

Memorandum 2020-30

**Stock Cooperatives and Uniform TOD Security Registration Act:
Property Restrictions**

In this study, the Commission¹ is considering whether the Uniform TOD Security Registration Act (“Uniform Act”)² could be adapted for use in making a nonprobate transfer on death of an interest in a stock cooperative. This study was prompted by the Commission’s recommendation that the Revocable Transfer on Death Deed (“RTODD”) not be made applicable to such an interest. As the Commission explained:

A stock cooperative is a kind of common interest development where the entirety of the development is owned by a corporation formed for that purpose. The owners of separate interests hold shares in the corporation, which entitle them to the exclusive right to occupy a specified apartment. Owners do not hold title to any part of the development.

As a result, ownership of a separate interest in a stock cooperative is not evidenced or conveyed by deed. Instead, it is conveyed by the sale of a share of stock. For that reason, a deed would not be an appropriate instrument to use to transfer ownership of a separate interest in a stock cooperative. A deed conveys title to real property, not the ownership of a share of stock.

To avoid any confusion or legal problems that would result from the mismatch between the use of a deed and the form of ownership in a stock cooperative, the Commission recommends that stock cooperatives continue to be excluded from the definition of “real property” that is used in the RTODD statute.

That approach would deny owners in stock cooperatives the benefits of using an RTODD. However, it is possible that a share of ownership in a stock cooperative could be transferred on death, outside of probate, under the existing Uniform TOD Security Registration Act. The Commission plans to conduct a separate study

1. Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission’s website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission’s staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting. However, comments that are received less than five business days prior to a Commission meeting may be presented without staff analysis.

2. Prob. Code §§ 5500-5512.

of that possibility, under its general authority to study the Probate Code.³

One of the issues that needs to be addressed if the Uniform Act is adapted to apply to stock cooperatives is how to handle the property restrictions that are common in these developments. That is the subject of this memorandum.

Unless otherwise indicated, all of the statutory citations below are to the Probate Code.

PROPERTY RESTRICTIONS

Reportedly, it is relatively common for stock cooperatives to impose the following types of restrictions on their members' property interests:

- Occupancy requirements
- Buy-back options.

The staff does not have data on how common such restrictions are. However, for the purpose of the analysis that follows, it is sufficient to know that they exist and to understand their general character. That understanding should enable the Commission to tailor the Uniform Act so that it achieves its purpose without disturbing any existing restrictions.

Occupancy Requirements

Some occupancy requirements turn on objective criteria, such as age (in senior communities) or income level (in units dedicated as low-income housing). A person who does not meet the requirements may not occupy the unit. For example, one occupancy agreement contains the following restriction:

The Member acknowledges and agrees that [stock cooperative]⁴ is a senior citizen housing development and, therefore, that residency in the dwelling unit is restricted to persons 55 years of age or older and to certain other qualified permanent residents. The Member agrees to reside in, occupy and use the dwelling unit in conformity with the age restrictions sanctioned by California Civil Code Section 51.3, as hereafter amended, and any successor statute thereto. Any occupancy, for any duration, of the dwelling unit by a

3. See *Revocable Transfer on Death Deed: Follow-Up Study*, 46 Cal. L. Revision Comm'n Reports 135, 157 (2019) (footnotes omitted).

4. While the staff has been permitted to informally review some stock cooperative governing documents, it is not clear that permission was given to disclose them publicly. For that reason, excerpts from those documents are reproduced without attribution and with redaction to conceal the names of the associated stock cooperatives.

person other than a Member, and visitation by third parties with any Member or non-Member occupant of a dwelling unit, shall be upon all terms and conditions set forth in this Occupancy Agreement, in the articles, bylaws, rules and regulations of the Corporation...

In some stock cooperatives, the board of directors must affirmatively approve any new occupant. An applicant who is not approved may not occupy a unit. For example:

Members shall consist of such persons as have been approved for membership by the Board of Directors and who have paid for their stock and received stock certificates, and have executed an Occupancy Agreement. The Board may adopt such guidelines as it determines appropriate setting forth standards for the approval for membership including, but not limited to, minimum levels of income and assets, maximum debt to income ratios, credit scores, etc.

Buy-Back Option

In some stock cooperatives, the corporation reserves a right to purchase a unit when the occupant's membership ends, either as a result of the member's death or departure. For example:

Section 4. Transfer of Membership. Except as provided herein, membership shall not be transferable.

(a) Death of Member. If, upon death of a Member, such Member's stock in the Corporation passes by will, trust or intestate distribution to a member of the Member's immediate family, such legatee or distributee may become a Member of the Corporation, subject to approval by the Corporation, execution of a new Occupancy Agreement and payment of all amounts due thereunder within sixty (60) days after Member's death. If the Member dies and an obligation is not assumed in accordance with the foregoing; then the Corporation shall have an option to purchase the stock from the deceased Member's estate in the manner provided in paragraph (b) of this Section, written notice of the death being equivalent to notice of intention to withdraw. If the Corporation does not exercise such option, the provisions of paragraph (c) of this Section shall be applicable, the references to "Member" therein to be construed as references to the legal representative of the deceased Member.

(b) Option of Corporation to Purchase. If the Member desires to leave the Corporation, the Member shall notify the Corporation in writing of such intention and the Corporation shall have an option for a period of thirty (30) days thereafter, but not the obligation, to purchase the membership, together with all the Member's rights with respect to the Dwelling Unit, at an amount to be determined by the Corporation as representing the transfer value thereof, less any amounts due by the Member to the Corporation. The purchase by

the Corporation of the membership will immediately terminate the Member's rights and the Member shall forthwith vacate the premises.

(c) Procedures Where Corporation Does Not Exercise Option. If the Corporation has waived its option to purchase the Member's share of common stock, pursuant to the preceding subparagraph (b), and the Member transfers his/her share to an approved transferee, then the Member shall be required to pay a transfer fee in an amount that the Corporation shall from time to time determine to be payable by the Member for all expenses incurred in connection with the transfer, and including any reasonable sum determined by the Corporation in consideration of its waiver of the Corporation's option to purchase the Member's share of common stock. When the transferee has been approved for membership and has executed the prescribed Occupancy Agreement, the retiring Member shall be released of his/her obligations under the Member's Occupancy Agreement, provided the retiring Member has paid all amounts due the Corporation to date.

That kind of purchase option is probably most useful in a stock cooperative that is formed as a "limited equity housing cooperative" ("LEHC").⁵ In such a development, a fixed "transfer value" is paid for a separate interest. The corporation holds any additional equity that accrues due to a rise in market value over time. Thus, the LEHC maintains the affordability of its units, by keeping their price artificially low.

It seems likely that the right of the cooperative to buy a separate interest back on the owner's death would be the easiest way to implement such price controls.

DISCUSSION

Any statute that authorizes a nonprobate transfer of a separate interest in a stock cooperative should be designed to preserve the enforceability of any lawful restriction on that interest. The staff believes that this can be achieved by codifying principles that already govern the inheritance⁶ of a separate interest by will, intestacy, or trust. This is discussed further below.

Occupancy Restrictions

An occupancy restriction of the type discussed above is binding on all owners in a stock cooperative and is designed for their mutual benefit. It is an enforceable

5. See Civ. Code § 817.

6. For ease of explanation, this memorandum uses variations of the terms "inherit" and "heir" in their colloquial, rather than technical sense. They are meant to refer to any transfer of property on death, whether by will, intestacy, or nonprobate transfer.

limitation on the owner's property interest. It should not be circumvented by an at-death transfer of the property.

That issue is not new. It already exists when a separate interest owner dies and that person's separate interest passes to an heir by will, intestacy, or trust. The person who inherits the separate interest may be ineligible, under the stock cooperative's governing documents, to occupy the property. In that case, what is the result?

The answer would seem to turn on the fact that the *ownership* of real property can be separated from the right to *occupy* that property. For example, a lessor retains ownership of leased property notwithstanding the fact that the lessor has surrendered the right to occupy it. The lessor still *owns* the property, but that ownership is subject to a restriction on the *use* of the property.

With that understanding, it should not be a problem if an owner's heir is ineligible to occupy an inherited interest in a stock cooperative. While the heir would not be able to reside on the property, the heir would still hold title and could sell the property to realize its value. This would effectuate the deceased owner's testamentary intention, that the heir receive a valuable gift, without disturbing a lawful restriction on the property's use.

In a prior memorandum, the Commission received input on this point from an attorney who specializes in common interest development law, Kelly G. Richardson. He affirmed the staff's understanding of how this works under existing law:

I work with a number of age-restricted communities, and the age restriction often is only as to residing there, not owning. So someone who was not age-eligible might still own the residence and rent it to someone who was age-eligible.⁷

The general principle discussed above, that an at-death transfer of an interest in real property should not defeat an enforceable limitation on the transferor's ownership, was codified in the RTODD statute:

Property is transferred by a revocable transfer on death deed subject to any limitation on the transferor's interest that is of record at the transferor's death, including, but not limited to, a lien, encumbrance, easement, lease, or other instrument affecting the transferor's interest, whether recorded before or after recordation of the revocable transfer on death deed. The holder of rights under that instrument may enforce those rights against the property

7. Memorandum 2018-59, Exhibit p. 5.

notwithstanding its transfer by the revocable transfer on death deed.⁸

That principle seems equally sound when applied to a nonprobate transfer of a separate interest in a stock cooperative.

Buy-Back Option

A transfer of a separate interest in a stock cooperative should not defeat the cooperative's reserved option to buy the interest back on the owner's death.

As discussed above, such an option may be especially important in an LEHC. It enables the LEHC to keep control over every transfer of a separate interest, allowing it to ensure the enforcement of the transfer value price control. It also allows an opportunity for the LEHC to carry out vacancy controls, like inspection and repairs, while allocating the costs of those measures to the departing owner.

In the stock cooperative governing documents that the staff has reviewed, when a stock cooperative purchases the separate interest of an owner who has died, the price is paid to the decedent's "estate." Presumably, the estate then distributes that amount to the appropriate heir.

That seems like the proper result.

Recommendation

The staff does not see an irreconcilable conflict between the right to inherit a separate interest in a stock cooperative and the continued enforcement of restrictions that burden the property. The heir can receive the value of the property, without disturbing existing restrictions on that property, if the principles discussed above are codified. That could be done with language along the following lines (with brackets showing language that would be contingent on the numbering and location of the provision):

§ [____]. Restriction on transferred property

[____]. (a) A separate interest in a stock cooperative that is transferred pursuant to [this part] remains subject to any limitation on the transferor's interest that was enforceable against the separate interest at the time of the transferor's death, including, but not limited to, a restriction on occupancy, an option to purchase the membership on the transferor's death, a limitation on the transfer value in a limited equity housing cooperative, a lien, an encumbrance, an easement, or a lease. The holder of those rights may

8. Section 5652(b).

enforce them against the separate interest notwithstanding its transfer pursuant to [this part].

(b) Except as provided in subdivision (c), property may be transferred pursuant to [this part] even if the beneficiary is not eligible, under the governing documents of the stock cooperative, to occupy the transferred property.

(c) If a separate interest is registered in beneficiary form pursuant to [this part] and the stock cooperative exercises an option to purchase the separate interest on the owner's death, the result is as follows:

(1) The separate interest is transferred to the stock cooperative rather than the beneficiary.

(2) The purchase price is paid to the beneficiary.

(3) Unless the law or the governing documents of the stock cooperative provide otherwise, the price to be paid is the fair market value of the separate interest, less the amount of any liens or encumbrances on the property at the time of the owner's death and any amount that the decedent owed the stock cooperative.

Comment. Subdivision (a) of Section [___] provides that a separate interest that is transferred pursuant to [this part] remains subject to any interests or limitations that were enforceable against it at the time of the transferor's death. For a comparable provision, see Section 5652(b) (revocable transfer on death deed).

Subdivision (b) provides that a separate interest may be transferred to a beneficiary who is not eligible to occupy the separate interest (e.g., the beneficiary is too young to reside in an age-restricted community). Such ineligibility does not affect the beneficiary's ability to transfer the property to another person.

Subdivision (c) addresses the effect of registration in beneficiary form when a stock cooperative exercises an option to purchase the registered property on the owner's death. Paragraph (3) of that subdivision makes clear that the price paid to purchase a separate interest may be limited by law or the governing documents of the stock cooperative. For example, in a limited equity housing cooperative, the amount paid will be based on a specified transfer value, rather than fair market value. See Civ. Code § 817.

The staff recommends that a provision along those lines be approved for inclusion in a tentative recommendation.

In addition, the staff invites public comment on whether the provision above anticipates and properly addresses all of the issues that could arise when effecting an at-death transfer of a separate interest in a stock cooperative that is burdened by restrictions in the governing documents.

Respectfully submitted,

Brian Hebert
Executive Director