

Preserving the Cooperative into the Future

By Randall A. Pentiuik

As most cooperatives reach the point where their original mortgages are paid off, and the HUD Regulatory Agreement ends, a debate occurs on whether they should remain as a form of housing cooperative, or convert to condominiums. We have written an article on this debate and will not reiterate it here; rather this article will present some strategies to help those boards that want to remain as a cooperative by taking steps to prevent future boards or memberships from undoing the decision.

Which tool described in this article that is most suitable will depend on the political climate of your cooperative. Some of our clients have divisions among the board or membership that make it unfeasible to undertake the more extreme measures available. Thus, the starting point is to evaluate what can pass political muster in your cooperative.

Before undertaking any of these strategies, it is necessary to examine your cooperative's Regulatory Agreement to determine whether HUD approval is needed. In most instances, such approval will be required. Since this article is written at a time when there has been no reported attempts to secure HUD approval of any of these strategies, we do not know how HUD will react, and at what level - whether at the district office or at the national office - it will be made. While we suspect that HUD continues to support housing cooperatives as a superior form of home ownership, we cannot predict whether it will agree with the policy of binding future boards and members. To that end, we recommend that you await termination of the Regulatory Agreement in order to bypass the issue altogether.

Amending the bylaws is one option. Here, you can mandate that any future decision to change the cooperative character of the corporation requires a supernumerary vote of the membership. You can choose the percent - between majority vote and unanimous vote. You can also specify that it be by the membership of record - or just those which constitute a quorum. Obviously, if you want to make it very difficult to change from cooperative, you will want to specify a very high percentage of those members of record. This change will need be approved by the membership under the current bylaw requirements for quorum and voting for amendments.

Another option is to place a supernumerary vote requirement in the articles of incorporation. The same issues associated with the bylaw amendment are applicable here. This change will usually require a vote of the membership. A thorough search of bylaws and articles is necessary to make this determination. The benefit of placing the limitation here is that articles are public documents, and open for inspection by all - unlike the bylaws, which is not recorded on the public registry.

Variations to the supernumerary vote requirement may be considered. For example, you may amend either the bylaws or the articles to not only require a higher membership vote, but also mandate that the board also approve it - so there would be two separate requirements. And the board approval can be a simple majority of those

present at a meeting with quorum, or some variation thereof - such as unanimous approval of all board members.

A third choice is to handle it through an instrument which is recorded in the cooperative's chain of title. In essence, this places developers on notice as they perform their due process in conjunction with their takeover bid. The authority of the board to direct this measure is dependent upon the bylaws and articles; if both are silent, the state statute should be researched.

Another approach may be the recording of a covenant that mandates the continuation of income maximums for incoming member-applicants in the case of limited equity cooperatives. That is, even though HUD and its income restrictions have expired, it may be possible to mandate the continuation of those restrictions - at least the income ceiling - in order to preserve the character of the cooperative, by using a covenant that runs with the land into the future.

More radical still is the concept of transferring title to the assets of the cooperative corporation into trust for the benefit of the membership, present and future. A trust document will be required, which may provide that there is no choice - that the property is to remain a cooperative for either a defined number of years as a minimum or for a perpetual term. A trustee needs to be appointed and a line of succession determined. It may be deemed appropriate for the cooperative board to serve as ex officio trustees.

Since this is a most severe alternative, it should not be attempted without full support of the board and membership. It requires a significant investment in time and money to agree and draft the terms of the trust document. To our knowledge, no cooperative has ever tried to do this, so it carries with it the risk of legal challenge by the current membership. If done correctly, there will also have to be changes to some of the current governing documents in order to place future members on notice that their rights have been affected to this extreme degree.

Finally, it should be noted that most bylaws allow the board to make the decision on refinancing. If the cooperative enters into a new loan arrangement, it is typically precluded from making any changes to the form of the entity until and unless the new loan is paid off. Of course, if there is a prepayment penalty, it becomes expensive and unlikely that future boards will want to do anything while those obstructions are in place.

Whatever option is selected, it will require competent legal counsel to provide expert guidance and drafting in order to do it right. For example, a doctrine in the law known as the prohibition against restraint in alienation of property needs to be circumvented by careful drafting. The risks are too great to attempt this without thorough consideration of the ramifications of the choices, in light of current law.

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