



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

REGION VII

Des Moines Field Office
Federal Building
210 Walnut Street, Room 239
Des Moines, Iowa 50309-2111

December 6, 2011

MEMORANDUM FOR: [REDACTED]

FROM: James V. Provenzale III, Associate Regional Counsel, 7BC

SUBJECT: [REDACTED]

This memorandum responds to your inquiry regarding an occupancy issue raised by the management agent of the above-referenced project. [REDACTED] is a cooperative project originally financed with a Section 221(d)(3) mortgage co-insured under Section 244. In 2001, the project refinanced under Section 223(a)(7) and became fully HUD-insured. It is the understanding of Counsel that the management agent would like to allow individuals to occupy units without requiring those individuals to immediately pay for the cost of a membership in the cooperative. While these residents would pay their share of the monthly carrying costs associated with the project, they would not be required to pay for the membership until they have sold their previous residences or one year passes, whichever occurs first. The management agent did not address what would happen if an individual fails to pay for the membership when either of those events occurs. You inquired whether there was any HUD requirement that would prohibit this proposed arrangement.

Issue

Can the owner of a HUD-insured cooperative housing project allow individuals who have not paid for their membership in the cooperative to reside in currently unoccupied units of the project for up to one year?

Conclusion

In response to your inquiry, Counsel reviewed HUD statutes, regulations, Housing Handbook 4550.2 ("the Cooperative Handbook") and the owner's Regulatory Agreement and Bylaws, as well as HUD's model forms for the Occupancy Agreement and Subscription Agreement. As detailed below, while Counsel found no statutory or regulatory provision that would conflict with the management agent's proposal, the owner's Regulatory Agreement and HUD's form for the Subscription Agreement do not

permit the owner to lease units directly to individuals who do not pay the entire cost of their membership upon admission to the project. Counsel also notes that Housing may have policy reasons for rejecting the proposal.

Analysis

As you know, the cooperative corporations that serve as mortgagors of HUD-insured projects are generally owned and managed by their members. To obtain a membership, an individual must make a cash investment in the cooperative. Upon becoming a member, the individual will have the right to reside in a unit of the project and enjoy certain benefits of property ownership, such as tax deductions.

Paragraph 5(d) of the owner's Regulatory Agreement provides the following: "The Mortgagor shall not without prior approval of the Commissioner, given in writing, . . . permit occupancy of any of the dwelling accommodations of the Corporation except by members of the Corporation." This provision, read in isolation, would appear to allow the owner to enter into leases with non-members, so long as HUD issues its prior written approval of the leases. However, paragraph 4 provides that occupancy shall not be permitted "except upon execution of an occupancy agreement . . ." Unlike the provision at paragraph 5(d), this restriction is absolute; it cannot be waived with the prior written approval of HUD. Accordingly, when paragraph 5(d) is read in combination with paragraph 4, it becomes clear that HUD cannot permit the occupancy of a unit by a non-member unless that unit is governed by an Occupancy Agreement.

Counsel did not review the specific Occupancy Agreement used at [REDACTED]. However, Counsel did review HUD's Model Form of Occupancy Agreement (form FHA-3237, see attachment), which the owner was required to use when the project was originally constructed. HUD's form of the Occupancy Agreement must be signed by members of the cooperative mortgagor. This fact raises the following issue: if every unit requires an Occupancy Agreement (see paragraph 4 of the Regulatory Agreement), and Occupancy Agreements must be signed by members (see FHA-3237), under what circumstances could HUD issue its prior written approval of occupancy by non-members under paragraph 5(d) of the Regulatory Agreement? The answer to that question lies in Article 7 of the HUD Occupancy Agreement, which allows members to sublet their units under certain conditions. If a member sublets his or her unit, that unit would be occupied by a non-member, yet still governed by an Occupancy Agreement in accordance with paragraph 4 of the Regulatory Agreement. Subletting is the only situation detailed in the Regulatory Agreement in which HUD can use its discretion to allow non-member occupancy. The Regulatory Agreement does not authorize the owner to lease a unit directly to an individual who is not a member of the cooperative.

In the case at hand, the management agent's proposal does not involve subletting units; the units in question are currently unoccupied. Since subletting is the only route to occupancy for non-members under the owner's Regulatory Agreement, the new residents under the agent's proposal would have to become members upon move-in, which raises another issue: can a prospective resident become a member without paying the entire cost of a membership immediately at move-in? More specifically, can a resident attain

member status immediately upon admission to the project while deferring payment for a membership until a maximum of one year after admission?

Once again, Counsel did not review the specific Subscription Agreement (the document used to sell memberships) used at [REDACTED]. Instead, Counsel reviewed the Model Form of Subscription Agreement (form FHA-3232, see attachment), which the owner is required to follow. The signing of the Subscription Agreement is a necessary pre-condition for membership; however, entering into the Agreement does not, in and of itself, guarantee that membership will be approved.

Paragraph 1(b) of the Agreement provides two options for payment of the subscription price (i.e., the cost of the membership) by a prospective member: immediately, upon signing the Agreement; or, "on written demand by the Corporation [owner]." In the case at hand, neither payment option would allow for residents to move into the project under the management agent's proposal. The former option would not be feasible because the prospective residents do not have the money to pay the subscription price immediately upon move-in. Under the latter option, the owner could demand payment of the subscription fee sometime after the Subscription Agreement is signed (e.g., one year later), but paragraph 1(b) of the Agreement states that "[s]uch demand will constitute notification of subscriber's acceptability for membership" This language indicates that, prior to the owner's demand for the subscription price, the subscriber is not a member of the cooperative. Accordingly, prospective residents of HUD-insured cooperative Housing projects cannot become members of the cooperatives until they have paid the full subscription price.

Even if the owner's Regulatory and Subscription Agreements permitted the owner to lease units directly to individuals who have not paid the full subscription price upon admission to the project, Housing would have policy reasons to reject the management agent's proposal. First, there is no guarantee that individuals would be able to sell their homes within one year of moving into the project. In dealing with the hapless residents who cannot sell their former homes within a year, management would be forced to either terminate their residency or continue the arrangement beyond the initial one-year period. In either case, the units, for a period of time, would be unavailable to people who have the means to make initial cash investments and are willing to take true ownership stakes in the cooperative. While renting units to non-members may provide some temporary relief to a financially strained owner, the long-term success of the cooperative will ultimately hinge on the ability of the owner to attract and retain quality members. Accordingly, unless the management's proposal is the only means of preventing a mortgage default, Counsel recommends that Housing reject the proposal.

If you have any questions regarding this memorandum, or would like to discuss this matter further, please contact me at extension 4496.