

# **CO-OPERATIVELY** **SPEAKING**

**EDMUND J. FLYNN COMPANY**

CO-OP SPECIALISTS SINCE 1920

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# COMPANY BACKGROUND

A strong sense of history and continuity defines the Edmund J. Flynn Company.

The company's origins go back to 1920 when Mr. Flynn pioneered the concept of co-operative ownership in Washington, D.C.. Since then the company has participated in the development of more than 40 co-operative projects.

From its beginning, the Edmund J. Flynn Company has been true to its heritage by maintaining a close identity with and support of co-operative ownership.

Although some of its business activities have changed over the years, the Flynn Company continues to provide settlement services to co-op buyers as well as Transfer Agent services to most of the co-operatives located in the Washington, D.C. metropolitan area. As Transfer Agent, the Flynn Company prepares and maintains the ownership records on behalf of the co-operative corporation.

Today, as always, the Edmund J. Flynn Company is ready to render its expert services to co-operative associations as well as to co-op owners and buyers alike.

**William M. Karas**  
CEO

**Joyce A. Rhodes**  
President

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# **PART ONE**

## **D.C. Co-operatives: A Historical Perspective**

Co-operatives have existed in the Washington area as a form of home ownership since 1920; there are approximately 120 co-operatives in the District alone. Yet, in spite of their long-term popularity, co-operatives are the least understood form of residential home ownership.

One possible reason why co-operatives are not a more familiar form of ownership is due in part to their highly urban locations. New York, Chicago and D.C. are some of the cities where co-operative associations have flourished for decades. Condo associations, on the other hand, are located in both urban and suburban areas. Consequently, buyers are more familiar with the condominium concept, but this was not always the case.

### **Condo vs. Co-op**

When condo apartments were first introduced in the Washington area during the 1960's, would-be buyers raised thoughtful questions about the condominium form of ownership—mainly, its organization and function.

Many are unaware as to how the condominium form of ownership was created. A creature of legislation, the condominium uniquely combines fee simple or real property ownership for each individual apartment unit together with an undivided interest in all the common areas and facilities of the association. Generally speaking, common areas are public spaces outside of one's apartment unit such as hallways, basements, pools, land, etc.. Each unit owner's interest in the common areas is undivided and indistinguishable from any other unit owner's interest. The common areas and the land on which the building stands are held by all the condominium unit owners as tenants in common. Legislation states that individual ownership of a condominium unit constitutes an interest in real property.

Ownership of a co-operative unit, on the other hand, is generally considered an interest in personal property because the

co-operative corporation has fee simple title or real property ownership of the entire property. This corporation, in turn, grants each member or owner the "right" to occupy a unit: herein lies the most significant difference between co-operative and condominium ownership. One's ownership interest in the corporation and the right to occupy a unit is considered an ownership interest in personal property and not in real estate. However, the daily operation of co-operatives and condominium associations is quite similar.

## **The Corporation Factor**

Co-operatives have never required any special legislation to give rise to their existence. Corporations can be formed for a number of legitimate purposes. Simply put, a co-operative is a corporation formed for the purpose of providing housing for its members or owners.

In 1920, Edmund J. Flynn in association with Alan E. Walker pioneered the co-operative form of ownership as it is known today in the Washington, D.C. area. The plan was novel, providing for 100% co-operative ownership as opposed to the common practice of selling only a portion of the building and placing the balance under rental.

The first co-operatives were organized, as they still are today, in the form of a corporation which typically holds fee simple title to the entire property. Some co-operatives own the building while leasing the land. Conceivably, a co-operative corporation could lease a residential building for occupancy by its members.

Membership in some corporations within the D.C. Metropolitan area is evidenced by two instruments: a stock certificate and a proprietary lease. Shares of stock are issued to show the value relationship of one unit to the other and to pro-rate the corporate mortgage payment, if any, the operation and maintenance expenses, and the property's real estate taxes.

The proprietary lease spells out the relationship between the owner members and the corporation. It contains many of the same clauses that are found in a residential lease but also refers to those special provisions distinguishing an apartment unit owner from a tenant, such as the owner's right to participate in the affairs of the corporation, vote or have the use and enjoyment of the unit indefinitely.

The Charter and By-Laws, which all corporations adopt, are the co-operative's governing documents which describe the relationship between the individual co-operative owners. They cover items such as how to liquidate the corporation should the membership ever decide to dissolve it, how to elect the board of directors, how to vote, when to hold annual meetings, and the like. The Charter and By-Laws vest in the Board of Directors the authority to run the building and establish policies, approve new buyers or renters, develop an operating budget and contract for services.

With the sale of the Broadmoor Apartments in 1948, a new form of co-operative was introduced to Washington, D.C.. In order to avoid the complex requirements of registration with the Securities Exchange Commission, the co-operative, although still a corporation, no longer issued stock but rather became a membership form of co-operative. In place of stock and proprietary leases, one document was issued which, in the case of The Broadmoor, was termed a "Perpetual Use and Equity Contract." The name has come to vary from one co-operative to another, sometimes called a Co-operative Ownership Contract and sometimes an Ownership Contract. Regardless of the name, the document is substantially the same in most membership co-operatives.

The Ownership Contract combines into one instrument most of the provisions that were previously contained in two separate instruments: the stock and lease. The Ownership Contract differs from the earlier stock co-operatives, however, in that it provides, in most cases, for one vote per unit rather than one vote per share in stock. Thus, small and large apartments acquire equal voting rights, bringing the co-operative even closer to the democratic concept.

## **The Nitty Gritty**

Simply stated, a housing co-operative is a corporation, owned and operated by its members and formed to provide housing for said members. All housing co-operative property is actually owned in the name of the corporation, which is directly responsible for the monthly payments of principal and interest on any corporate mortgage indebtedness, the payment of real estate taxes on the corporate property and for any other operating costs such as insurance, service contracts, salaries and the like.

Individual members (also known as owners or stockholders), by virtue of their ownership interest in the corporation, have the right to occupy their dwelling unit, participate in the operation of the co-operative corporation, and have an obligation to pay their proportionate share of the co-operative's annual operating budget.

If a member fails to pay his pro-rata share of the co-operative's budget, the other members, acting through the co-operative, are required to pay the deficiency. This is one reason for providing an operating reserve. However, the co-operative has a lien on each member's Ownership Documents and ultimately has the right to sell the defaulting member's apartment unit in order to recover the defaulted payments.

The co-operative's operation is governed by its Certificate of Incorporation and its By-Laws. These documents give each owner the right to annually elect the Board of Directors. The Board is charged with managing the business affairs of the co-operative and supervising the operation of the co-operative's physical plant. Day-to-day management is generally delegated to a property management firm selected by the Board. The Board adopts the annual budget which contains estimates of the association's operating costs for the coming year. The budget is the basis for establishing the monthly fees charged to each member. The Board also has the authority to establish, amend, and enforce the House Rules which, in conjunction with the Ownership Documents, govern the use and occupancy of the property.

# **PART TWO**

## **Co-operative Financing**

For nearly 60 years after the first co-operative was organized by Edmund J. Flynn, bank financing was not available to co-op buyers. D.C. banks, organized under Federal Charter, were not authorized to loan money secured by a pledge of a borrower's ownership interest in a co-op. This lack of financing adversely affected not only the value but also the marketability of co-ops.

This situation changed in 1979 when the Federal Home Loan Bank Board issued its final regulation authorizing federal savings and loan associations to make loans on individual co-op units. That same year the principals of the Edmund J. Flynn Company convinced American Security Bank to develop a pilot loan program for financing co-op resales. Harbour Square, a co-operative located on the waterfront in Southwest D.C., was eager to participate in the development of such a loan proposal. This was the first time a D.C. lender entered into a formal arrangement, called the Recognition Agreement, with a co-op association to provide purchase money for financing resales.

Although American Security's pilot loan program was short-lived due to market conditions, high interest rates and a \$50,000 loan limit, this first D.C. area co-operative loan program became the basis for future participation by other lenders. As a result, bank financing for Washington co-ops began.

## **The Loan Process**

Applications for co-op loans are underwritten in the same manner as applications for any residential loan. Lenders follow the underwriting guidelines prescribed by the secondary lending market, typically Fannie-Mae.

A lender will verify sources of income and confirm the borrower's financial obligations including installment debt, student loans,



alimony/child support, and investment property. The lender will then obtain the borrower's credit report from a consumer credit reporting agency. The next step is the co-op unit appraisal which is performed by an appraisal firm that has been engaged by the lender. Costs for the credit report and the appraisal are paid for by the borrower either separately or as part of the lender's application fees (check with your lender).

The lender may require a report of termite inspection prior to settlement depending on the type of unit, i.e. townhouse, or the location of the unit relative to the ground in a multi-family building. The report is ordered and paid for by either the seller or the purchaser/borrower as stipulated in the sales contract.

Hazard insurance, which covers the replacement value of the unit, is generally not a requirement because the replacement value of the unit being financed is covered by the co-operative corporation's master insurance policy. The lender, however, will require the settlement officer to obtain a certificate of insurance from the co-op's insurance carrier verifying such coverage.

There is no title search performed on the unit because the ownership interest in the co-op unit is considered personal property. Typically, any transaction involving the transfer of personal property is not recorded among the land or real property records in the Recorder of Deeds office. Washington, D.C. now requires that the transfer of an ownership interest in a co-operative unit be recorded by the filing of an Economic Interest Deed. This requirement became effective October 1, 2009.

It is, however, common practice for a lender to have the settlement office order a search of the non-land or chattel records in the Recorder of Deeds office to determine if there are any issues which may encumber the seller's ownership interest in the unit or affecting the credit worthiness of the borrower.

Lastly, there is no survey requirement because no land or real estate changes hands in the transfer of a co-operative unit.

# The Loan

It should be noted that in the Washington D.C. area, the price quoted for a co-operative unit is the full price, which includes the allocated portion of any corporate or blanket mortgage financing. Since the price of a co-op unit includes the unpaid share of the blanket mortgage allocation, the current balance of the blanket mortgage is included in the total financing permitted by a lender (see simplified example).

Co-op unit financing differs among the participating lenders since there are a variety of home loan programs from which to choose. Each lender has minimum down payment requirements, maximum loan amounts, different repayment schedules and loan fees. In addition, some co-ops have minimum cash down payment requirements. Not every lender offers co-op financing. Among the lenders that do, not all have a Recognition Agreement with each and every co-operative association. Check with the lender or with the co-op's management.

## Financing a Co-op Unit (simplified example):

Purchase Price	\$100,000
Present Corporate Mortgage Allocation	- \$25,000
<b>Seller's Equity</b>	<b>\$75,000</b>

Lender's loan is based on the equity value.  
For example, if lender will finance 80% of the unit's equity value:

Equity Value	\$75,000
	x 80%
<b>Loan Amount from Lender</b>	<b>\$60,000</b>

Therefore, at Closing:

Lender's Loan	\$60,000
Blanket Mortgage	+\$25,000
Cash Payment	+\$15,000
<b>Purchase Price</b>	<b>\$100,000</b>

# Recognition Agreement

The loan documents for co-op unit financing are akin in principle to those needed to perfect a lien on real property: a note states the loan amount, rate of interest, payment schedule, etc.. Also a security agreement outlines the borrower's obligations to repay the loan and the circumstances leading to foreclosure in the event that the borrower defaults in his or her obligations to the lender or to the co-op.

The single document that is absolutely unique to co-op unit financing is the Recognition Agreement. This pre-approved form is signed by the borrower, an officer of the co-op association and an officer of the lender at the time of settlement.

Simply stated, a Recognition Agreement is a legal document wherein the co-operative association recognizes the lender as having a security interest in the borrower's unit. It also establishes the steps that either the lender or the co-op will take in the event the member/borrower defaults to the lender or to the association. The terms of the Recognition Agreement must be mutually agreed upon by the co-op association and the lender before any loan closing.

A co-operative association may require that some monies be escrowed at settlement in connection with a Recognition Agreement. This escrow is applied to the loss of any monthly assessment payment.

A loan on a co-op unit is secured by an assignment of the borrower's Ownership or Proprietary Documents to the lender as collateral security for the debt. The lender holds the Proprietary Documents until the loan is paid. The borrower's indebtedness is recorded in the office of the Recorder of Deeds among the chattel or non-land records with the filing of a Uniform Commercial Code Financing Statement (UCC-1).

A loan on real property is secured by a pledge of the owner's deed to the real estate. This pledge is in the form of a Deed of Trust in favor of the lender that is recorded among the land records in the office of the Recorder of Deeds. The unit owner retains actual possession of his or her deed or title to the property even though it has been pledged to secure a debt.

# **PART THREE**

## **Settling a Co-op Sale**

What does the term “settlement” mean as it applies to a co-op sale? Settlement is the act of depositing with the Settlement Officer the purchase monies and such documents that are required to effect a valid transfer of a unit from a seller to buyer, and the buyer’s assumption of seller’s obligations under the Ownership or Proprietary Documents. These actions are considered good and sufficient tender of performance.

The Settlement Officer conducts the settlement in accordance with the terms and conditions of the Sales Agreement. All contingencies must be fully satisfied by supporting documentation before settlement can take place, including the requirement that the purchaser be approved for membership and occupancy by the Board of Directors.

Co-op settlements differ from real property settlements in that there is no transfer of real property. An ownership interest in a co-op unit is an interest in personal property, not real estate.

Evidence of ownership in a condominium unit is referred to as fee simple title with an undivided interest in the common elements of the condo association. Ownership in a condominium is represented by a deed. The evidence of ownership in a co-operative unit, however, is most likely to be represented by a form of co-operative ownership contract or shares of stock and a proprietary lease or some other document commonly referred to as Proprietary Documents.

There are many similarities and a few differences in transferring an interest in a co-op unit as compared to a house or condominium. Generally speaking, there is no real estate tax proration as is common when conveying real estate. The exception is The Promenade Towers in Bethesda, Maryland. The Promenade Towers assesses and pays the real estate taxes following the same payment schedule as other real estate owners.

With the exception of Washington, D.C., there is no transfer or recordation tax imposed on the sale of a co-op unit. The District of Columbia's recordation tax is calculated the same as the transfer and recordation tax charged on the sale of houses and condos. The tax on Co-ops became effective October 1, 2009.

There is no mechanism among the land records in the Recorder of Deeds Office to record the chain of ownership within a co-operative corporation; hence, there is no title search fee or the need to purchase title insurance. On the other hand, the non-land or chattel records on file in the Recorder of Deeds office are searched prior to closing to determine if there are any purchase money liens, tax liens and the like, filed against the seller of the co-op unit. The buyer pays for the cost to conduct a search of the non-land or chattel records. In addition, the co-operative's ownership records are reviewed by the Board or by the co-op's Transfer Agent to confirm that the seller is a member of the co-op in good standing and the rightful owner of the Proprietary Documents which the seller is transferring to the buyer.

## **Parties to a Co-op Settlement**

Besides the buyer and seller, the co-operative corporation is an important party to the transaction. First of all, the sale is conditioned upon the co-op approving the buyer for membership and occupancy. Without formal written approval by the Board, there can be no sale or settlement. Also, by approving the transfer, the co-operative is confirming that the seller is a member of the co-operative and the rightful owner of the unit being transferred. If a lender is involved, the co-operative must agree to enter into a Recognition Agreement with the lender whereby the co-operative recognizes the lender as having a security interest in the unit for which a loan is being made.

## **Application and Approval**

A number of important steps must be taken before settlement can occur. The most important, of course, is that the transfer of membership and occupancy be approved by the Board. Approval

must be in writing and signed by an officer of the Board.

To obtain board approval, the buyer must make an application to the co-operative for resident membership. Each co-op has its own requirements for the sale and transfer of ownership. Typically, an application form seeking information about one's employment status and income, as well as a listing of one's assets and liabilities, is completed by the buyer and submitted to the Board. This information is reviewed by the Board to assess the applicant's ability to handle the monthly carrying costs associated with ownership. Verification of employment, a consumer credit report and letters of personal reference are usually part of the application package. The co-operative may require the seller or buyer to pay a fee for the cost of obtaining a credit report and for handling the review process. Following submission of the application package to management, most co-op boards schedule an interview with the buyer to greet the prospective owner, answer any questions and explain some of the more important policies concerning the co-operative's operation.

## **Settlement and Transfer**

In preparation for closing, the settlement officer will initiate a written request to the co-operative's managing agent for a statement concerning the status of the seller's account, as well as verification of the monthly assessment payments allocated against the unit, i.e. the monthly co-op fee. The total monthly co-op fee covers the unit's share of the cost to operate and maintain the property, including the unit's pro-rata share of the real estate taxes. The monthly fee also includes the principal and interest payment for any corporate mortgage indebtedness which may be allocated to the unit. Special assessment payments are also verified. All payments are pro-rated according to the terms of the agreement.

In transferring an interest in real property there is no need for the seller to bring his deed to settlement since a title search would have confirmed the seller's ownership interest in the property. It is imperative, however, that the seller of a co-op unit bring his original

Proprietary Documents to settlement as these are the seller's evidence of ownership which the seller assigns to the buyer. If the seller is unable to locate his Proprietary Documents, the co-op will issue substitute Ownership Documents provided that the seller completes one of the following requirements as dictated by Board policy: (1) provide an affidavit of loss, (2) require the seller to purchase a bond in favor of the co-op to indemnify it and the buyer against loss, or (3) initiate a suit for Quiet Title. Both the bond and the suit for Quiet Title are costly measures. The purpose of these actions is to ensure that the seller's ownership interest has not been conveyed or pledged to a third party.

If the Proprietary Documents have been pledged by the seller as collateral security for a note or share loan, then the Proprietary Documents are released by the note holder or lender upon pay-off and returned to the co-operative.

Settlement can be scheduled when the settlement officer has all of the verifications and supporting documents in hand. A settlement statement is prepared which follows in principle the standard HUD-1 form.

At settlement, the seller will assign his right, title and interest in the Proprietary Documents to the buyer. The buyer accepts the assignment and pays the balance of the purchase monies to complete the sale.

Following settlement, the settlement officer must arrange for the President and Secretary of the co-operative to sign and seal the Proprietary Documents, and if there is a purchase money loan involved in the transaction, the Recognition Agreement and related documents must be signed as well. This is usually coordinated through the co-operative's Transfer Agent.

The members of the Board in each and every co-operative are themselves resident owners who volunteer their time. The process of transferring ownership is a reasonable process provided that the policies and procedures established by the co-operative are followed and the Board's involvement in the process is respected.

# **PART FOUR**

## **Brief Description of Co-operative & Condominium Ownership**

The co-operative and condominium forms of ownership are similar in some respects, but there are also some important differences. Most of the similarities are operational in nature while the differences are generally in their legal framework and financing arrangements. Let's take a closer look.

### **CO-OPERATIVES**

The basis for the co-operative form of ownership is typically found in laws establishing corporations. No special legislation is needed to organize a corporation for the purpose of housing its stockholders/members.

The first U.S. co-operative was organized in New York City in the 1880's. In 1920, Edmund J. Flynn in association with Alan E. Walker, introduced the first "100% Plan of Co-operative Ownership" to Washington area residents.

Housing co-operatives are owned and operated by the stockholders or member owners. The corporation holds title to the property of which the individual units are a part and each stockholder or member owns a proportionate share of the corporation.

Housing co-operatives are non-profit corporations that are organized either as stock or non-stock corporations. If organized as a stock corporation, each member is a stockholder who receives a stock certificate indicating the number of shares assigned to the unit. The member also receives a proprietary lease granting him/her the exclusive right to occupy a specific unit in the project and to use and enjoy the common elements subject, of course, to the Articles of Incorporation, By-Laws, Rules and Regulations of the co-operative. This right of use and occupancy is appurtenant to, and inseparable from, ownership of an interest in the co-operative entity.



These two instruments, the stock certificate and the proprietary lease, constitute the member's evidence of ownership or "title" to the unit. The member's ownership of the unit is an interest in personal property, not real estate.

Co-operatives organized without capital stock are membership co-operatives. Although still organized as a non-profit corporation, a membership co-operative typically issues a single Ownership Document in place of stock and proprietary lease. It reflects both the member's ownership interest in the corporation and the member's exclusive and permanent right to occupy the unit and to use the common elements. The evidence of ownership in a membership co-operative varies from one co-operative to another, sometimes called a Co-operative Ownership Contract, Perpetual Use and Equity Contract or a Mutual Ownership Contract. Because of its many forms, the evidence of ownership in a co-op is commonly referred to as Proprietary Documents.

The affairs of the co-operative are managed by the Board of Directors elected by the unit owners to oversee the care, maintenance, operation and administration of the association. The cost to operate a co-operative is proportionately allocated among the unit owners as stipulated in the Articles of Incorporation and/or By-laws.

Loans made to purchasers and owners of co-operative units are secured by a pledge and assignment of the unit owner's Ownership Documents, i.e. Proprietary Documents. The lender holds the borrower's Proprietary Documents as collateral security for the loan. The lender's security interest in the Proprietary Documents is further perfected by recording a Uniform Commercial Code Financing Statement (UCC-1) with the Recorder of Deeds which evidences the borrower's debt on the public records.

The organizational documents of a co-operative can be structured to serve the financial needs of present and future owners. These associations are referred to as "limited equity" or "low yield" co-operatives in contrast to the more common "market rate" co-operatives. Limited equity co-operatives limit the market value of a unit being sold so that it can be purchased by people with

low or moderate income.

Co-operative ownership provides the same tax benefits as all other forms of home ownership. The tax deductions available to the co-operative corporation, as result of the payment of real estate taxes and interest on the corporation's mortgage, are passed through to the individual unit owners in proportion to their ownership interests provided that the co-op qualifies under Section 216 of the IRS Code. Briefly stated, if in a particular year more than 20% of the co-op's gross income is derived from non-tenant stockholders, it cannot pass through interest and real estate tax deductions to its otherwise qualifying "tenant stockholders" (i.e. the unit owners). Also, interest on an individual unit owner's loan is likewise, tax deductible pursuant, of course, to any limitations stipulated in the tax code.

Each co-operative association has its own policy governing the sale or rental of individually owned units.

The co-operative form of ownership may also be applied to such entities as office buildings, medical centers, mobile home parks, as well as commercial business enterprises.

It should be emphasized that in the Washington area, the price quoted for the sale of a co-operative unit is the full price including the unit's pro-rated share of any corporate mortgage financing on the co-op's property.

## **CONDOMINIUMS**

The basis for the condominium form of ownership is found in state and local law.

Each of the 50 states has laws that enable condominiums to be formed. Sometimes referred to as Horizontal Property Acts, these laws require that a project be declared a condominium and that the legal documents conform to the format stipulated in the state laws.

Condominiums were first legally established in the United States in 1958 when the Commonwealth of Puerto Rico passed a law providing for condominium ownership. Legislation for condominium

ownership in the District of Columbia was passed in 1963.

A condominium is a form of ownership in which the individual unit owner owns fee simple title to the unit as well as an undivided interest in the common elements of the condominium, which interest is appurtenant to, and inseparable from, ownership of the unit. The individual's ownership interest is subject to the Declaration, By-laws, Rules and Regulations of the condominium.

Each condominium unit owner is a member of the condominium association. Like a co-operative, the affairs of the condominium association are managed by the Board of Directors elected by the unit owners to oversee the care, maintenance, operation and administration of the association.

The cost to operate a condominium association is proportionally allocated among the unit owners as stipulated in the Declaration and/or By-laws.

Loans made to purchasers and owners of a condominium unit are secured by a mortgage or Deed of Trust which is recorded among the land records in the jurisdiction where the condominium is located. The Deed of Trust is a lien against the unit in favor of the lender which provides collateral security for the loan.

The condominium unit is always treated as real property for tax purposes and unless otherwise stipulated in the tax code, there are no limitations on the owner's ability to deduct interest, real estate taxes and the like.

A condominium association may have some form of policy governing the sale, lease or disposition of individually owned units.

The condominium form of ownership may also be applied to office buildings, industrial parks, medical centers and almost any other form of real property.

# PART FIVE

## Condominium vs. Co-operative

<b>GENERAL CHARACTERISTICS</b>	<b>CO-OPERATIVE</b>
<b>Living Space</b>	<ul style="list-style-type: none"><li>• Owned by a co-operative corporation and leased to individual co-operative member (tenant-stockholder)</li></ul>
<b>Financing</b>	<ul style="list-style-type: none"><li>• Corporate Mortgage allocation</li><li>• Unit Share Loan</li></ul>
<b>Collateral</b>	<ul style="list-style-type: none"><li>• Project mortgage–co-operative project (land &amp; improvements)</li><li>• Unit Share Loan–share and occupancy agreement</li></ul>
<b>Mortgagor</b>	<ul style="list-style-type: none"><li>• Project mortgage–co-operative project (land &amp; improvements)</li><li>• Unit Share Loan–share and occupancy agreement</li></ul>
<b>Common Area/Facillites</b>	<ul style="list-style-type: none"><li>• Owned by co-operative corporation</li></ul>
<b>Real Estate Taxes</b>	<ul style="list-style-type: none"><li>• Paid by co-operative corporation</li></ul>
<b>Basic Documents</b>	<ul style="list-style-type: none"><li>• Articles of Incorporation</li><li>• By-laws</li><li>• Proprietary Documents</li><li>• Special share loan documents (Recognition Agreement, Security Agreement, UCC-1 Financing Statement)</li></ul>
<b>Income Taxes</b>	<ul style="list-style-type: none"><li>• Pass-through deduction to members in co-operative qualified under Section 216 for propotionate share of project mortgage interst and real estate taxes</li><li>• Direct deduction of unit share loan interest</li></ul>

## **CONDOMINIUM**

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- Separately titled: owned by individual
- 

- Unit Mortgage
- 

- Condominium unit and undivided interest in common elements
- 

- Unit owner
- 

- Owned collectively by unit owners as tenants in common, each unit owner having an undivided interest
- 

- Tax on each unit and its undivided interest in the common estate paid by each unit owner
- 

- Declaration
  - By-laws
  - Rules and Regulations
  - Unit Deed
- 

- Direct deduction of unit mortgage interest and real estate taxes
-

# **PART SIX**

## **Mr. Flynn's "100% Co-operative Plan"**

Years ago Mr. Flynn wrote that every Washingtonian should become familiar with the details of the "Flynn 100% Co-operative Plan." He stated that "this plan has afforded home ownership to thousands here, who before its introduction, had no hopes or financial reasons of ever owning their own homes or, for one reason or another, did not want the worries and cares of individual home ownership."

The Flynn "100% Co-operative Plan" has been successful in the Washington, D.C. area since its inception in 1920. It has been applied to residential co-operatives including more than 45 well-known and large developments without a single failure, even in the grim Depression years of the 1930's. This is truly a remarkable record that emphasizes the soundness of the Flynn Plan.

It is interesting to note Mr. Flynn's marketing philosophy for the sale of co-ops in the 1920's, 1930's and 1940's. These early co-ops were sold on the basis of a substantial down payment, which assured the purchaser a markedly lower-than-rent monthly outlay for combined purchase payments and maintenance costs. By having monthly purchase payments less than rent, monthly payments did not put a strain on the pocket book. Mr. Flynn wrote that this arrangement "means extra income during good times... permits you to maintain a comfortable home during any depressed economic period. The low down payment method of financing, with its obvious reliance on never-ending prosperity, has no place in the Edmund J. Flynn '100% Co-operative Plan'." This was an admittedly conservative, yet prudent, approach.

## **What is Meant by "100% Co-operative"?**

"100% Co-operative" means that the co-op association will commence business with full membership, that is, a responsible owner for every co-operative unit. Prices are assigned and costs

allocated based on a value relationship of each individual unit to the value of the apartment building as a whole. Mr. Flynn's plan also differed from many other so-called co-operatives at the time because the association could operate as a non-profit enterprise without any dependence on speculative income from commercial rentals in order to remain solvent.

## **Is a Co-operative Buyer a Real Owner?**

Yes, under this co-operative plan “an owner of a commercial or residential unit in a Flynn co-operative building will own his space in perpetuity...will enjoy every prerogative of an individual owner that is consistent with a well-organized mutual ownership enterprise....will have the privilege to sub-lease, sell, transfer, or pledge his ownership interest at any time, subject only to the necessary safeguard that occupancy rights cannot be transferred without approval of the association of co-operative owners. Therefore, the owner of a co-operative unit under this plan will have the maximum incidents of outright individual ownership.”

## **Are Prices Quoted “Equity Value” Prices or is “Full Cost” Included?**

Many co-operative plans quote only the “equity” or “down payment” as the price of the unit. But doesn't the allocated corporate mortgage add to the total cost of the unit? Mr. Flynn wrote that “...it would be pure deception to attempt to make the purchaser of a house believe that his mortgage was not included in the price he was paying for it. A buyer of a co-operative unit is entitled to the same treatment. Under the Flynn Plan, the price quoted to a prospective buyer includes the share of corporate mortgage allocated to the unit.” To this day, all co-op sales in the D.C. Metropolitan area follow this pricing principle.

# **PART SEVEN**

## **Why Condos Became Popular**

If co-ops are such a sound and sensible form of ownership, why aren't there more co-ops being organized and sold? Co-ops continue to be organized and are typically located in the densely populated urban areas. On the East Coast, New York City has the greatest number of co-ops followed by Washington, D.C.. Unlike condominiums, no special legislation is required for a group to form a corporation and purchase a rental apartment building in the name of the co-operative housing corporation.

Nevertheless, why are condominiums more popular? The answer can be summed up in one word: financing. Co-ops in Washington were first organized by Edmund J. Flynn in 1920. For nearly 60 years thereafter, bank financing was not available to purchasers of co-op units. Banks in the District of Columbia are organized under Federal Charter and federally chartered banks were not permitted to loan money secured by a pledge of one's ownership interest in a co-op. Co-op purchasers had to pay cash for their unit or the seller had to take back a note for part of the cash requirement.

The lack of bank financing adversely affected co-op ownership in two ways. First of all, it made co-ops difficult to sell; second, it suppressed the value of co-ops. Just think of what today's real estate market would be if buyers could not finance their purchases.

In 1979, an important event took place that would ultimately improve the marketability of co-operatives. On August 2, 1979, the Federal Home Loan Bank Board (FHLBB) issued its final regulation authorizing federal savings and loan associations to make loans on individual co-operative units in accordance with the rules governing loans on single-family dwellings and to otherwise amend its rules to provide similarity of treatment between co-op loans and other home loans. The effective date of the new regulation was September 6, 1979.



The new rule then allowed loans up to 95% of the appraised value of the co-operative unit, less the allocated portion of the corporate mortgage. Loans in excess of 80% have to be insured according to other FHLBB regulations.

Therefore, as of September 6, 1979, federal savings and loan associations were permitted to make loans on individual co-operative units to be secured by an assignment of the borrower's Proprietary Documents to the lender. For insured or guaranteed loans, such loans may be made on any terms acceptable to the guaranteeing or insuring agency.

Banks were slow to tap the potential of this new lending opportunity. More importantly, bank managers were generally resistant to involve their institution in making loans collateralized by personal property. And yet, at the time, these same banks were aggressively marketing other loans secured by personal property of diminishing value, i.e. car loans, boat loans, and the like.

About the time when sources of bank financing for co-op resales was gaining momentum, enabling legislation for condominium ownership was enacted. In D.C., the year was 1963. Even though condominiums were not real estate in the traditional sense (i.e. land), the legislation said they were. As "real estate," condos soon found favor among bankers, developers and consumers.

# **PART EIGHT**

## **Why Oh Why Should I favor Co-ops?**

As a form of multi-family ownership, co-ops offer several distinct advantages. A few of the more significant advantages are highlighted.

First of all, title to the land is in the name of the housing corporation. This is significant because the corporation has a mortgageable asset. For example, if there were a need to fund a costly capital improvement, the membership could decide to fund the cost by placing a mortgage on the property resulting in small payments every month over time as opposed to one or more special assessments. Condominium associations have no "property" or equity to mortgage for long term financing.

Second, most delinquencies and other problem matters can be handled administratively, thereby avoiding costly and time-consuming legal action.

Thirdly, the membership can establish policies to control the owner/investor ratio within the association. A rental policy can be established to insure that the number of investor-owned units does not exceed the secondary market requirements for First Trust financing. Furthermore, the real estate tax rate on the co-op's property in the District of Columbia is likewise affected by the owner/investor ratio. Depending on the organizational structure of the condominium when first established, the condominium board would have legal difficulty in restricting an owner's right to rent.

There are other advantages as well. One obvious benefit is the cost to settle a co-op purchase. The cost is modest when compared to buying a condo. For example, there is no title insurance, no title search and, except for the District of Columbia, no transfer or recordation tax to purchase.

Another obvious benefit is the relative simplicity in organizing a

co-op. For example, to convert an existing rental building from an investor-owned rental property to property owned by a co-op association involves only a change in ownership. Simply stated, the property as a whole is conveyed from the seller of the apartment building to the co-operative corporation. The property does not have to be subdivided into individual lots as is the case in a condo conversion, which reduces the cost to convert.

Co-ops are taxed more like rental buildings. There is one tax bill. The bill for a co-op owned corporation is typically much less than the taxes in the aggregate for the unit owners in a condo. A contributing factor is that co-op sales are not recorded.

A more subtle benefit is the incidence of delinquencies in a co-op. Delinquencies are minimized as a result of the application process. Typically co-ops require prospective owners to apply for resident membership. This includes a statement of income, assets and liabilities, a credit report and the like. The process of having one's financial status reviewed by the Board (i.e. future co-owners) discourages applicants with questionable credit. The co-op relies on the membership to meet its financial obligations which include, among other obligations, real estate taxes and the monthly payment on its corporate mortgage. Therefore, the credit worthiness of a prospective member is vital to the financial well being of the association. This process minimizes delinquencies. Lenders are quick to state that co-op borrowers, as a group, are reliable payers and that foreclosures are nearly non-existent.

The Edmund J. Flynn Company has been true to its heritage by being a constant and dedicated promoter of co-operative housing since Mr. Flynn first introduced co-ops to Washington in 1920. Most of Washington's "Best Addresses"\* are co-ops. This is a convincing testimony to the fact that co-ops are a viable and proven form of ownership.

May there be a co-op in your future!

*\*Best Addresses, A Century of Washington's Distinguished Apartment Houses.*  
Goode, James M.. Smithsonian Institution: 1988.

# **Co-operatives organized by the Edmund J. Flynn Company...since 1920**

The Hoyt*	Meridian Hill Apartments
Dumbarton Court	1702 Summit Place*
The Netherlands	Potomac Plaza Apartments
Rutland Court	Potomac Plaza Terraces
Cavanaugh Court	Frances Carlton Sarasota, FL.
The Adelphia*	The Mendota
The Stafford	The Ontario
The Lambert	Kenwood House, Chevy Chase, MD
1705 Lanier Place	Woodley Gardens Rockville, MD
Cleveland Park Apartments	The Presidential
The Porter	Harbour Square
3407-9-11 Twenty Ninth Street	Hamlet Place, Chevy Chase, MD
55 M Street*	The Saxony
65 M Street*	The Norfolk
66 New York Avenue*	2800-2802 Devonshire
76 New York Avenue*	1860 California Street
1201 First Street*	Winchester-Underwood
The Clydesdale	Madison Terrace
Hampshire Gardens	The Chastleton
3810 Southern Avenue*	
The Broadmoor	
The Avondale	

\*No longer exists