

Date of Hearing: April 17, 2013

ASSEMBLY COMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT  
Norma Torres, Chair

AB 1024 (Torres) – As Amended: April 10, 2013

SUBJECT: Real property: divided lands

SUMMARY: Makes several changes to the law to assist in the development and finance of cooperative housing. Specifically, this bill:

- 1) Exempts a stock cooperative or community apartment project from the requirement to obtain a public report from the Bureau of Real Estate (BRE) if the following conditions are met:
  - a) Shares in the stock cooperative or community apartment project are sold to no more than 35 people;
  - b) All shareholders live in the state;
  - c) All shareholders have a preexisting business or personal relationship or by the nature of their business or finance experience or by the business or finance experience of their professional advisors who are not affiliated with or compensated by the issuer of the shares, have a reasonably assumed capacity to protect their own interests in connection with a transaction;
  - d) Each purchaser is purchasing the share for themselves and not to sell;
  - e) The offer or sale of shares is not done through an advertisement; and
  - f) The entity issuing the shares files a notice with the Commissioner of Corporations noticing the sale of shares in the stock cooperative or community apartment project.
- 2) Expands the category of institutions that provide financing to a limited equity housing corporation or workforce housing cooperative trust, in order to allow the LEHC to be exempt from the requirement to get a public report from BRE, to include a state or federally chartered credit union or a certified community development institution (CDFI).
- 3) Allows a stock cooperative or LEHC to be sold or leased subject to a blanket encumbrance if all prospective purchasers are notified that the property is subject to a blanket encumbrance and one of the following conditions is met:
  - a) The property has or will receive a public report from BRE;
  - b) The governing documents of the homeowners association (HOA) of the stock cooperative require the HOA to be formed within one year of 50% of the shares being sold and maintain a financing reserve equal to at least three months of the amount of debt service payments due on the blanket encumbrance during the term of the blanket encumbrance;  
or

- c) Every purchaser in the stock cooperative is an accredited investor with a net worth of \$1,000,000 not including their home or at least \$200,000 in annual income or \$300,000 as a couple, or are close family members.
- 4) Exempts stock cooperatives from the election provisions of the Davis Stirling Act governing common interest developments (CID) if the governing documents of the HOA provide that all members and shareholders of the cooperative are automatically members of the board of directors of the HOA.
- 5) Allow members of a stock cooperative to bring a cause of action to challenge the election of the board of directors in a stock cooperative.

EXISTING LAW

- 1) Requires that when lands, lots or parcels of any size are subsidized and financed or leased then the subdivision must obtain a public report from the BRE unless one of the following conditions exists:
  - a) The undivided interest are held or going to be held by people who are related by blood or marriage;
  - b) The undivided interests are going to be purchased by people who demonstrate to the satisfaction of BRE that they are knowledgeable and experienced investors who comprehend the nature and risk in owning the interests. Restricted to no more than 10 persons who must furnish BRE with a statement that they understand the risk of purchasing, they are purchasing with funds from their own account and for their own use and do not plan to resell their interest and that they expressly waive the protection provided to a purchaser through disclosure of a public report;
  - c) The undivided interests are created subject to a foreclosure;
  - d) The undivided interest is created by a court order or decree; and
  - e) The offering or sale of undivided interests is in a CID for which the Commissioner of Corporations has issued a permit.
- 2) Provides that a limited-equity housing cooperative or a workforce housing cooperative trust is exempt from the Subdivided Lands Law (Business & Professions Code Section 11003.4 et al) if the cooperative complies with all of the following conditions:
  - a) A public entity directly finances or subsidizes at least 50% of the total construction or development cost or \$100,000, whichever is less, of the limited-equity housing cooperative or the real property on which the limited-equity housing cooperative will be located was sold by the Department of Transportation for the development of a and limited-equity housing cooperative that has a regulatory agreement approved by the Department of Housing and Community Development (HCD) for the term of the permanent financing;

- b) No more than 20% of the total development cost of a limited-equity mobilehome park and no more than 10% of the total development cost of other limited-equity housing cooperatives is provided by the members;
  - c) A regulatory agreement for at least the term of the permanent financing or subsidy is duly executed between the recipients of the financing and either a federal or state agency as specified or a local public agency providing the financing under a regulatory agreement that meets HCD's standards;
  - d) Assurances for completion of the common areas and facilities to be owned or leased by the limited-equity housing cooperative are in writing unless a construction agreement contains these assurances;
  - e) There are governing instruments for the organization and operation of the cooperative;
  - f) There is ongoing fiscal management of the cooperative;
  - g) Membership information is distributed to any perspective purchaser prior to purchase;
  - h) Any federal, state or local public agency that executes a regulatory agreement must be satisfied with the governing documents of a limited-equity housing cooperative and other agreements as specified;
  - i) Any federal or state agency that is providing a subsidy to the limited-equity housing cooperative must receive a legal opinion that the cooperative meets all the exemption requirements;
  - j) Permits a limited-equity cooperative that meets all the exemptions to choose to comply with the Subdivided Lands Law (Business & Professions Code Section 11003.4 et al); and
  - k) The developer of the cooperative must claim the exemption from the Subdivided Lands Law (Business & Professions Code Section 11003.4 et al) with the Bureau of Real Estate (BRE) on a form provided by BRE and which BRE will keep for four years.
- 3) Makes unlawful for lots or parcels within a subdivision to be offered for sale subject to a blanket encumbrance unless the blanket encumbrance includes a release clause which allows a purchaser of a lot or parcel to obtain legal title free and clear of the blanket encumbrance by meeting the terms of the lender.
- 4) Permits a subdivision to be offered for sale subject to a blanket encumbrance without a release clause if the following conditions are met:
- a) The purchaser or lessee deposits an amount that is the entire sum of money paid for a lot or parcel or an amount that the Commissioner of BRE determines is sufficient to protect a purchaser is deposited into an escrow account until:
    - i. A proper release can be secured;

- ii. The owner, subdivider or agent, or the purchaser or lessee, defaults on the sales contract; and
  - iii. The owner, subdivider or agent orders the return of the deposited money to the purchaser.
- b) The title to the subdivision is going to be held in a trust that the commissioner of BRE determines is acceptable until a release can be obtained;
  - c) A bond is issued to the State of California and furnished to the commissioner which provides for the return of the moneys paid or advanced by any purchaser or lessee; and
  - d) The commissioner of BRE provides an alternative requirement which is deemed acceptable to protect the interest of the purchaser or lessee. (Business and Professions Section 11013.2)
- 5) Exempts the sale of securities from the approval of the Commissioner of Corporations if the following conditions exist:
- a) All shareholders have a preexisting business or personal relationship or by the nature of their business or finance experience or by the business or finance experience of their professional advisors who are not affiliated with or compensated by the issuer of the shares have a reasonably assumed capacity to protect their own interests in connection with a transaction;
  - b) Each purchaser is purchasing the share for themselves and not to sell;
  - c) The offer or sale of shares is not done through an advertisement; and
  - d) The entity issuing the shares files a notice with the Commissioner of Corporations noticing the sale of shares in the stock cooperative or community apartment project.

FISCAL EFFECT: Unknown

COMMENTS:

Background: The supply of entry level affordable housing is far short of demand for low to moderate-income working Californians. The U.S. Department of Housing and Urban Development (HUD) reports that 12 million renter and homeowner households pay more than 50% of their annual income for housing. Nationwide, more than 1.2 million families of all income levels live in homes owned and operated through cooperative associations. Cooperative members own a share in a corporation that owns or controls the building and or property in which they live. Each shareholder is entitled to occupy a specific unit and has a vote in the corporation. Every month, shareholders pay an amount that covers their proportionate share of the expense of operating the entire cooperative which typically includes underlying mortgage payments, property taxes, management, maintenance, insurance, utilities and contributions to reserve funds. Housing cooperatives can be townhouses, apartments, single family homes, student housing, senior housing, and mobilehome parks. The purpose of the cooperative

structure is to prevent speculation, encourage long-term residency, and preserve the affordable character of the cooperative for future residents.

Purpose of this bill: In California, a housing cooperative (referred to in statutes as a “stock cooperative”) is created when a corporation is formed for the purposes of holding title to a property, and where all or substantially all of the members or shareholders of the corporation are entitled to lease a unit in the property. Housing cooperatives lower the barrier to property ownership, and create an important vehicle for the creation and preservation of affordable housing. AB 1024 would remove some of the more significant barriers to developing cooperative housing, in addition to making two minor amendments to facilitate the approval and operation of housing cooperatives.

Public Reports for Housing Cooperatives: The California Subdivided Lands Act requires that a new housing cooperative with five or more units apply for and obtain a public report from the BRE (formerly the Department of Real Estate) prior to leasing a unit to a cooperative member. A public report is designed to protect consumers by creating a set of documents to inform purchasers of financial and structural matters related to the purchase of a unit. To obtain a public report, a cooperative must prepare numerous documents and forms, often with the help of attorneys, accountants, and engineers and submit the information to BRE. Obtaining a public report could cost a new cooperative \$10,000-\$20,000 in professional and filing fees, and could take up to a year. This bill creates an exemption from the public report requirement when the purchasers meet the requirements of California’s Securities Limited Offerings Exemption under Corporations Code 25102(f). This allows cooperative members to lease their units and move in without a public report when all of the members have a pre-existing relationship with the cooperative and/or its directors or organizers, and where the shares are not publicly advertised. This mirrors the presumption made in California securities law, which is that a pre-existing relationship sufficient to allow the purchaser to know the business acumen or financial status of the cooperative – as well as the accountability created through pre-existing relationships – are sufficient to allow a securities offering without need for review and approval by a regulatory agency. This provision of the bill would apply to situations where tenants organize themselves to purchase their building and own it cooperatively.

Removing Barriers to Shared Financing: The California Subdivided Lands Act prohibits, with a few limited exceptions, the sale of housing cooperative shares when the units are subject to a “blanket encumbrance.” Blanket encumbrances most commonly take the form of a mortgage taken out by the corporation and secured by the entire property. The prohibition on blanket encumbrances serves to protect cooperative members from losing their homes and investments in the event that the cooperative defaults on its mortgage. However, the prohibition on blanket encumbrances has the effect of banning housing cooperatives in California, because the most common way that a cooperative finances the purchase of a building is by means of a single blanket mortgage. This bill creates safeguards to protect members of cooperatives, while allowing a cooperative to obtain a mortgage. A cooperative could sell units subject to a blanket encumbrance so long as cooperative members receive clear and specific notice of the risks of buying a share subject to a blanket encumbrance and the cooperative has built a reserve fund sufficient to make mortgage payments for three months, or obtained a public report from BRE, or every investor has sufficient net worth to assume the risk of a blanket encumbrance.

Elections for board members in cooperatives: Cooperatives are by definition common interest developments and must comply the Davis Stirling Act (the Act). The bill requires elections to

conform to an extensive process including requiring the homeowners association to provide each owner with a double stuffed envelope in which to return a ballot. In some cases the bylaws of an HOA require all of the members to serve on the board of directors. Therefore election of the members is not required. This bill would exempt cooperatives from that procedure if, the governing documents require all members to serve on the board.

Exempting LEHC from the Public Report Requirement: Current law exempts Limited Equity Housing Cooperatives (LEHCs) from the public report requirement when a LEHC is financed by one or more agencies, listed in the statute, and when those agencies enter into a regulatory agreement to ensure proper structuring and operation of the LEHC. This bill would add state or federally chartered credit unions and state or federally certified community development financial institutions (CDFIs) to the list of financing agencies qualified to enter into the agreement under the public report exemption. State CDFIs are certified by the Department of Insurance and must have community development as their primary mission and they must lend in urban rural or reservation-based communities in the state. A community development financial institution may include a community development bank, a community development loan fund, a community development credit union, a microenterprise fund, a community development corporation-based lender, or a community development venture fund. Federal CDFIs are certified by the U.S. Treasury, have a primary mission of community development, and provide both financial and educational services.

Double referred: If AB 1024 pass out of this committee, the bill will be referred to the Committee on Judiciary.

REGISTERED SUPPORT / OPPOSITION:

Support

California Center for Cooperative Development (sponsor)  
Bay Area Community Land Trust  
East Bay Cooperative Housing California  
San Francisco Community Land Trust  
Sustainable Economies Law Center  
Walnut House Cooperative  
Two individual letters

Opposition

None on file.

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