



Mortgage on cooperative housing

On April 8 2009 a decision of the High Court of Eastern Denmark agreed with the arguments presented by a cooperative housing association stating that it could not approve the buyer in question as member of the cooperative. The reason for this was that the buyer, Thomdahl A/S, was a business entity that could not meet the residency requirement stated in the cooperative's articles.

The case in brief

The case involved a member of a cooperative housing association who had mortgaged his share certificate. When the owner subsequently defaulted on the payments to the secured creditor, foreclosure proceedings were commenced.

Thomdahl A/S, the secured creditor, wanted to acquire the cooperative housing association with the intention of subsequently selling it to a third party.

On February 27 2009, the Enforcement Court awarded the buyer, Thomdahl A/S, the cooperative housing association as a result of the foreclosure proceedings. The Enforcement Court concluded that, provided that the acquisition took place with the intention of subsequently selling the property to a third party, the residency requirement did not preclude the secured creditor from acquiring the property through foreclosure, even though the secured creditor, as a business entity, could not meet the residency requirement.

The cooperative housing association appealed the decision to the High Court of Eastern Denmark.

It argued that it could not approve the buyer as an owner, because the buyer did not meet the residency requirement of Section 3(4) of the articles.

The legal background

Act No. 204 of March 29 2004 amended the existing Act on Cooperative Housing Associations and other Cooperatives, making it possible for a member of a cooperative to grant a creditor a mortgage on the owner's share certificate.

Pursuant to Section 509(2) of the Danish Administration of Justice Act, a secured creditor may levy execution on cooperative housing.

Moreover, pursuant to Section 559a(6) of the Administration of Justice Act, a foreclosure auction may take place according to the terms and conditions applicable to foreclosure of cooperative housing, as determined by the Minister of Justice through consultation with the Minister of Economic and Business Affairs. Pursuant to item 4 of the terms and conditions, awarding ownership of shared ownership property through foreclosure proceedings is conditioned upon the cooperative housing association's final approval of the buyer.



The decision of the High Court of Eastern Denmark

The Eastern High Court concluded that the Enforcement Court should not have awarded the buyer ownership, because the articles of the cooperative housing association contained a provision pursuant to which members of the cooperative were obligated to live in the apartment. Consequently, the association could not approve the buyer as a member.

A condition requiring use of the apartment entails a residency requirement. In relation to cooperative housing, this is also the general rule. It is for this reason that the High Court of Eastern Denmark concluded that business entities cannot be members of cooperative housing associations.

Great deference is thereby given to the provision in the articles regarding residency requirement.

Consequently, the High Court of Eastern Denmark reversed the Enforcement Court's decision of February 27 2009, and referred the case back to the Enforcement Court for reconsideration.

Conclusion

Based on the decision of the High Court of Eastern Denmark of April 8 2009, it can be concluded that a secured creditor can levy execution on cooperative housing and commence foreclosure proceedings, but the creditor cannot be certain that he or she will be awarded ownership, and thereby enforce the security, in that the cooperative housing association must provide final approval.

The issue that business entities and secured creditors face can therefore not be resolved by for instance subletting the apartment or through subsequent sale to a third party, in that the residency requirement will not be met. Secured creditors who wish to provide loans to members of cooperative housing can, however, resolve the issue by conditioning the loan on the non-existence of a residency requirement provision in the articles.

The Court's decision leads to uncertainty, not only for financial institutions who have lent money to members of cooperative housing associations, but also for those members who in the future wish to obtain a loan secured by mortgage on the share certificate, in that financial institutions are now going to be less likely to provide loans under these facts. Should financial institutions nevertheless decide to provide loans to members of cooperative housing associations, the risks associated with such a loan will be reflected in the higher interest rate, which in turn may deter potential purchasers from acquiring housing in the cooperative.

Recommendation

Based on the above, we are of the opinion that financial institutions who acquire a mortgage on share certificates should ensure that nothing in the cooperative's articles will preclude the institution from foreclosing on the property, in the event that the debtor defaults on the loan. Additionally, the financial institution should include a provision in the loan agreement that will provide for the immediate payment of the entire debt, should the articles subsequently be amended to the detriment of the institution.



It should be noted, however, that the issue will only be relevant in those situations where the cooperative housing association cannot approve the purchaser of the cooperative housing association. Foreclosure proceedings where the purchaser is an actual physical person who intends to occupy the apartment, should not present any issues for the secured creditors, provided that the purchaser is able to meet any other requirements that may be applicable pursuant to the cooperative's articles.

The issue will also be relevant when personal bankruptcy is involved, in which case the trustee is required to sell debtor's assets. According to the decision of the High Court of Eastern Denmark of January 13 2006, the trustee assumes debtor's entitlement to dispose of the property. Consequently, contrary to the above outlined scenario, the trustee can dispose of the property and sell it to a third party.

In the event the trustee sells the property to a third party, the trustee must pay special attention to the articles of the cooperative housing association, since the mortgaged asset can only be disposed of if the purchaser can meet the requirements of the articles.

It should be noted that upon the conclusion of the Danish Parliament's 2009 holiday period, the legislature is likely to propose an initiative that will settle the legal status that the Court's decision places secured creditors of cooperative housing in, as there is a risk of increasing losses for those creditors. Note also that the Minister of Justice has recommended that the Danish Parliament take action.

If you have questions regarding the above or require additional information about mortgages on shared ownership property, please contact attorney Thomas Weitemeyer (twe@mwblaw.dk) or junior associate Helga Johannesen (hjo@mwblaw.dk).

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