

Mutual Benefit Organization as Ownership Option for MVMCC
Presented by Ann Gronvold on February 9, 2011
Edited to Include Answers to Questions and Comments at the Presentation

Our discussions about ownership cannot be separate from the basic issues that concern us all:

- 1) Affordability: we want to keep our monthly rents as low as possible
- 2) Quality of life: we want to be safe from having high density housing built on Park land to meet needs for low income housing in the City of Novato
- 3) We want to continue the good governing and financial management of the park.

In contemplating the possibility of ownership, we must ask: How will ownership affect these basic concerns?

My short answer is that we live in an imperfect world -- and whether we continue to be tenants of the City, with or without a 99 year lease, or pursue ownership through a Mutual Benefit Organization, the choice we make depends on what makes us feel most secure. I'm willing to bet there will be differences of opinion about what is the most secure option.

In our culture, the idea of owning your own land, collectively as a community or as an individual, has been raised to near sacred levels, as important as any constitutional right. So, naturally, emotions run very high, and in turn, that affects our opinions about what feels most secure and intensifies all our discussions.

Tonight, I'm going to talk about how ownership through a Mutual Benefit Organization would affect our month-to-month costs and our other basic concerns. In doing my research, I uncovered more questions than answers.

First, a few words about Mutual Benefit Organizations:

They come in two forms: Mutual Benefit Association & Mutual Benefit Corporation.

They are virtually identical in the eyes of the law, but because of the size of our community, it is more advantageous to have a Mutual Benefit Corporation for two reasons:

- 1) Board members and volunteers are slightly better protected from any liability in the unlikely event of a law suit
- 2) Many business and service companies won't sign contracts with an Association, but they will do business with a corporation.

The law that governs Mutual Benefit Corporations is the Davis Stirling Act.

A bit of background history --

Multi unit housing communities, now called Community Interest Developments or CIDs began to happen in the 1960's when land prices became too expensive for many people to own their own homes.

But thousands of these communities did not maintain their property. (For many reasons -- not least was because developer/owners pocketed rents rather than maintaining the property or establishing reserve funds to cover such expenses.) By the 1970's these multi-unit housing developments were turning into slums. The State of California had to step in to bail them out at taxpayer expense.

It was a huge strain on an already strapped State budget, and a huge problem for local communities.

To resolve the problem, the California State Legislature UNANIMOUSLY enacted the Davis Sterling Act in 1986. In fact, the law was so strongly supported that Governor Gray Davis insisted that his name be put on the bill before he'd sign it! (Hence Davis-Sterling Act).

One of the Act's key purposes is to support and help Home Owner Associations succeed.

Davis-Stirling has built in a variety of measures that protect homeowners, ensuring that the communities will be adequately maintained and well managed. For example: making income from rents non-taxable as long as they are used for running and maintaining the property; outlining procedures for conflict resolution within the community that include mandatory use of public mediation and arbitration services; outlining election procedures that mandate hiring an outside, independent inspector to oversee elections to be sure they're fair.

So, we have a law with built-in directives and protections that support ownership as a Mutual Benefit Corporation.

If we take this path, how would owning the park through a Mutual Benefit Corporation affect our bottom line?

1) Affordability

34% of our monthly rents goes to paying off the bonds. Once the bonds are paid off, the rents can be reduced. Although, given the long term refurbishing and maintenance projects we have, our rents would not drop that full amount.

A future concern is that AG, the New York Corporation that insures the bonds, insists that rents be raised to the maximum possible each year, whether or not it's financially necessary.

The only way to avoid this requirement to raise our rents is by refinancing -- and we can do that whether or not we have title to the park.

To refinance, we'd have to pay a big up-front expense to set up the loan with the bank. Plus something like a \$400,000 fee to AG for their premium for insuring the bonds. Bottom line: Would it reduce our rents? If so, then it might make sense.

A huge unknown is will the City be willing to transfer title to the Park once the bonds are paid off?

If not, how much more will we need to pay? And how much would our monthly rents increase?

These are huge unknowns, and without any concrete numbers or concrete information, without the advice of qualified legal and financial experts, we cannot intelligently discuss ownership or make an informed decision.

Tax costs.

There are income taxes paid to the State and Federal Government.

And there are real estate taxes.

Income taxes are not really an issue, and I'll talk about that shortly.

Real estate taxes are a big issue.

As long as the City owns the Park, we do not pay Real Estate Taxes.

Instead, we pay in-lieu-of-taxes to cover the City's costs.

It's something like \$67,000 a year.

And the in-lieu-of-taxes are raised annually by 75% of CPI.

If we became owners through the Mutual Benefit Corporation

We would be responsible for Real Estate Taxes

We need to know what is the actual difference between the amount we now pay for in-lieu-of-taxes and the amount we'd owe for real estate taxes.

Although our rents would be reduced by an unknown amount once the bonds are paid off, would that amount compensate for possible increases we'd owe for real estate taxes plus payments on any loans that we would have to take out?

And if not, can we afford it?

As a Mutual Benefit Corporation we can apply to the County of Marin for an exemption or partial reduction of real estate taxes. I've been told that this has been explored and the answer is no.

Until we have the actual numbers for the costs, we cannot make a reasoned decision on this.

Any tax exempt non-profit corporation would also have to pay real estate taxes -- we all have to pay real estate taxes. Even the churches do!

Income Taxes

As long as funds received (ie our rents) are used to maintain and run the park, we do not, at law need to pay taxes. Even if, at the end of the year, after everything is paid off, there's a surplus, that "profit" is not taxable as long as it is carried over to the next year and designated for park maintenance, including cash reserves in case of emergencies or for repairs and replacements of infrastructure

However, any profits we make from other activities, like Pub night, our Gala Dinners, Bingo -- these are not considered a necessary expense of running and maintaining the park. So profits from these activities are taxable.

The same rule applies to any non-profit tax-exempt corporation -- any net income from activities or events that are not directly related to running or maintaining the park would be taxable.

It is possible to apply to be Income tax-exempt at the state and federal levels. Based on my reading, I'm not sure it's necessary, but if we go down this route we should consult with a qualified attorney who is an expert in Community Interest Development Law.

2) Fear of high density housing being imposed on the park

Unfortunately, we have no guarantees.

And ownership is no protection. There's something called eminent domain, where a government can determine they need land for the public good, and force an owner to sell their land -- usually at well below market rates.

This is really unlikely based on how I've observed the City of Novato operate. But it's important to be aware that there's no magic way to prevent it either -- and even people in private homes have no guarantees if they are on land that the government determines is necessary for public benefit.

It might be worth our while for our peace of mind to find out what building restrictions exist since we border both wetlands and TPL land. I know that we are not able to install a security gate on our road because there must be 24-hour access to wetlands.

3) Continued good governance and management of the park.

Under the Davis Stirling Act, there are many built-in requirements and procedures that a Home Owners Corporation must follow.

As residents, the responsibility of ownership of the Park falls on us, and we must address questions like:

Currently a small percentage, maybe 10% of the park residents show interest by coming to meetings about the park -- like this one or our regular PAC and HOL meetings. And when there are openings on the board a number of residents do not even vote. I believe that's a problem if we become self-owned, for it sets up a situation where a small minority can have way too much power. How do we encourage resident owners to become sufficiently aware of what's going on the park to have self-government make sense?

How do we ensure that there will be sufficient numbers of people who are competent and willing to serve on our board and manage the park?

How can we ensure that they have sufficient education of relevant laws, financial & accounting practices, and any other relevant expertise that is necessary to good management. Is it possible to pay for some kind of training for new board members? There might even be videos of some trainings and other sources of info that we could obtain for not a great deal of cost.

Once the city is gone, we lose access to their staff, and their resources of skill, knowledge and expertise in legal and financial matters.

Where can we turn, and at what cost, to find that level of expertise and knowledge?

Ultimately, our discussions must include the City and address the Council Members concerns not just for our community, but their concerns as representatives of all the residents of Novato.

There seems to be two different mind-sets here in the Park: those who think that the City doesn't care about us, that they're only interested in this property as an asset; and those who believe that the City Council Members believe in public service, truly have our best interests at heart, and are doing the best they can.

My own, personal sense is that the Council Members are still discovering, learning and thinking about what we're doing here, what's involved, and haven't made up their mind, and haven't set a definite course yet on the subject of ownership.

But apart from that, in life, I just think it makes the best sense to believe people are doing their best they can. And then you're much more likely to have good conversations and collaboration to come up with a solution that everyone is reasonably comfortable with.

So I'd like to end my presentation tonight with a plea -- in this imperfect world there are no perfect solutions. Each one of the options we're looking at and those we may look at in the future, has benefits and drawback.

I'm continually blown away by how many thoughtful, smart, creative people live in our Park. Let's get together on this, and let's get creative.

What do you like about each option put forward. What could you not live with in a plan that still has some features you do like. Let's talk about them, and then we can come up with a basic option that works, and explore ways to bring in or compensate for features we like from other plans, and wind up with the best possible solution of all. Not perfect, but one that works well enough for everyone concerned.

Information that came out in questions after the presentation:

How would it look day-to-day? I'm not sure, and can only offer my own opinion. We already have the structure in place -- PAC is a mutual benefit corporation. And the board has been doing a bang up job of managing the Park in recent years. If we decided that PAC would take title to the Park, before that title passed from the city, I think we would want to revisit and review its by-laws and update, upgrade, and perhaps improve them. Also, we might want rename PAC. But we would not have to create the Mutual Benefit Corporation from Scratch.

I believe that day-to-day would look pretty much the same, it would just be running the Park on our own, without any help or directives from the City.

Every homeowner in the park would automatically become a member of the Mutual Benefit Corporation with an indivisible ownership share in the whole Park. As an analogy, it's as if we all owned the sky -- each one having an undivided ownership interest in the sky, but we all own the whole sky together.

One option for assuring consistent, competent and sufficiently knowledgeable management of the Park is to hire a CID licensed manager/company. Currently managers and management companies are not required by the State to be licensed to manage a CID, but it is an option. Hopefully having a state-approved CID management company would imply good quality.

Finding a lawyer

CID (Community Interest Development Law) is an important and growing field of legal expertise -- We want someone who really understands the big picture and has had the experience to tell us where we fit in to the big picture, what's required and how it would work. What we don't want is someone who's had 5 or 6 cases, throws up a lot of words on their website to sound savvy, but whom you can't understand. If he or she makes things terribly complicated and you don't understand what they're saying, they're not any good. Remember, if he or she is representing you, they're going to be dealing with other people on your behalf -- and if the other people can't understand that attorney either, it's going to waste a lot of time and money.

I did find, on line, an attorney in San Rafael who not only practices CID law, but teaches seminars and has been rated 5 out of 5 stars by his colleagues through Martindale & Hubbell, for integrity, knowledge and skill. When he works with clients, he gives them a detailed plan of action up front, before you've agreed to hire him, so you know exactly how much it will cost -- no hidden surprises down the road. I've passed his name onto the Forum Committee.

Do we put together the plan for a Mutual Benefit Corporation first and then approach the City of Novato, or do we have to get title from the City first?

I believe the two go hand-in-hand. There's too much information we need from the City. Moreover, it's important to collaborate with the City in making this happen -- by working collaboratively we'll wind up with something that works best for all parties.

Clarification re “Nonprofit Tax-exempt Corporation: Non-profit means you’re not in it for the money. The law lists the things that are officially “non-profit”, for the greater good purposes. Once you have non-profit corporation status, you file with IRS to get a 501c3 tax-exempt status. This, in turn, can be submitted to the State Franchise Tax Board to get tax-exempt status at the state level.

However, the tax-exempt status at the federal and state level ONLY applies to income taxes. It does not apply to real estate taxes. A 501c3 still has to pay real estate taxes.