

POLICY GUIDELINES

IN PLAIN LANGUAGE FOR

CO-OPS FINANCED UNDER

SECTION 61 (FORMERLY 34.18)

AND SECTION 27 (FORMERLY 15.1)

OF THE NATIONAL
HOUSING ACT

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FOREWORD

The Agency for Co-operative Housing (“the Agency”) has drawn up these easy-to-read guidelines for co-op members and managers. The guidelines explain

- how the S27/ S61 (formerly 15.1/34.18) Co-operative Housing Program works
- a co-op’s duties under its operating agreement with Canada Mortgage and Housing Corporation (CMHC)
- other CMHC policies that apply to the co-op.

Next to many of the titles in the guidelines there is text in italics. It points to the related clause in the operating agreement or CMHC Commitment Letter. Clause numbers given agree with those found in the sample agreements at the end of these guidelines. The clause numbering in your own operating agreement may differ. If there is no text *in italics*, it means that the rule is not in the operating agreement. Instead it comes from a CMHC policy. Sample operating agreements are attached as Appendix A and Appendix B.

These guidelines interpret but do not replace CMHC’s policies. CMHC’s policies govern wherever they conflict with these guidelines.

The operating agreement is the legal contract between the co-op and CMHC. If it conflicts in any place with these guidelines or CMHC’s policies, it governs. Note that a co-op with a financial workout from CMHC will have other duties. These are set out in a workout agreement. In places that agreement may take priority over the operating agreement.

The Agency oversees the S27 and S61 programs on CMHC’s behalf in British Columbia, Alberta, Ontario and Prince Edward Island. Wherever these guidelines refer to the Agency, it means “the Agency, on CMHC’s behalf.”

Special Note for Co-ops Funded under Section 27 (Formerly 15.1) of the *National Housing Act*

The S61 and S27 programs are very similar. These guidelines cover both. However, some of the program details vary. As well, some of the operating agreements and Commitment Letters for S27 co-ops are different. Paragraphs 22.1 to 22.3 of at the end of these guidelines point out these differences.

Special Note for Co-operatives Begun under the Section 27 Program and Continued under the Section 61 Program

Certain co-operatives originally financed under the S27 Program were later converted to the S61 Program. They may or may not have signed a new operating agreement. If they did not, the conditions specific to the S61 Program will be found in the S61 Commitment Letter.

PURPOSE OF THE GUIDELINES

These guidelines were written to help co-operatives understand the S61/27 Program operating agreements and related CMHC policies.

GENERAL

1.1 Purpose of the Operating Agreement

The operating agreement is a legal contract between the co-operative and CMHC. It sets out what the co-op must do in return for financial assistance from the federal government. The letter in which CMHC first agreed to finance the co-op's development sets out more requirements ("Commitment Letter").

1.2 Housing Low-Income Occupants [S61: Paragraph 2(c)]

Note: Some S27 agreements have a different provision on this topic. See section 22 of these guidelines.

The operating agreement sets out the percentage of units available for low-income occupants when the co-op started.

1.3 CMHC's Right to Withdraw Assistance [S61: Paragraph 7; S27: Paragraph 7]

If the co-op does not follow the operating agreement, CMHC may require repayment of the unearned portion of the capital grant it made to the project. (See section 3.2 of these guidelines.)

1.4 Term of the Agreement [S61: Paragraph 12; S27: Paragraph 11]

The operating agreement is in effect until the mortgage loan is fully repaid.

1.5 Changing Incorporating Documents [Commitment Letter]

The co-op's Articles of Incorporation set out its non-profit nature. The *National Housing Act* (NHA) defines non-profit.¹ The co-op needs the Agency's written consent to change its Articles of Incorporation.

¹ The definition in the NHA is: "Non-profit corporation' means a corporation, no part of the income of which is payable to or is otherwise available for the personal benefit of any proprietor, member or shareholder thereof."

MANAGEMENT AND MAINTENANCE

2.1 Good-Management Requirement [S61: Paragraph 8; S27: Paragraph 7]

The co-op must provide efficient management of the property and keep it in good repair. It can hire its own staff or a property-management company. If the co-op wants to hire a management company, it needs the Agency's written approval before signing the contract.

2.2 Property Inspections [S61: Paragraph 8; S27: Paragraph 7]

The Agency has the right to inspect the co-op's property. It must give the co-op reasonable notice before doing so.

- The Agency's normal practice is to inspect co-ops deemed to be at risk every two years.
- A normal inspection is limited to a visual study of the building exterior, any vacant units, grounds and building common areas.
- The inspector looks at the property's overall upkeep. This includes standards of cleanliness, maintenance and repair. The inspector brings any health or safety concerns to the co-op's attention right away. Later on, the Agency sends the co-op a report with other findings.
- If it has other concerns, the Agency may decide to inspect occupied units or carry out a full physical inspection of the property.

2.3 Loan Repayment [S61: Paragraph 6; S27: Paragraph 4]

The co-op must make its monthly mortgage payment on time.

FEDERAL ASSISTANCE

3.1 Types of Federal Assistance

The co-op may have received three types of federal assistance:

- a capital grant to cover ten per cent of the cost of purchasing and developing the co-op property
- a mortgage rate of eight per cent, which was lower than market rates at the time
- a forgivable Residential Rehabilitation Assistance Program (RRAP) loan.

3.2 Capital Grant [Commitment Letter]

CMHC provided a loan to cover 100 per cent of the co-op's approved development costs. The co-op makes monthly mortgage payments based on 90 per cent of the loan amount. The other ten per cent is forgiven in equal monthly amounts over the full life of the mortgage. This assistance is known as the capital grant.

3.3 Interest Reduction Grant [*Commitment Letter*]

In some cases, the mortgage was written at an interest rate of eight per cent. In other cases, the rate was higher but the co-op repays the loan at eight per cent. The difference is considered a subsidy.

3.4 Residential Rehabilitation Assistance Program (RRAP) Loan

If the co-op bought existing housing that needed repairs, the work was paid for in part with a forgivable loan from CMHC. While legally a loan, the co-op made no payments on it and over ten years it was written off.

HOUSING CHARGES [*S61: Paragraph 2(A, B, E); S27: Paragraph 1(1B), 2, 5*]

4.1 Setting Housing Charges

CMHC set out the co-op's first-year housing charges in the operating agreement. After year one, the co-op decides how much it needs to charge in order to cover its costs.

4.2 Approval of Housing Charge Changes

The operating agreement says that CMHC must approve any change in housing charges. CMHC later suspended this requirement.

INGOING INCOME LIMITS

5.1 Requirement to Serve Low-Income Persons [*S61: Paragraph 2(b); S27: Paragraph 1(1a)*]

The operating agreement says the co-op must have a subsidy-surcharge system. (See paragraph 6 below on surcharges.) If the co-op does not want this system, CMHC allows ingoing income limits instead. The intent either way is to ensure that the co-op is housing persons with low incomes.

5.2 Ingoing Income Limits

See 5.1 above. If the co-op applies ingoing income limits, a household's income at the time of move-in must not be above Statistics Canada's "second quintile" of family income for that province. The Agency provides the co-op with this information every year.

5.3 Enforcing the Ingoing Income Limit

A co-op may ask for relief from the ingoing income limit if it cannot find eligible occupants. The Agency may approve an increase to the income limit in order to reduce vacancy loss and ensure that the co-op can cover its costs.

5.4 Household Income Exceeds Income Limit

The income limit applies only at the time of move-in.

5.5 End to Ingoing Income Limits

In the five years before the mortgage is fully paid off, ingoing income limits no longer apply.

5.6 Verification of Income [S61: Paragraph 3(a); S27: Paragraph 1(3)]

The agreement says that the co-op must confirm the income of occupants before move-in and at least once every 30 months after that. However, ongoing income checks are not needed in co-ops that use income limits instead of a subsidy-surcharge system.

5.7 Definition of Household Income [S61: Paragraph 2(d); S27: Paragraph 1(4b)]

Income means total gross household income, less

- living out or travelling allowances
- earnings of a second income earner up to \$1,000 a year
- the first \$1,000 of income not from social assistance payments for a one-parent family
- \$300 per dependent child
- capital gains
- family and youth allowance.

SURCHARGES

6.1 Definition and Purpose

A surcharge is an amount added to the monthly housing charge based on a household's income. If the co-op chooses surcharges instead of ingoing income limits, the surcharge revenue must be used to subsidize the housing charges of lower-income households.

6.2 Surcharge Amounts [S61: Paragraph 2(f); S27: Commitment Letter]

The operating agreement or Commitment Letter sets out surcharge amounts and when they apply.

Surcharges apply based on this formula:

- (a) Households with a monthly income up to 4.5 times the housing charge pay no surcharge.
- (b) Households with a monthly income more than 4.5 and up to 4.75 times the housing charge pay the housing charge plus one third of the surcharge.
- (c) Households with an income above 4.75 and up to 5 times the housing charge pay the housing charge plus two thirds of the surcharge.
- (d) Households with an income above 5 times the housing charge pay the housing charge plus the full surcharge.

Whenever the co-op raises its housing charges, it has to set new surcharge amounts.

6.3 Decrease in Surcharge

The co-op can ask for Agency approval to reduce the amount of the surcharge if the housing charge plus the surcharge is more than the rent for similar rental units in the area.

RENT SUPPLEMENTS

7.1 Rent Supplement Program

Some co-ops receive funding under a Rent Supplement Program administered by the Agency or the province.

7.2 Rent Supplement Amount

The rent supplement for a unit is the difference between a housing charge based on the household's income and the normal unit housing charge.

DISCRIMINATION

8.1 No Discrimination [S61: Paragraph 10; S27: Paragraph 8]

The operating agreement sets out grounds on which a co-op may not discriminate. Provincial human-rights laws include these grounds and others. The co-op must follow the human-rights law in its province.

8.2 Housing for Special Groups

It is not discrimination if the co-op reserves housing for seniors or gives preferential treatment to individuals from disadvantaged groups.

OPERATING EXPENSES

9.1 Normal Operating Expenses [S61: Paragraph 2(e); S27 1(5)]

The normal operating expenses of housing co-ops under this program include

- property taxes
- insurance
- maintenance and repairs (including cleaning services)
- utilities and services (e.g., water, electricity, gas, oil, cable TV)
- security services
- interest on mortgages and loans
- amortization of capital assets (usually, but not always, equal to the principal portion of the co-op's mortgage payments)
- ground rent, if the co-op is on leased land and pays an annual rent
- marketing and advertising
- administration (including management and bookkeeping fees)*
- professional fees (e.g., legal, audit)
- governance (including dues to co-operative housing associations and modest social expenses that encourage member involvement)*
- collections and bad-debt expense
- GST/HST
- allocation to the co-op's capital replacement reserve

The cost of the co-op's meeting room and office space are also allowable operating costs.

- * CMHC considers six per cent of a co-op's total operating budget to be a proper amount for administrative and governance costs together.

9.2 Ineligible Expenses

The co-op may not treat the expenses below as operating costs of the housing project:

- the cost of running any non-shelter areas of the property (e.g., a daycare centre)
- the share of common operating expenses (e.g., taxes) for the non-shelter areas
- the cost of non-housing benefits, e.g., vocational-training resources
- costs that belong to another phase of the co-op developed under a different program*
- gifts and donations, unless small
- the cost of extra housing-related services (e.g., cable TV) for income-tested households

- * Where there is more than one phase, the co-op should divide co-op-wide expenses, such as administration costs, among all project phases.

The co-op can cover ineligible expenses through

- an extra charge added to the housing charges
- revenue from non-subsidized sources, such as
 - earnings from the investment of member loans, deposits and shares
 - funds raised through social events
- non-shelter revenue, such as laundry and parking.

CAPITAL REPLACEMENT RESERVE

10.1 Purpose of the Capital Replacement-Reserve Fund [*Commitment Letter, Schedule B*]

The capital replacement reserve is used for the replacement of worn-out capital items. Capital items are more expensive things that last longer than one year (see paragraph 10.3). The reserve is not for normal maintenance or minor repairs to the buildings and grounds.

10.2 Annual Contributions to the Capital-Replacement Reserve [*Commitment Letter, Schedule B*]

The Commitment Letter sets out the initial amount the co-op must put in a capital replacement-reserve fund.

10.3 Spending on Pre-approved Items [*Commitment Letter, Schedule B*]

The co-op can use capital-reserve funds to replace the items below:

- stoves and refrigerators
- laundry equipment
- roofing, including coating, flashing, eaves-troughs and downspouts
- plumbing
- heating equipment, such as boilers (hot water or steam), forced-air furnaces, radiant-heating components, solid-fuel-burning systems, chimneys and related equipment.

Advance approval is not needed.

Other Eligible Spending

With the Agency's advance approval the co-op can also spend capital-reserve funds on the items below:

Capital-replacement reserve plans

Major building components

- outside wall finishes with a shorter life expectancy than the rest of the building, including exterior painting and stucco
- outside doors and windows
- outside caulking that is hard to reach and hard to replace
- above-ground waterproofing, including vapour barriers

Major building services

- domestic hot-water tanks, booster pumps, circulating pumps and sump pumps found in multiple-unit buildings
- septic tanks and tile beds
- air-handling systems

Basic facilities

- kitchen facilities, such as sink and faucet installations, counter tops and cabinets
- bathroom facilities, such as toilets, sinks, vanities, tubs, and fixtures

Safety features

- fire-alarm systems, such as hardwired smoke alarms and smoke and heat detectors linked to a central alarm
- required fire-fighting or prevention equipment
- emergency lighting
- intercoms systems in multiple-unit buildings
- other safety items

Other major facilities, equipment and features

- parking lots, enclosed garages, and driveway and walkway surfaces, including multiple-unit garage surfaces and concrete slabs
- garbage-disposal systems in multiple-unit buildings, such as compactors and disposers,
- inside floor coverings, including those in common areas and suites
- outdoor fences
- water softeners, where the local water is very hard

Regulated changes

- building changes required by the law within a fixed period of time

Other items

The items below are meant to last for the life of the building. Replacements can be paid for from the reserve where they fail:

- foundations or significant sections of foundations
- other structural components, such as walls, floors and roof framings
- brickwork and pre-cast concrete panels
- retaining walls
- electrical installations, including transformers and emergency generators
- balconies.

10.4 Capital Replacement Reserve Plan

Co-ops should draw up a capital replacement reserve plan. With a good plan in place, a co-op knows how much to put in its reserve each year and when it will need to spend money.

The Agency will approve a capital-replacement plan for up to five years. Before the five years are up, the co-op should update the plan and seek approval for the next five years in the plan.

A co-op can spend reserve funds on any item listed in its plan as long as

- CMHC or the Agency has approved the plan
- the plan
 - is a long-term plan (at least ten years)
 - has a complete schedule for replacing capital items
 - includes estimates of how much each item will cost
- the item falls within the current approved five-year period of the plan, and
- the co-op is setting aside at least the annual amount required under the plan.

New technical studies may or may not be needed when the co-op updates its plan. The update must include a refreshed schedule of replacements and a new cash-flow forecast.

Co-ops can contact the Agency or any co-operative housing federation for more advice on capital-reserve plans.

10.5 Emergency Spending

Emergency replacements are repairs to capital items that that must be done quickly to remove or avoid a health or safety hazard. Examples are replacement of a furnace in the winter or fixing a structural failure that threatens the members' safety.

The co-op should complete such repairs right away, letting the Agency know as soon as possible. The co-op can pay the cost of emergency replacements from the capital-replacement reserve.

10.6 Investing the Capital Replacement Reserve [*Commitment Letter, Schedule B*]

The co-op must

- show the capital replacement reserve fund in a separate account in its books
- keep the money only in
 - a bank, credit union or caisse populaire, or
 - government bonds or other investments approved by CMHC.

CMHC allows the co-op to keep the reserve with its other funds. The operating agreement does not require interest earned to be added to the fund but it is best practice to add it.

INSURANCE

11.1 Required Level of Coverage [*Commitment Letter*]

The co-op's mortgage contract requires the co-op to carry enough insurance to protect the mortgage lender.

The co-op should have at least the following:

- fire insurance to cover the full cost of replacing the building(s) and equipment
- insurance for such other risks as wind storms, hail, lightning and floods
- insurance with a "loss-payable" clause stating that the holder of the first mortgage is entitled to the first claims to be paid out.

Enough insurance must be in place at all times to pay out the balance left on the mortgage, plus all interest owing, if there is a total loss. The co-op may insure with any federally or provincially registered Canadian insurance company.

PROPERTY TAXES

12.1 Property Taxes [*Commitment Letter*]

CMHC and the co-op will determine which of them will pay the property taxes.

LENDING AND ENCUMBRANCES

13.1 Encumbering the Property *[S61: Paragraph 4(a); S27: Paragraph 2(1)]*

The co-op may not add any other mortgage or charge (an “encumbrance”) to any part of its property without CMHC’s written approval. The Agency will review any request from the co-op to encumber its property and will make a recommendation to CMHC.

13.2 Lending or Giving Away Co-op Funds *[S61: Paragraph 4(b); S27: Paragraph 2(2)]*

Except for small gifts and donations, the co-op may not lend or give away any co-op funds, or guarantee any debt of a third party, without the written permission of the Agency.

13.3 Co-op Control of Shares and Loans

The co-op controls members’ shares and loans. It also controls any other non-housing money, such as interest earned on the shares and loans. Co-operative principles and, in some provinces, the provincial co-op statute, govern the use of these funds.

EARLY PAY-OUT OF CMHC MORTGAGE

14.1 When Early Payout May Happen

Most mortgage agreements under the program do not allow the co-op to prepay its mortgage. However, early payout may occur if the co-op sells part or all of its property.

14.2 Early Payout Approval

CMHC will normally approve an early payout of the loan only if a co-op is in financial difficulty and the early payout is part of a workout solution.

14.3 Impact on Federal Capital Grant

If the co-op pays out its mortgage early, CMHC will normally require full repayment of the unearned portion of the capital grant (see paragraph 3.1 above).

14.4 Effect on Operating Agreement

Once the mortgage is paid in full, the operating agreement ends.

SALE

15.1 Sale of Property [*S61: Paragraph 9; S27: Paragraph 9*]

The co-op must have CMHC's permission before selling all or part of its property. CMHC must have approved the details of the sale in advance. A co-op wishing to sell any property must apply to CMHC through the Agency.

15.2 Sale within the Co-op or Non-profit Sector

CMHC will allow the sale of a co-op's property to another co-op or non-profit housing provider in special circumstances. These include:

- The co-op is merging or combining with another co-op or non-profit housing provider.
- The co-op is transferring some units to another co-op or non-profit

The sale may take place only if it is in the best interests of the co-op and in keeping with the program purposes. The property will be sold for \$1 and the buyer will take over the outstanding mortgage. The buyer must operate the property within the program and follow the CMHC operating agreement.

15.3 Sale on the Open Market

To ensure its survival, the co-op might need to sell a portion of its property outside of the co-op or non-profit sector. Any such sale must be at fair market value.

CMHC might consider such a sale if, for example,

- the condition of the building makes the property unsafe or inadequate as shelter and the repairs needed are too costly
- needs have changed and the units cannot be filled, and
- the units cannot be sold to another non-profit housing provider.

FINANCIAL RECORDS AND REPORTING

16.1 Financial Records [*S61: Paragraph 5(a) and (b); S27: Paragraph 3(2)*]

The co-op has to keep financial records in a form acceptable to the Agency. The Agency has the right to inspect the co-op's books and records at any reasonable time, with reasonable notice.

16.2 Reporting Requirements [S61: Paragraph 5(a)]

Note: Some S27 agreements have a different provision on this topic. See paragraphs 22.1 to 22.3 in these guidelines.

The co-op has to hire a licensed public accountant to audit its financial statements each year. The co-op must file its audited financial statements and Annual Information Return with the Agency within four months of its fiscal year end.

16.3 Audited Financial Statements

Audited financial statements normally include

- the auditor's report
- a statement of financial position, also called a balance sheet
- a statement of revenue and expenses (separately for shelter and non-shelter components, as may apply)
- a statement of reserves
- a cash flow statement and
- notes to the financial statements.

16.4 Duties of the Auditor

The auditor must confirm

- that the audit has been conducted according to generally accepted auditing standards
- that the statements have been prepared according to Canadian generally accepted accounting principles (GAAP)²
- whether or not the financial statements present fairly the co-op's financial position and the results of its operations and cash flows during the year
- that the capital replacement reserve fund is at the level required.*

* The information on these subjects in the Annual Information Return filed by the auditor will serve as the auditor's confirmation.

16.5 Separate Reporting for Multiple Phases

If the co-op has operations under more than one federal program, it must record operating revenues and expenses separately for each program.

² In practice, CMHC requires co-ops to account in certain ways that do not agree with GAAP. For instance, the cost of assets funded by the mortgage is to be charged to income at the same rate as the mortgage principal is repaid.

ANNUAL INFORMATION RETURN

17.1 Annual Information Return (AIR) [S61: Paragraph 5c; S27: Paragraph 3(3)]

The co-op has to complete an Annual Information Return (AIR) and file it with the Agency within four months of its fiscal year end. The Agency may require the co-op to explain information in the Annual Information Return.

17.2 Agency Reports

The Agency will review the AIR and then provide the co-op with three reports:

- a **Risk Assessment Report** that gives the co-op a “risk rating”; the rating is based largely on whether the co-op will be able to meet its financial obligations on time.
- a **Compliance Review Report**; this lists any areas where the co-op is not following the operating agreement and says what the co-op must do
- a **Co-op Data Report**; this shows how the co-op and its peers have done in key areas over the past three years.

RETENTION OF DOCUMENTS

18.1 Obligation to Keep Records [S61: Paragraph 11; S27: Paragraph 10]

The co-op must keep all documents, vouchers, records and accounts relating to its business for at least seven years.

ON-SITE REVIEWS

19.1 Triggers for On-Site Reviews

The Agency will initiate an on-site review if a risk assessment, annual compliance review or something else suggests that the co-op may not be managing its property well or following the terms of the operating agreement.

19.2 On-Site Review

During an on-site review the Agency may

- review the co-op’s books and records [S61: Paragraph 5(a) and (b); S27: Paragraph 3(2)]
- meet with the board, manager or committees
- inspect the property [S61: Paragraph 8; S27: Paragraph 7].

Following the on-site review, the Agency will complete a report. The report will say what the co-op needs to do to improve. The Agency will share the report with the co-op’s

board of directors. It will follow up as needed to make sure the co-op takes care of the problems set out in the report.

GOVERNANCE

20.1 Governance

The co-op should ensure its good governance by electing and training a committed board of directors.

In keeping with the co-op's non-profit nature, members of the board of directors must not receive any payment for their services as directors of the co-op.

If the Agency believes that a co-op is not well governed, it may ask the co-op to

- get training for board members
- require directors to resign if they are in breach of their duty
- hold elections for new directors to fill vacancies on the board
- consider naming temporary directors from outside of the co-op.

20.2 Conflict of Interest

A conflict of interest occurs when a director, officer, employee or committee member takes part in co-op decisions that could give that person, or their relative or business associate, some benefit the rest of the co-op would not have.

Any board member or manager with a conflict of interest must disclose the conflict to the board and withdraw from discussions and decision-making about the matter.

BREACH OF OPERATING AGREEMENT

21.1 CMHC Remedies

If the co-op is not following its operating agreement, CMHC may

- appoint a receiver to manage the property
- require immediate repayment of the mortgage loan [*S61: Paragraph 7; S27: Paragraph 5*]
- increase the interest rate on the outstanding loan amount, including the unearned portion of capital grant. [*S61: Paragraph 7; S27: Paragraph 5*]

This may happen if the co-op

- misses mortgage payments
- fails to pay its property taxes

- does not file its audited financial statements and AIR or
- breaches the operating agreement in another serious way.

SECTION 27 AGREEMENTS

22.1 Agreements with Different Provisions

Some co-ops financed under Section 27 of the *National Housing Act* have operating agreements that are the same as those of the Section 61 Program. Other Section 27 co-ops have a different operating agreement. Listed below are the points where the Section 27 operating agreement may be different.

22.2 Low-Income Requirement [Paragraph 1(1a)]

The operating agreement may or may not state that the co-op must provide housing for families and individuals of low income.

22.3 Financial Reports [Paragraph 3(1)]

The operating agreement may say that the co-op will provide a balance sheet and a detailed statement of revenue and expenditures, rather than a full audited statement. However, provincial law governing co-operatives requires co-ops to appoint an auditor to audit the co-op's financial statements annually. If they disagree, provincial law overrides the operating agreement.