

HOUSING COOPERATIVES

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Hot Topic Alerts



Housing cooperatives are an alternative to traditional home ownership or rental that have generated renewed interest in recent years. The reasons for this interest vary. For some, a housing cooperative is a type of home ownership that does away with worries about upkeep. In some cities, co-ops are being used as a way of increasing the stock of [affordable housing](#). In the past, co-ops were thought of as limited to [luxury buildings](#) in large cities, or a [utopian experiment](#). Today, however, co-ops are spreading across the country and across the real estate market.

In this Hot Topic Alert, we look at the definition of a cooperative and how it differs from other forms of home ownership. We examine how co-ops are governed, with the focus on how prospective residents can become a part of the co-op. We also review some of the most recent legislative and court activity regarding the approval of buyers. Finally, we look at proposed solutions to some of the persistent legal issues surrounding the screening process.

WHAT IS A HOUSING COOPERATIVE?

Housing cooperatives come in many different shapes and sizes. Many of them are multi-family buildings, such as converted apartment buildings. They can also be developments of single-family homes or townhomes, with ownership put into cooperative form. No matter what they might look like on the outside, all cooperatives have a similar structure.

A [cooperative](#) is a legal entity, typically formed as either a corporation or limited liability company (LLC). This legal entity owns housing stock, whether that stock is a single building or a tract of detached houses. The residents who live in the housing have an ownership interest only in the legal entity. They do not own their residence or any part of the physical structure that they live in. The cooperative owns the residence, and the residents pay rent or fees to the cooperative entity. This entity usually operates on an [at-cost basis](#), meaning that residents pay fees that meet the expenses of the cooperative without the idea of making a

profit. The management of the cooperative is the responsibility of the residents, who elect the board that runs the co-op. New residents must be approved before they are allowed to buy a share of the co-op.

There are some key differences between cooperatives and the other forms of common-ownership communities. In a [condominium](#), residents own their individual units and share the common areas with other owners. Residents pay a monthly fee to the condominium association for upkeep and common improvements. In a [tenancy-in-common](#), a form of ownership that has some popularity in cities that put a [moratorium on condominium conversions](#), owners own an “undivided” share of the premises. Owners of a share in a tenancy-in-common, unlike condominium owners, do not have a definable physical space that belongs to them. Instead, each owner has an “undivided” share in the physical premises. Cooperative owners have no legal interest in any space or structure. Their ownership is the ownership of a piece of a legal entity.

Another important difference between co-ops and other types of multi-family residences is that co-op residents often develop a strong feeling of [community](#) that is not present in other types of ownership. This is due in no small part to the participatory nature of a co-op. Co-ops are run by residents, who elect the board of directors and who often have the opportunity to share in making decisions about the co-op. The approval process for buyers also can foster a collection of like-minded co-op shareholders.

Under the laws of the states, housing cooperatives may take many forms. However, for purposes of federal taxation, and the shareholders’ income tax deductions for real estate taxes and mortgage interest, a cooperative must [meet certain requirements](#). These include a requirement that the cooperative issue only one class of stock, and that shareholders may not receive any distributions from the profits or earnings of the cooperative, unless the cooperative is being dissolved. In addition, each shareholder must

be “entitled, solely by reason of his ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by such corporation.” This last requirement excludes shareholders in manufactured home park cooperatives in which the corporation owns the land on which the shareholder has placed a dwelling unit that he or she owns.

WHO’S IN CHARGE?

Cooperative associations are usually corporations. Although the laws of many states provide for special rules for the formation and operation of cooperatives aimed at distinguishing them from regular business corporations, cooperatives are still run according to many of the same rules as other corporations. This means that the day-to-day affairs of the cooperative are the responsibility of a board of directors.

The board of directors of a cooperative is [elected by the shareholders](#) at an annual meeting, unless the cooperative’s bylaws provides for staggered terms. Unless the articles of incorporation or the bylaws of the cooperative state otherwise, votes are typically apportioned according to ownership, so that each unit receives [one vote](#). The powers of a cooperative board are [limited](#) by the state law governing co-ops, by the bylaws of the association, and by the articles creating the association. The bylaws and articles are [considered](#) a contract between the cooperative and its shareholders. [Bylaws](#) usually give the board “all the powers and duties necessary for the administration of the affairs of the Corporation.” This includes the power to accept or reject applications for membership and occupancy.

The powers of a board of directors are broad, but the exercise of those powers has limits. Courts have usually [held](#) that a board has a fiduciary relationship to the members of a cooperative, although some courts have [held](#) that the duty is to the cooperative itself, and not to the individual co-op members. The board members must act in [good faith](#), and within the

limits of their authority set out in the articles and bylaws. The decisions that the board makes are usually final. Courts hesitate to overturn or block board actions, relying on the so-called “[business judgment rule](#).” That rule calls for courts to defer to the decisions of the board, except in unusual circumstances.

The deference given to board decisions does not mean that co-op members have no recourse if they disagree with the actions of the board. First, they may vote to amend the governing bylaws to restrict or otherwise change the powers of the board. Second, members of the board are elected by the general membership of the co-op, and those members must run for re-election. The vote is the fundamental check on the abuse of power. Third, courts have started to retreat from the near-absolute deference that the business judgment rule would seem to dictate. Courts in [Florida](#) review board decisions to determine if they are “reasonable,” and comply with the bylaws and articles of the association. The District of Columbia Court of Appeals also uses a “reasonableness” standard, and has [expressly declined](#) to adopt the business judgment rule for decisions by housing cooperative boards

A move away from the business judgment rule may be a trend for court decisions in this area, and it may drive future legislation. One of the reasons cooperatives are becoming more popular as housing options is the opportunity for residents to have a say in how their

communities are run. As accountability becomes more important to more residents, more ways to hold boards accountable can be expected.

WHOSE CO-OP IS IT, ANYWAY?

You’ve found the ideal co-op for you, and it’s at a price you can manage. You’ve reached an agreement with the seller, so everything should be fine: just sign some papers, pay the money, and pick a move-in date. That’s all it takes, right?

Not quite. Sales of co-op interests are usually made “subject to the approval by the board.” You still have to be approved by the co-op board before you can close the transaction. The process of getting approval by a board can be a nerve-wracking one of indeterminate length. Boards look at many different aspects of a buyer, including their financial affairs, and also their personalities and lifestyles. The [financial scrutiny](#), which can include approval of the purchase price, helps to ensure the financial stability of the cooperative. The personal scrutiny helps the board to make sure that new residents will be compatible with, and not be disruptive to, the other members of the community.

The approval process will vary, and is mostly a matter of following the procedure set out in the bylaws and lease of the co-op. Brokers who handle sales of co-ops are in the best position to help a buyer get started with this [process](#). As a general rule, buyers will be asked to submit detailed financial information, including income tax returns, and releases for credit checks. Buyers must also submit personal and professional references, and references from prior landlords. If the written application and the supporting documents are in order, the next step is a personal interview with the board. [The interview](#) lets the board get to know the buyer better, and is also an opportunity to answer any questions that the board may have about an applicant.



Once the interview is done, and references are checked, it is up to the board to make its decision. In many states, such as [New York](#), boards are free to reject a prospective member for “any reason or no reason.” Some courts have held that a co-op board must act in the “best interests” of the co-op when making a decision on an application, but the business judgment rule will lead a court to [uphold](#) the board’s decision unless the board acted outside the scope of its authority, in a way that did not legitimately further the corporate purpose, or in bad faith. If the bylaws or articles say that the board will not withhold its consent to a purchase “unreasonably,” the courts will examine the board’s rejection to see if it was in fact reasonable. Cooperative boards are also subject to state, federal, and local [fair housing laws](#). An application may not be rejected due to the applicant’s race, sex, religion, age, national origin, disability, and, in some states and communities, marital status or status as LGBT. Discrimination may be hard to prove, given the subjective nature of the board approval process.

Once the application has been submitted, and the interview is over, the buyer must wait for a decision. The time for reaching a decision may be set out in the bylaws. Ordinances in some communities may set a time for a decision. In [Suffolk County, New York](#), a co-op board must notify the applicant that it received the application within 10 days of the receipt of the completed application. The buyer must be notified of the board’s decision no later than 45 days after that. In [Westchester County](#), boards must notify the applicant of a decision within 60 days of giving notice that the completed application was received. Westchester boards must also notify the Human Rights Commission of all rejected applications.

What happens if an application is rejected? The prospective buyer may never know the reason. Unless the co-op’s bylaws or articles, or applicable law, say otherwise, there is no requirement that a rejected applicant be told the reasons for his or her rejection. Boards are [sometimes advised](#) not to provide applicants with the specific reasons for rejection, out of

fear of future litigation. Legislation introduced in 2018 in the [New York City Council](#) and in the [New York State Assembly](#) would require co-op boards to inform rejected applicants of the reason an application was rejected. That legislation has not advanced through the legislative process. In [Suffolk County, New York](#), however, a letter of rejection must include the grounds for the rejection. This type of legislation is [opposed by many](#) involved in the co-op market. The opponents believe that adopting requirements that reasons be given “likely discourage shareholders from serving on their boards,” and “undermine decades of viable practice.”

The process for applying for approval to purchase a co-op is [notoriously stressful](#). The buyer has to wait, perhaps for months, to find out if he or she is buying a new home. This leads to uncertainty about when the potential buyer’s current home should be put on the market. The real estate professional assisting the buyer is also placed in a difficult position. There is little, if anything, he or she can do to speed the approval process, or even to know what is going on with it. The buyer/representative relationship enters into a kind of limbo: when is it time to look for other properties? How does the representative keep a good relationship during the possibly long, certainly frustrating, waiting period? The result of the process can also be difficult. Rejection can be an [emotionally trying experience](#) for the buyer. On the other hand, applicants should remember that they are asking permission to join what could be a very closely-knit community. That may not make the process any less stressful, but it may make it more understandable.

CASE LAW REVIEW

As discussed above, courts have typically given co-op boards wide latitude in deciding which applications for membership to approve. Here are some recent cases that address the potential limits on that latitude.

- An applicant whose application to purchase a cooperative apartment was denied brought suit alleging violations of state and federal anti-discrimination laws. The court granted the cooperative board's motion for summary judgment. The board's background check revealed that the prospective buyer was involved in numerous lawsuits, including suits against the FDIC that challenged his lifetime ban from working in the banking industry. The court agreed that the board denied the application based on the applicant's "litigious tendencies and personal dishonesty," and not his race. *De La Fuente v. The Sherry Netherland, Inc.*, Case No. 17 Civ. 4759 (S.D.N.Y. July 30, 2019).
- Buyers sought to cancel a contract to purchase a co-op apartment. The contract allowed either party to cancel if the board did not give its "unconditional consent" to the sale. The board twice gave its conditional approval. The sellers claimed that conditional approval was not the same as a refusal. The court held that two offers of conditional assent were made and rejected, so the buyers were entitled to cancel the contract. The board's supposed offer of unconditional approval after the buyers had terminated the contract was without effect. *Bloom v. Westereich*, 2019 N.Y. Slip Op. 04452 (App. Div. June 6, 2019).
- The seller of a co-op claimed that the board of directors violated anti-housing discrimination laws by imposing "uniquely onerous conditions" on approval of the sale of the unit to the French Ambassador to the United Nations. The seller's claim failed, as she did not plead any concrete factual allegations in support of her claim that the board was motivated to frustrate the sale of the unit by anti-French bias. *Farkas v. River House Realty Co., Inc.*, 173 A.D.3d 405, 2019 N.Y. Slip Op. 04322 (June 4, 2019).
- The board of directors approved the buyer's application to purchase a unit. Two weeks later, the board rescinded its approval, based on an erroneous report from a board member that the buyer did not intend to live in the unit, as required by the purchase contract. The trial court issued an order directing the board to allow the sale to go through. The appellate court held that the decision to rescind the approval was "wholly arbitrary, and thus not entitled to the protections generally provided to cooperative boards by the business judgment rule". The court affirmed the order directing that the sale proceed. *Kallop v. Board of Directors for Edgewater Park Owners' Co-op, Inc.*, 155 A.D.3d 491, 64 N.Y.S.3d 219 (2017).



- Sellers who alleged that the board of their co-op refused to approve a sale to an unmarried man raised a genuine issue of fact regarding discrimination. The board gave no reason for its disapproval. Sellers alleged that the later refusal to approve a sale to a single woman for a higher price was to “cover” their prior discrimination. *Berkowitz v. 29 Woodmere Blvd. Owners’, Inc.*, 50 Misc.3d 84, 323 N.Y.S.3d 830 (2015).

LEGISLATIVE SOLUTIONS TO APPLICATION TRANSPARENCY ISSUES

State laws and local ordinances can create a more transparent and predictable application process that would benefit co-op buyers and sellers and their respective real estate professionals.

For instance, bills have been introduced in New York that relate to applications for cooperative membership. Two identical bills ([A.B. 6194/S.B. 4677](#)) would require co-op boards to maintain a standardized application and list of requirements for all cooperative apartments. The board would be required to provide the standardized application and list of requirements to any prospective purchasers and prospective sellers, or their respective real estate agents, promptly upon request, along with instructions as to where and how to submit the required materials. Written acknowledgement of the receipt of an application would have to be provided within ten business days of receipt. An acknowledgement of receipt would have to state whether the application fully satisfied the requirements, the way or ways the application failed to comply, and if additional materials are requested for clarification. The prospective purchaser would have to be informed of the decision on his or her application within 45 days. If there is no action on an application within 45 days, the prospective purchaser would be permitted to inform the board that if no action is taken within ten days, the failure to act will constitute consent to the sale. A.B. 6194 was introduced on March 4, 2019, and is in the Assembly Housing Committee. S.B. 4677 was

introduced on March 20, 2019, and is in the Senate Judiciary Committee.

Two other more narrow New York bills ([A.B. 1267/S.B. 6408](#)) would require uniform application procedures. These procedures would include a timeline for applications to be established by the cooperative. There would be no requirement in law as to what that timeline must be, and the bills do not set out any consequences for failure to follow the timeline. A.B. 1267 has advance to third (final) reading in the Assembly, while S.B. 6408 has been recommitted to the Senate Rules Committee. It seems unlikely that the housing cooperative approval process will be fixed with federal action. Real estate has always been largely been a state or local matter. The federal government has limited means for managing housing policy (e.g. limitations on federally guaranteed housing finance), but there are no current proposals to use even those limited means to promote transparency in the cooperative application process.

The federal government might begin to show more interest in regulating cooperatives if the cooperative model continues to be used as a way of promoting [affordable housing](#). There is historical precedent for this interest: during the 1930s and 1940s, cooperative housing, or “[mutual housing](#),” as it was more commonly known, was an important part of federal housing policy. More recently, federally-sponsored [limited equity co-ops](#), in which there are limits on the ownership interests of members and on the equity they can earn on the resale of their units, were widespread and are still providing affordable housing in many cities. [Affordable housing advocates](#) suggest that a return to these co-ops could once again be a source for affordable housing, and affordable home ownership.

CONCLUSION

Cooperatives are an attractive housing option for many buyers. They are, however, not without their own unique pitfalls. The approval process, in which the neighbors are allowed to approve or disapprove a purchase after an agreement is made between a willing buyer and a willing seller, is not something that happens in most other real estate transactions. While there does not appear to be much interest in doing away with this practice, there are efforts underway at making it a more transparent process.

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