Insurance Upon Completion. In Management Type, Insurance Upon Completion cases, cooperative members for all units in the project must be procured and be approved by HUD-FHA prior to endorsement of the mortgage for insurance, although the HUD-FHA Director, to adjust for last-minute dropouts, etc., may in his discretion permit closing with a 97% membership. HUD-FHA is not required to insure unless the presale requirements have been met. If, however, the Director feels that a closing should be permitted with less than 97% membership, he should obtain the same guarantees as set forth below:

- (1) A closing may be permitted with less than 100% sales only if the aggregate carrying charges to be paid by the members procured will be sufficient to pay the operating costs of the project, or if the builder or sponsor will agree to pay the carrying charges on any unsold units for a period of three years after endorsement or until sold, whichever is less.
- (2) In Investor-Sponsor or Nonprofit-Sponsor cases, it is required that cooperative subscribers for at least 97% of the units be obtained and approved by HUD prior to endorsement of the refinancing mortgage.