Testimony by Members of the Board of Directors of cu4ml Regarding

Proposed Changes in HPD Mitchell-Lama Regulations

13 September 2011

On 3 August 3, 2011, HPD proposed 16 amendments to the rules governing Mitchell-Lama and other city-aided Limited-Profit Housing Companies. On 13 September 2011, a hearing was held at HPD to allow Mitchell-Lama residents (and the public) to present commentary on the proposed amendments to the "Mitchell-Lama Rules."

At its board meeting in August, the cu4ml board of directors found that six of the 16 proposed amendments were of particular concern to the organization's mission to preserve the Mitchell-Lama cooperatives: proposals number 3 [amending §3-02(n)(4)], number 4 [amending §3-02(p)(3)], number 6 [eliminating §3-03(e)], number 8 (adding paragraph (1-a) to §3-07(b), number 13 [amending §3-14(i)(6)], and number 14 [amending §3-14(i)(6-a)(i)]. Following is a summary of the comments expressed by eight cu4ml board members: J. Cohen, M. Foutz, R. Heitler, J. Meyler, A. Niederman, J. Poindexter, E. Reimann and S. Stroman as representatives of cu4ml.

The 13th and 14th proposed amendments would change the process that a board of directors must follow in order to withdraw the cooperative from Mitchell-Lama and convert it to a private cooperative. The first change proposed is that the process applies when the board of directors is "considering dissolution and/or reconstitution," whereas, without amendment, the process describes requirements that would not apply until the board has reached the stage of "intending to dissolve and/or reconstitute." Cu4ml feels that it is far better to begin these requirements at the earliest possible point in the process, and is pleased with this change of wording in §3-14(i)(6).

<u>Proposal # 13, amendment of §3-14(i)(6),</u> proposes important and protective changes regarding the “feasibility study” step in the consideration of dissolution.

1. The amendment proposes that in the resolution to authorize a board of directors to <u>begin</u> preparation of a feasibility study, the amount of money to be authorized will be limited to $100,000. Any additional expenditure will require a separate shareholder authorization, and is again limited to $100,000 at any one time.

> Cu4ml is pleased to see that the shareholders will have to approve each $100,000 spent on this study. Experience has shown the Mitchell-Lama cooperatives that, once a study is initiated, boards feel free to spend without shareholder approval, and have been diverting maintenance-charge income intended for upkeep and operation of the cooperative to pay for the feasibility study (and other steps in the privatization process), to the detriment of the cooperative.

2. The 13th proposal describes the content of the feasibility study, an aspect of the process that has been overlooked in previous regulations. The amended regulation would require, but not be limited to (i) a physical condition survey and the costs of projected capital needs; (ii) the real property tax increases that would result from dissolution; (iii) estimates by the City and State taxing authorities of the property transfer taxes that would result from dissolution; and (iv) a professional market study that would project sales prices for dwelling units of the privatized cooperative.

> Cu4ml is pleased that the provision of a table of contents for a feasibility study, which has not previously been outlined for M-L cooperatives. More than one cooperative has been provided with a "feasibility study" that reports only the attractiveness of privatization, unbalanced by comparison with the advantages of remaining in the Mitchell-Lama Program or mention of the disadvantages of privatization. Nevertheless, we feel additional points should be specified in this amendment, as follows.

A. Each of the estimates (physical condition, taxes, capital needs, sales prices, loans and other debts and the total debt service) should be projected for at least five years beyond the date of anticipated dissolution. Dissolution and loss of the benefits of being in the M-L Program are certain to entail annual increases in the costs of operation. Even the property transfer taxes would not be one-time-only added burdens because most cooperatives would have to borrow the money to pay those taxes, adding a debt burden that would not be borne by remaining in the M-L Program.

B. The feasibility study should be current – appropriate to the cooperative as of and at the time that it is distributed to the shareholders. Feasibility studies have been known to drag on for years,
and can become stale long before the shareholder vote on whether to proceed with further expenditures and steps toward privatization. At St. Martin's in Manhattan, for example, the feasibility study was approved in 2006, the engineering study was completed in 2006, but the study and the report have not yet (in 2011) been accepted by the board of directors nor distributed to the shareholders.

The most crucial numbers for the viability and stability of a *privatized* M-L cooperative – projected sales prices of its apartments – would be the most volatile of all the numbers in the study, and their uncertainty should be made clear in the study.

C. The completed study must be distributed no less than 90 days before shareholders are asked to vote on whether to authorize beginning the preparation of a preliminary offering plan (a "red herring") and funding for that expensive process. Shareholders must be given time to evaluate the results of the study because not only are most M-L cooperators new to real estate conversions and their complexities and consequences, but they are generally full-time employed family people who cannot suddenly stop work to devote many hours or days to evaluating a privatization feasibility study.

<u>Proposal no. 14, proposes two changes in §3-14(i)(6-a)(i)</u>.

1. The first change is to require explicit statement of the amount of funds to be authorized for the preparation of an offering plan ("black book") to be submitted to the office of the New York State Attorney General for filing. The current regulation does not require that the amount be revealed at the special meeting called to have the shareholders vote on whether or not to approve the expenditure.

The inclusion of the specific (presumably maximum) amount authorized to be expended for the preparation of an offering plan for submission to the Attorney General is a prudent change, and cu4ml appreciates and applauds this proposal. Experience of the past decade has demonstrated that handing a blank check to directors dedicated to withdrawal of a mutual housing company from the Mitchell-Lama Program can lead to expenditures that exceed all expectations of the cost of "exploring" privatization, seriously reduce upkeep of the property, and inflict financial hardship on the cooperative.

The most prominent example of runaway expenditures for privatization has been East Midtown Plaza, where the cumulative expenditures during the first nine years of the process, reported in the annual reports as "legal fees for privatization," now (2011) exceed $2 million – $2 million drained from the operating budget of the cooperative. Since the first report of these expenditures, the amount reported for any year has been at least $137,000.; it rose to $502,009. in its peak year – so far. Of this $2 million, $1 million was expended prior to the final shareholder vote that rejected the offering plan; this cost would not be greatly different for any other cooperative of any size, because the legal process will not vary greatly in cost among cooperatives of different numbers of dwelling units. The second $1 million was expended in the now-33 months of litigation by the board to challenge the shareholder vote. Not every cooperative would suffer that much damage or for so long a time. Cu4ml urges HPD to do all it can, including enforcing this part of its proposed amendment, to protect other Mitchell-Lama cooperatives from such exploitation by runaway boards of directors.

2. The second change extends shareholder control over expenditures of funds in furtherance of dissolution by requiring shareholder authorization of any <u>additional</u> expenditures beyond the initial amount authorized. As is already in the regulations, the authorization of funds to <u>initiate</u> preparation of an offering plan requires approval by 2/3 of the dwelling units of the cooperative. In contrast, the proposed amendment would drop this requirement to a mere simple majority of cooperative members present at a meeting, which – depending on quorum size at the cooperative – could mean as low as 12.5 to 17 % of the dwelling units could approve additional funds.

This drastic reduction in the number of votes required to approve further expenditures is an open invitation to manipulation by a board that would propose a modest, relatively acceptable amount in the vote to <u>initiate</u> offering plan preparation, then much greater amounts could be authorized by a far smaller proportion of the dwelling units to <u>continue</u> once preparation of the plan has begun.

There is a second reason for objecting to this change. Between the time of the vote to

authorize funds to initiate preparation of an offering plan and a vote to authorize further expenditures to continue preparation of the plan, conditions in the building, in the city, and in the economy may well change. Just as with the vote on initiating the offering plan and the final vote on its approval, any vote for additional funds should require the approval of 2/3 of the dwelling units. Authorization by a lower proportion would imply that the completed plan is unlikely to achieve the 2/3 vote of approval required for withdrawal and dissolution. In that case, funds would have been expended in a futile pursuit.

Cu4ml recommends that HPD replace the last sentence of §3-14(i)(6-a)(i) as proposed with the following sentence, which is consistent with the rest of §3-14(i) of the regulations.

> **"Subsequent to any such vote authorizing funds for the preparation and submission of the offering plan, the approval for any additional expenditures in furtherance of dissolution and/or reconstitution shall require approval of two-thirds (2/3) of the dwelling units in the mutual housing company."**

Proposal # 6, elimination of §3-03(e) Removal, and further proposal to eliminate one paragraph of §3-02(i)(1). The proposal to eliminate the possibility of over-income eviction is warmly applauded by cu4ml. Indeed, we have urged in prior years that this regulation be deleted because it is obsolete and is not exercised, yet provides a potent weapon used by proponents of privatization to create fear among Mitchell-Lama cooperators that they are subject to eviction if they pay over-income surcharges.

We further recommend that the entirety of the fourth paragraph of §3-02(i)(1) be removed. This short paragraph refers to a "mandate of the housing company" to transfer to a smaller apartment – a mandate that does not exist for Mitchell-Lama mutual housing companies. (This is just housekeeping of the regulation, with the benefit that it removes another weapon used by proponents of privatization to make cooperators fear that they could be forced to leave their homes and "move down.")

Proposals # 3 and # 4, amendment of §3-02(n)(4)(iv) and §3-02(p)(3). One of the ways that the deck has been stacked in favor of making it appear that shareholders approve of withdrawing from Mitchell-Lama and going to free-market prices has been "warehousing" of apartments by non-resident shareholders, estate holders, applicants and boards. Some shareholders move to their other residences, only occasionally returning to the building to make an appearance. They do not redeem their Mitchell-Lama shares, hoping to "cash in" on the windfall profit that might be realized by sale of the shares on the free market. Some estate holders do the same because they are not occupants of an apartment permanently vacated by the death of the last resident shareholder. Such facts do not reveal themselves if the income affidavit is the only document required as proof of primary residence.

This game is also played by some applicants from the waiting list who legitimately obtain the shares of an apartment, but never move in, just hold the shares. Also, some boards do not promptly reallocate apartments vacated by deaths or (less commonly) voluntary move-outs, hoping for privatization of the emptied apartments so that the corporation might gain the full

private-sale prices, not just flip taxes, if such unoccupied apartments can be sold on the market.

In some coops, shareholders are not required to submit affidavits; they are allowed to accept the surcharge and thereby escape having to reveal either their incomes or their primary residences. In other coops, there are random audits of existing residents, and shareholders at, *e.g.*, St. Martin's, have had to submit to residency audits several times during the past 35-plus years. We hope that mandatory yearly reviews using income taxes and other proofs of residency will apply to all apartments in all the coops. The income affidavit is not enough.

Overall, the proposed rule changes requiring increased documentation and oversight of primary residency are critical to the security of the cooperatives. Proposal # 3 would increase the stringency of proof of primary residency of current shareholders by requiring submission of several forms of income documentation, not just the income affidavit, and Proposal # 4 would extend this increased oversight to assuring that any successor to an apartment adequately documents that the apartment has been and will continue to be the successor's primary residence. Cu4ml urges that HPD adopt and enforce these amendments.

Proposal # 8, amendment of §3-07(b). We recommend that, to be consistent with the five-year projection of needed repairs, the report of the "physical condition of the property and all appurtenant equipment" proposed by this amendment be required every five years, not an undefined "periodically." In addition, plans for financing of anticipated repairs should accompany each report. We also recommend that the report clearly include inspection of the condition of all unoccupied (vacant, in-estate, and warehoused) apartments. Such apartments seem particularly susceptible to deterioration through lack of use and therefore of upkeep, reducing the quality of the housing for current neighbors as well as its attractiveness to prospective shareholders.

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Cu4ml enthusiastically endorses adoption and enforcement of most of these amendments as proposed, and we are particularly eager that the changes (including the modifications we recommend) be adopted and published promptly. Finally, we urge enforcement of these revised regulations as well as of all the other regulations in which Mitchell-Lama residents have placed their trust and confidence.

Thank you for accepting our comments and for allowing us to appear at the hearing on September 13, 2011. We appreciate your studied efforts to improve the regulations and are eager to partner with HPD to preserve the Mitchell-Lama cooperatives.