The Co-op Discount

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Abstract

Cooperative and condominium housing differ in several ways that might be expected to influence their pricing. Most but not all of these differences argue for a higher valuation for condominiums. Hedonic equations estimated on a national sample indicate that the price differential on the average condo/co-op unit in 1987 was 12%. Condos maintain a price premium under a variety of specifications, although its magnitude depends on the bundle of attributes being priced.

Key Words: cooperative housing, condominium, house prices

Most owner-occupied housing in multiunit structures takes on one of two legal forms. One is condominium ownership, in which the occupant has title to a specific apartment and a part interest in common areas and facilities. The second form, cooperative, is a corporation that issues stock representing an ownership stake in the project and entitling occupancy of a specific dwelling. Initial share allocations are proportional to the size and amenities offered by the different units in the co-op project.¹

Debt financing in condo projects occurs via mortgages on individual units. Co-ops use a “blanket” mortgage (also known as a master mortgage, a project mortgage, or an underlying loan) on the entire project, with the co-op corporation as the borrower. In addition, if the project has appreciated over time, resales of individual shares are often financed by “share loans” to the individual owners. These share loans are collateralized by the shares.

Some co-ops have limited equity status, a vehicle for promoting preservation of affordable housing. In a limited equity cooperative, the cooperative corporation, through its bylaws, places a limit on the return allowed when shares are sold, with the intent of keeping the unit in the affordable housing stock, regardless of current market values.

Condos and co-ops thus differ in ways that might result in different market valuations for physically and locationally comparable units. This article discusses those differences and estimates their market importance.

1. Evolution of the Markets for Condos and Co-ops

Cooperative housing in the U.S. dates back to the 1870s. Prior to the early 1960s, real estate laws were such that the cooperative form of ownership was the only practical way of allowing occupant-ownership of units in multifamily structures. Many co-ops went bankrupt
during the depression of the 1930s, tarnishing the image of this type of housing. However, following World War II, the FHA introduced an insurance program for the “blanket” mortgages on cooperatives. This insurance program renewed lender confidence in co-ops, and it is estimated that half of all co-ops in 1970 had FHA insurance coverage of their mortgage.

Although there does not appear to have been any outright prohibition of condominium housing in 20th century U.S. markets, there was little development of this ownership form until the 1960s, when states began to enact enabling legislation. By 1967, all but one state had enacted condominium legislation. Condominium development expanded rapidly thereafter, especially during the 1970s, when the interaction of inflation and the tax code drove down the real cost of home ownership. Co-op growth lagged that of condos during this period, but accelerated during the 1980s, supported by new loan programs in the secondary mortgage market. Nonetheless, by 1991, condos outnumbered co-ops about six to one, with co-ops concentrated in the Northeast. Together, condos and co-ops account for about 5% of the nation’s housing stock.

We argue later that several aspects of co-op ownership impose economic externalities on owner-occupants. By limiting these externalities, condominiums may offer advantages over cooperatives, and these advantages may cause condo demand to exceed co-op demand. In many jurisdictions, however, the regulations faced by developers seeking to convert an existing rental project were less onerous for co-op conversion than for condo conversion (HUD, 1980), and this supply cost advantage benefited the expansion of cooperatives.

Nowhere was this supply cost advantage of cooperatives more apparent than in New York. New York City and its surroundings have always had a disproportionate share of the nation’s cooperative housing and today account for about one-third of the U.S. total. The expansion from World War II to 1970 seems driven largely by landlords’ desires to avoid the city’s rent-control constraints (Sahling and Stein, 1980). Even though New York State legislation in 1964 authorized condominiums, the tax-driven boom to owner occupancy in the 1970s in New York City was channeled mostly into cooperatives. Part of the reason for New York’s continued emphasis on co-ops was the relative ease of conversion to cooperatives, combined with the absence of much developable residential land in the city. In addition, both consumers and lenders in New York were already familiar with the cooperative form, and the information costs and illiquidity encountered elsewhere were less a factor in New York.

Another factor favoring co-ops in New York was the state usury law that, until the early 1980s, permitted interest rates on co-op blanket loans to exceed those on condos by one percentage point. Finally, perhaps in New York more than elsewhere, there was demand for the exclusivity more readily available through cooperatives than condos. We expand on this point later.

2. Sources of Different Market Valuations for Co-ops and Condos

Co-ops and condos differ in several ways that would be expected to lead to different market valuations of physically and locationally comparable units. The first four of these characteristics tend to lower the value of co-ops relative to condos, although the fifth could add to the value of co-ops.