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Offering Plan Checklist of Documents and Information Provided by Sponsor:

1. A schedule showing the purchase price and percentages of interest in the common elements for the units, the number of rooms and baths or useable square footage and the estimated monthly common expenses and real estate taxes. (Also, estimated monthly mortgage charges if financing is provided.)
2. An operating budget for the condominium for the first year of condominium ownership prepared by an independent real estate expert in the format required by Department of Law regulation, including appropriate footnote information.
3. Certification by the expert preparing the budget for inclusion in the Plan.
4. Projection from an expert or local supplier of consumption, rate and total cost for furnishing heat, hot water, electricity and other utilities to common elements.
5. If unit owners will pay cost of heating their own units directly, a projection from an expert or local supplier of consumption, rate and total cost for furnishing heat, hot water, electricity and other utilities for individual units.
6. If available, a letter from the local tax assessor of estimated assessed valuations after completion of construction. (If unavailable, then a letter from another expert familiar with local tax assessment practices as to estimated assessed valuations and/or a statement of how projected taxes in the price schedule were computed.)
7. Zoning designation of the property and of surrounding areas (with brief description of surrounding areas).
8. Two sets of building plans and specifications with original exhibits for the condominium prepared by the architect (for submission to the Attorney General's office).
9. A general description and outline specifications of the property prepared by the engineer or architect in the format required by the Attorney General.
10. Certification of the engineer or architect for inclusion in the Plan.
11.
 - a. Floor plans of each model unit in scale showing room dimensions
 - b. Isometric drawing showing unit boundaries.
12. Map of area surrounding condominium outlining the condominium boundaries.
13. Copy of the building permit.
14. Copy of the most recent title report for the property continued to within 30 days of submission to Dept. of Law.
15. Copy of the Sponsor's deed upon acquisition of the property or copy of Contract of Sale.
16. Copy of the commitment for building loan mortgage.
17. Copy of any mortgage commitment for permanent mortgages to purchasers and the forms of note and mortgage which the lending institution will require purchasers to execute.
18. Copies of all commercial leases, management contracts and all service and maintenance contracts which the Sponsor will make on behalf of the condominium.
19. A specimen multi-peril insurance policy.
20. Letter from insurance broker or agency setting forth the projected insurance coverage and opining as to the adequacy of insurance to avoid co-insurance (or if policies are agreed, replacement cost).
21. Registrant information forms for principals of Sponsor.
22. List of all other cooperatives, condominiums, homeowner associations and other public offerings in which the principals have been involved in the past five years, along with dates of first closings under each.
23. Certified financial statement of Sponsor or a statement of the amount of Sponsor's net worth.
24. Department of Law broker/dealer statement (Form M-10) for Sponsor.
25. Name and address of architect and biographical information including a list of properties designed by him.
26. Name and address of selling agent and biographical information, including experience, listing specific properties.
27. Form M-10 for the selling agent (or information as to any current registration with the Department of Law).
28. Detailed inventory of asbestos in each unit and in all other areas of property, including the location, amount of asbestos containing material, and condition.
29. Records, reports, violations or any other information concerning the presence of lead based paint and/or lead based paint hazards.
30. Proposed Management Agreement – not required if will be officially self-managed.
31. Copy of mortgage and note or bond for financing procured by Sponsor, if financing.
32. Copy of construction loans or end loans.
33. Copy of Surety Bond or Letter of Credit.
34. Proposed professional and commercial leases, if any.
35. Copy of specimen title policy for all individual condominium units.
36. Copy of Tax Abatement Documents

Where have all the co-ops gone

Prior to enactment of the Tax Reform Act of 1986, some sponsors elected to use the cooperative, rather than the condominium, form of conversion, in order to obtain capital gains treatment of the gain realized by the sponsor upon the conversion.

The Tax Reform Act of 1986 eliminated the favorable tax treatment that had been afforded to the disposition of assets held for purposes of appreciation (capital assets) or for use as instrumentalities in an income-producing business by sections 1221 and 1231 of the Internal Revenue Code.

Currently there is no federal tax savings to be achieved from structuring a conversion transaction to qualify for capital gains treatment.

The condominium form lends itself more readily to (i) mixed use, such as residential and commercial, in order to avoid the complex and troublesome provisions of Section 216 of the Internal Revenue Code (the 80/20 Rule) and (ii) higher sales price.

Condop

In some instances, combinations of cooperative, condominium and other forms of ownership may be put together in the same building or project.

This combined format, which occurs where the optimum utilization of each form can be attained as to each part of the project, is called a condominium-cooperative or a "condop."

This type of hybrid, although complex in structure and operation, is employed on occasion to enhance the economic viability of the project.

Condo Basics

Each unit has the status of a distinct and separate real estate parcel and is taxed as a separate tax lot by the local authorities.

Purchaser financing is in the form of a mortgage covering an individual unit, similar in many ways to mortgages on single-family homes.

Federal income tax deductions for interest and taxes they are allowable for condominium units on the same basis as for privately owned homes.

Common Elements – Common Interest – Common Charges

The commonly owned portions of the condominium premises, known as "common elements," comprise all aspects of the property other than the individually owned units.

The ownership interest of each unit owner in the common elements is determined by the percentage of common interest appurtenant to the unit.

The percentage of common interest generally determines the proportion of expenses for operation and maintenance of the common elements ("common charges") to be contributed by each unit owner.

Determining Common Interest

The different methods for allocation of percentages of common interest to units, as specifically described in Section 339-i[NYCLS] of the Real Property Law, are extremely broad.

- (i) Fair Market Value
In the approximate proportion that the fair value of the unit at the date of the declaration bears to the then aggregate fair value of all the units, or

- (ii) **B. Floor Space**
In the approximate proportion that the floor area of the unit at the date of the declaration bears to the then aggregate floor area of all the units, but such proportions shall reflect the substantially exclusive advantages enjoyed by one or more but not all units in a part or parts of the common elements, or
- (iii) **C. Equal**
The interest of each of the units shall be in equal percentages, one for each unit as of the date of filing the declaration, or in equal percentages within separate classifications of units as of the date of filing of the declaration, or
- (iv) **D. Grab Bag**
upon floor space, subject to the location of such space and the additional factors of relative value to other space in the condominium, the uniqueness of the unit, the availability of common elements for exclusive or shared use, and the overall dimensions of the particular unit,

Of the four currently available methods of allocation, the procedure provided for in sub-paragraph (D) is most widely used. The former square footage and value allocation methods are combined and supplemented by additional broadly stated determinants designed to provide a maximum of flexibility capable of application to a wide variety of developments.

The "separate classification" test as described in sub-paragraph (C) has also been used with success, especially in low-rise new construction developments, where a limited number of model types are to be constructed. In such cases, clarity and convenience are often better achieved by use of separate classifications than by the more complex and subjective method set forth in paragraph (D).

Notwithstanding the broad-based standards for allocation of common interests set forth in the statute, the natural tendency of some developers to assign low percentage allocations to units earmarked for future developer ownership or sale should be tempered with care.

At a minimum, records reflecting a rational basis for allocations should be generated and maintained in the event of need for future reference or substantiation.

Condominium Act & Martin Act

Condominiums are governed in New York entirely by Article 9B of the Real Property Law, McKinney's Consolidated Laws of New York, enacted in 1964 (the "Condominium Act").

All forms of common interest ownership of projects in New York are subject to the jurisdiction of the New York State Department of Law in accordance with the provisions of the Martin Act.

Martin Act requires that in any instance in which a public offering or sale of securities in or from the State of New York involves a participation interest or investments in real estate, a written statement or statements, known as "offering statements" or "prospectuses," must be filed with the New York State Department of Law prior to such offering.

The essential purpose of the "offering statement" or "prospectus" section is to afford potential investors, purchasers and participants an adequate basis upon which to found their judgment as to whether or not they wish to participate in such an offering.

Benefits of Conversion of Rent Regulated Units

The attempt by owners to convert existing rental residential properties to common ownership is usually generated by the desire to take advantage of the enhancement of property values, which are economically inhibited by rent restrictions.

Since the economic return on rent regulated property fails to keep pace with inflation, conversion of the property is the best method for an owner to break out of the rent control/stabilization vise.

Conversions to Condominium Ownership

NY GBL Section 352-eeee provides certain minimum requirements for offering statement or prospectus submitted to the Department of Law for the conversion to condominium ownership in the City of New York.

Non-Regulated Residential or Commercial Property

Where it is proposed to convert an existing property which is neither rent-controlled nor rent-stabilized and is subject only to the conventional laws of contract and real property law, other than complying with the requirements and procedure of the Martin Act, the parties may agree upon any terms that suit their purpose.

Rent-Regulated Residential Property

Where existing residential properties which are sought to be converted to condominium ownership are rent regulated or controlled the provisions of the particular statute controlling the rents are superimposed upon the Martin Act. This has the effect of complicating the procedures affecting rent regulated conversions beyond those applicable to non-rent regulated properties.

Rent Regulation (Rent Control & Rent Stabilization)

1. 1. Rent increases are regulated by Department of Housing and Community Renewal (DHCR).
 2. 2. Lease renewals are automatically granted as a right of the tenancy.
 3. 3. Extension of renewal rights will be granted to family members or partners (not roommates) residing with the named leaseholder for two years or more. Lease renewal rights vest with non-leaseholders residing for less than two years when named lease holder is over 65 years or disabled.
 4. 4. Establishing residency in unit
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Rent Control

All formerly rent controlled housing accommodations which have become vacant since 1971 are either decontrolled or have become regulated under the Emergency Tenant Protection Act of 1974 (ETPA).

Thus, the housing stock in this category is diminishing rapidly and over time will disappear entirely by either attrition or legislative action.

However, until that occurs, in any conversion effort where even a single housing accommodation remains covered by rent control, the provisions of that law must be met. In any such instance the sponsor has the choice of proceeding with the conversion as an "eviction plan" or a "non-eviction" plan.

Rent Stabilization

Until 1969 when the Rent Stabilization Law was enacted, no housing accommodations built after 1947 were subject to rent regulation. That statute imposed rent stabilization upon all apartments not subject to rent control in all buildings containing six or more units.

In 1974 by the ETPA which recontrolled all non-controlled apartments in buildings of six units or more in New York City into the rent stabilization system.

All buildings built after the effective date of the ETPA (July 1, 1974), except those accorded tax abatement under R.P.T.L. § 421-a[NYCLS] or under N.Y.C. Administrative Code § 11-241 *et seq.* (1985) (see § 19.06[4][c][iii], [d] and [e] *supra*), remain free of controls.

These statutes resulted in practically all buildings containing six units or more built before 1947, and not subjected to major rehabilitation since then, becoming hybrids.

These hybrid buildings consisted of part rent controlled apartments and part stabilized apartments, with the rent controlled units gradually being phased out and becoming stabilized.

In many instances an eviction plan is preferable but the current onerous requirements make it unlikely in most cases that such a plan would be feasible, and the converter's only recourse is to pursue the non-eviction route.

Eviction Plan.

An eviction plan accords to the sponsor the right to evict the occupant of the rent regulated housing accommodation upon compliance with the specific requirements of the locally applicable law.

This compliance governs: (1) the contents of the plan itself;

This compliance governs: (2) meeting the requirements of the applicable law as to the percentage of tenants-in-occupancy who must buy before the plan can be declared effective;

This compliance governs: (3) meeting the time and procedural requirements of the applicable statute in proceedings to evict the non-purchasing tenants, after the plan is declared effective and the closing has occurred.

The present law, in jurisdictions where applicable, requires, for eviction plans to be approved, that 51% of the tenants-in-occupancy purchase their apartments, under the terms of the plan.

Non-Eviction Plan.

The aforementioned percentage is often unattainable in conversions. Consequently, except under unusual circumstances, eviction plans involving buildings containing units that are subject to rent regulation and/or G.B.L. are relatively rare.

In their place converters now resort to non-eviction plans under which non-purchasing tenants cannot be evicted, as long as their occupancy continues to be protected.

The concept of the non-eviction plan grew out of several situations where eviction plans failed because they could not meet the statutory requirements as to the required percentage of purchasing tenants.

In those instances, the sponsor, nevertheless, proceeded to declare the plan effective and waived the right to evict non-purchasing tenants, relying instead upon attrition of the controlled or stabilized tenants vacating the apartment, to obtain possession of the housing accommodation.

This resulted in a situation where the sponsor becomes the owner of the apartment or a third-party purchases the apartment under the terms of the plan (subject to the existing tenancy) and becomes the landlord as long as the controlled or stabilized tenant remains in possession and the tenant remains protected by such rent regulation.

This *ad hoc* development in the conversion process gradually became legitimized and a 15% purchasing requirement was uniformly imposed upon non-eviction plans.

In some jurisdictions (New York City, for instance), the law permits non-tenant purchasers to be counted toward the 15% requirement where the purchaser affirms an intent to occupy the apartment when it becomes vacant.

This has led to a sharp upsurge in the number of non-eviction plans being promulgated where converters seek to get rid of rent regulation and are willing to bide their time in gaining possession of the unsold and continuously controlled apartments.

Red Herring & Black Book

The red herring and the black book are used only in conversion projects.

In conversion plans the only thing done by the sponsor at the outset is to prepare the red herring and submit it to the Attorney General and to the tenants. This involves the expenditure of funds for the experts who participate in the preparation of the red herring and for the payment of filing fees to the Attorney General.

After submission of the red herring, the Attorney General takes four to six months to review the red herring and give the sponsor comments.

After the acceptance for filing of the plan (the "black book") by the Attorney General, service of the plan upon the tenants-in-occupancy commences the running of the time for purchase of units at the offering price set forth in the plan or amendment.

Upon the Attorney General's acceptance of a substantial amendment to the plan, tenants-in-occupancy are given an additional 30 days to purchase their units. The time limit is fixed as specified in the plan in conformity with the Attorney General's Regulations and any applicable provision of the rent regulations governing the tenancy of the unit occupant.

A court has held that where deficiencies exist in the plan at the time of its acceptance for filing by the Attorney General and the service of the "black book" on the tenants, the deficiencies cannot be cured by a subsequent amendment to the plan correcting the deficiencies.

A new filing, free of deficiencies, is required which will recommence the running of the time limits to purchase at the insider's price.

In new construction projects a draft plan is submitted to the Department of Law and is not given or shown to prospective purchasers until the plan has been accepted for filing. After acceptance for filing, however, the shares (or the units) may be offered on the market by the selling agent through advertising or any other method of publicizing their availability.

Removal of Unit from Rent Regulations

Once a legal valid rent equals or exceeds \$2000, a landlord/sponsor can apply to the Department of Housing and Community Renewal (DHCR) to have the unit removed from rent stabilization or rent control.

Annual rent increases are regulated by annual DHCR determination.

Major Capital Improvements to the Building

The monthly combined rent of all units can be increased to equal 1/60th of the cost of the building-wide improvement.

Major Capital Improvements to the Unit

The monthly unit rent can be increased by 1/40th of the cost of the unit improvement.

Hardship Claim

Removal of Regulated Tenants

Owner Use – difficult with corporate or LLC owner

Legally valid basis for eviction

- non-primary residence (< 180 days per year)
- income limitation (\$175,000+ for at least two years)

SCARY STUFF

Paikoff v. Harris.

The holder of unsold shares had sought to evict the tenant after his lease expired. While generally it has been assumed that only tenants already occupying an apartment during a cooperative or condominium conversion were protected, the court held that the Martin Act applies to any tenant renting from someone other than a "purchaser under the plan."

The court also ruled that while tenant-shareholders are indeed purchasers under the plan, a holder of unsold shares is not--contrary to a long-held industry assumption that such apartments, previously rent-controlled or rent-stabilized, were deregulated.

Tax Exemption & Abatement Benefits.

If the offering plan represents that the unit owners may or will receive particular tax benefits (e.g. section 11-243 (J-51) of the New York City Administrative Code or section 421-a[NYCLS] of the Real Property Tax Law), the plan must state that the sponsor will use its best efforts to obtain those benefits, and must project the amount, commencement and duration of the benefits.

1. Highlight as a special risk if the plan states that the unit owners may or will receive tax benefits and the sponsor does not anticipate obtaining the benefits before the closing of the first unit.
2. If the tax benefits are not in place at the time the proposed offering plan is first submitted to the Department of Law, describe the effect on the projected total monthly carrying charges with and without tax benefits.
3. If tax benefits may be available but sponsor is not applying for such benefits, highlight as a special risk and state that sponsor will cooperate with the board of managers to obtain the benefits and will keep and make available all records required in order to obtain the benefits.
4. State that a sponsor applying for J-51 benefits must request an opinion letter from the New York City Department of Housing Preservation and Development ("HPD") and that such opinion letter must be obtained before the plan is declared effective.
5. Sponsor must represent that it will keep all records required by HPD and will make them available to HPD whenever requested to do so.
6. Sponsor must disclose that HPD routinely conducts audits, which can result in the reduction or revocation of benefits if proper documentation is not provided.
7. Sponsor must state:
 - Upon closing it will make all tax benefit documents available to the board of managers for inspection and copying for the life of the benefits; and
 - It will file all applications and timely comply with all procedures required to properly process and maintain the tax benefits.
8. Set forth in schedule form any progressive decrease in tax benefits during the benefits period.

Tax Assessments

The law (RPTL § 581(1)[NYCLS]) provides that these units should not be assessed at the total of the fair market value of each unit but rather on the basis of the value of the total property as a single entity.

The restriction on assessments of condominium units has been the focus of heated dispute in New York for a number of years, as the statutory limit upon the value of units sometimes results in lower real estate taxes than those paid by owners of equivalent single family homes.

Footnotes

1. During the initial stages of the transaction, it is important that sales personnel be consulted in making crucial decisions relating to apartment layout, choice of amenities, permissible uses and even some seemingly legal decisions such as the designation of specified areas as limited common elements, general common elements or portions of units.
2. Sponsor should determine whether a parking space/storage area offered to the unit owner will be owned by the owner as a separate unit, part of his/her own unit, or be owned by the condominium as a common element and assigned or leased to the unit owner pursuant to a separate agreement.
3. In the event the sponsor elects to provide mortgage financing, the plan must disclose all details of such financing,
4. Special rights of sponsor with respect to any commercial units in the condominium should be disclosed in the plan, pursuant to the sponsor's general obligation to disclose all material facts of the offering
5. A 1997 amendment to The Condominium Act permits boards of managers to borrow money for capital repairs and improvements on behalf of the condominium. While the law requires majority unit owner consent, it significantly expands the borrowing ability of condominiums.
6. The three-day review period may be replaced by a seven-day period for rescission by purchaser after execution of a purchase agreement and receipt of the Offering Plan and amendments. Such a provision permits purchase agreements to be consummated while the purchaser is present and interest in the project is high, putting the burden on the purchaser to rescind later.
7. In the event construction loan or other financing arrangements contain provisions precluding the declaration of effectiveness until a greater percentage of units are sold, such information should be disclosed in the plan.
8. Financial disclosure amendments are required to be filed by all sponsors and by holders of unsold shares, setting forth the scope of the sponsors ownership interest in the project, his/her financial obligations for the next twelve months, the means of funding such obligations, whether the sponsor is current on other obligations, etc.
9. There is no statute or regulation providing for any minimum reserve or working capital fund in new construction or vacant condominium offerings. The decision regarding the amount of the reserve or working capital fund to establish is solely that of the sponsor, who must weigh marketing considerations when reaching the decision whether to create such funds.
10. The regulations set forth detailed requirements for the comprehensive building description that must be included in the plan. The description is prepared by an independent professional engineer or architect. In the event a major building system is not being rehabilitated and is likely to require major upgrading within five years of the date of the report, this fact must also be highlighted as a special risk.
11. The board of managers, on behalf of the unit owners, shall have a lien on each unit for the unpaid common charges thereof, together with interest thereon, prior to all other liens except only (i) liens for taxes, (ii) all sums unpaid on a first mortgage of record, and (iii) all sums unpaid on a subordinate mortgage of record held by the NY job development authority, the NYS urban development corporation, the NYC housing development corporation.
12. While the sponsor is in control of or a member of the board of managers of the condominium, he owes a fiduciary duty to the condominium, and should be aware of possible claims of self-dealing.
13. The blanket requirements of the General Business Law and the Regulations relating to the necessity of full and fair disclosure in the prospectus of all material facts, with no material omissions, should be carefully considered before the final decision is made to omit disclosure as to any participant.

Submission and Approval of the Plan for Filing by the Attorney General

Preparation and Initial Submission of the Plan

A draft of the offering plan requires the participation, in addition to the sponsor, of the lawyer, the accountant, the real estate sales and management expert, the engineer and all other personnel.

The plan follows a boilerplate form, but it should be carefully tailored to the requirements of the individual project.

The Plan must include a description of the project, a proposed budget for the first year of operation, an engineering report, the allocation of units and common interest, certifications by the sponsor, the sponsor's real estate consultant and the sponsor's engineer and all other material terms of the offering.

Declaring the Plan Effective

Where the project involves new construction, the plan may be declared effective by the sponsor at any time after the number of purchase agreements defined in the plan (lender requirement) have been executed.

In conversion projects, the plan can be declared effective when the percentage of purchase agreements under applicable law have been executed.

When a sufficient number of purchase agreements have been executed, other conditions set forth in the plan have been satisfied and applicable law and regulations have been complied with, the sponsor may, at its option, declare the plan to be effective.

Prior to effectiveness, the plan constitutes, by its terms, a conditional offer. By declaring the plan effective, the sponsor agrees, subject to very specific conditions, to go forward and consummate the proposed transaction with purchasers.

Under current law, effectiveness must occur within fifteen months of the date of acceptance for filing of the plan by the Department of Law or the plan is deemed abandoned.

In order to avoid unnecessary delay, once the requirements for effectiveness have been met, the plan may be declared effective by means of a notice to tenants and subscribers. This is followed by an amendment setting forth detailed information required by the Department of Law evidencing the fact that the requirements for effectiveness have been fulfilled.

Timing

A realistic estimate of the time required to complete filing and other preliminary requirements and to achieve requisite sales so that closings may occur is frequently of crucial importance to the client.

This is especially true in the case of new construction where costs, including expenditures for construction and debt services, are substantial, and may increase even further beyond expected levels as the project proceeds, with no corresponding flow of income into the development.

The Regulations contain implicit recognition of the need for expedited processing of new construction transactions in a case where the premises are not already occupied by one or more residential tenants. Section 20.1(f) of the Regulations provides for review by the Attorney General of a proposed offering and issuance of a deficiency letter containing requested revisions within a period not to exceed thirty days after submission.

This arrangement is in sharp contrast with provisions relating to conversions of premises occupied by residential tenants wherein applicable statutes and regulations mandate a period of between four and six months before such review and statement of deficiencies may occur.

Following receipt of the deficiency letter issued by the Attorney General, it is generally not unreasonable to project a period of approximately fifteen days for making necessary revisions and additions. Such a projection assumes, of course, the availability and swift response of all personnel involved, including sales and marketing consultants, architectural and engineering professionals as well as accountants and the client.

Even with such cooperation, unforeseen problems or issues may arise that require negotiation with the Attorney General's staff. Obviously, this may lengthen the period necessary to obtain final acceptance for filing.

The effect of the Attorney General's failure to issue a deficiency letter within the requisite thirty-day period is far from clear. There is at least some authority for the proposition that in the absence of a deficiency letter timely issued by the Attorney General the proposed prospectus may be deemed accepted for filing.

However, considering the protective public policy objectives of the General Business Law and the Attorney General Regulations, it would be unwise to rely uniformly upon such a construct, especially where changes, when requested, would be relatively easy to effectuate.

Perhaps more complex, as well as potentially frustrating, are issues arising from major new requests for changes and/or information that are made after expiration of the prescribed thirty-day period supplemental to original requests made during such period. It is suggested that even in such situations the requested additional material should be provided if this can be done with relative ease and speed.

The cases give scant guidance as to the likely outcome where the requested material is withheld. *Gonkjur Assocs. v. Abrams*, 88 A.D.2d 854, 451 N.Y.S.2d 747 (1st Dept. 1982), *aff'd*, 58 N.Y.2d 878, 460 N.Y.S.2d 528 (1983).

In any event, counsel should, prior to making a recommendation to the client regarding a suggested course of conduct, arrive at an objective evaluation of the substance and propriety of the requested revisions, irrespective of timing.

If the changes requested have a material bearing on the nature of the offering it may be that the sponsor has an independent statutory obligation to effectuate the changes, regardless of the Attorney General's request, whether timely made or otherwise.

Preparation and Filing of Prospectus

Special Risks

A number of items should be considered for inclusion, for example, extraordinary uncertainty in income or expense projections, problems with blanket or unit financing, issues connected with obtaining real estate tax exemptions or benefits for unit owners and "sweetheart" arrangements between the promoter and the condominium.

Where the units and common areas are being offered by the developer "as is," without warranties regarding materials, workmanship or otherwise, it is suggested that disclosure as a risk factor may also be advisable.

Price Schedule and Projected Budgets

Condominium and Cooperative Conversion Protection and Abuse Relief Act of 1980, 15 U.S.C. § 3607, which provides for **Termination of Self-dealing Contracts**

Changes in Prices and Units

Generally, all price changes require a prior amendment to the offering plan, except unadvertised price decreases for individual units.

Amendments limited solely to price changes are deemed accepted for filing when submitted to the Attorney General.

State that no change will be made in the size or number of units and/or their respective percentages of common interest and that no material change will be made in the size or quality of common elements, except by amendment to the plan and, when applicable, to the declaration.

Obligations of Sponsor

[a]--Escrow Requirement

maintenance of all funds in an escrow account prior to issuance of a **permanent certificate of occupancy** except to the extent that sponsor's engineer, architect, or other qualified expert specifies that a lesser amount is reasonably necessary to perform the work necessary to obtain such certificate. It should be noted that the above requirement is applicable to proceeds from closings on units notwithstanding any arrangements with lenders regarding disposition of these funds.

Alternatively, sponsor must deposit with an escrow agent an unconditional, irrevocable letter of credit, post a surety bond in the amount so certified, or provide other collateral acceptable to the Department of Law.

The above provisions should be pointed out to and discussed with prospective lenders in the early stages of negotiations for the construction loan. Special attention should be given to the requirement that, in the absence of the specified letter of credit or surety bond, a portion of the initial purchase proceeds must continue to be held in escrow even after closing of title to the units has been consummated.

TCO → CO LENDER

Inasmuch as units are generally closed after issuance of temporary certificates of occupancy, with a permanent certificate of occupancy not obtainable until substantial completion of the entire condominium project, such supplemental escrows can be expected to be substantial in amount and duration.

The construction lender, on the other hand, may anticipate receiving all or a substantial portion of the proceeds from initial unit closings as partial pay-downs on the construction loan in consideration of the required release of the units conveyed from the lien of the blanket construction mortgage.

This fundamental issue regarding disposition of closing proceeds should be pinpointed and disposed of in the early stages of negotiations for financing in order to avoid unnecessary problems during the filing and/or offering and closing process.

It should be noted that the lender's presale requirement frequently exceeds the fifteen percent minimum sales required by Section 20.3(m)(2) of the Regulations in order for the offering plan to be declared effective.

The language in the plan should carefully distinguish between the two requirements in order to preclude the possibility of a misapprehension that the lender's presale requirement supplants the lower regulatory minimum as an absolute prerequisite for effectiveness and closings.

[b]--Warranties

Section 20.3(t)(13) of the Regulations requires the sponsor to state whether the sponsor agrees to warrant the materials or workmanship of each unit or common elements, and to fully disclose the terms of the warranties.

General Business Law Article 36-B[NYCLS] creates an implied warranty upon the sale of a new home, including new dwelling units in cooperative or condominium buildings that have five stories or less. Actions for breach of this warranty must be commenced within six years.

[c]--Payment of Common Charges for Unsold Units

[5]--Taxes, Deductions to Unit Owners and Tax Status of Condominium

[6]--Transmittal Letter and Certifications

The required form and content for the certifications of the sponsor, engineer or architect and sales professional to be included in the offering plan, as well as the transmittal letter of counsel for the sponsor, which must accompany submission of the proposed plan to the Attorney General, are set forth in Section 20.4 of the Regulations.

Post Closing and Beyond

[1]--General

After unit closings, the management and operation of the property are turned over to the new owners and the managing agent, attorney and their other representatives, in accordance with the terms of the plan.

After the consummation of the plan and the completion of the closing, an amendment to the plan is prepared. This is called the "post-closing amendment," which provides information regarding the closing and the events occurring shortly thereafter, such as the closing adjustments, the disposition of reserve funds and the election of officers and directors.

Once the closing has occurred and the new representatives of the common ownership interests take over the management and operation of the property, they are required to organize their activities so as to put the property in a fiscally and managerially sound long term position.

[2]--Sponsor Issues

From the point of view of the promoter, the period commencing with initial unit closings and continuing until completion of sales and closing of all unsold units constitutes a test of the adequacy of the offering plan and the organizational documents.

Depending upon the attitude and constituency of unit purchasers, and the proposed uses and required sell-out time for unsold units, these documents may constitute the sponsor's most immediate and effective insulation against potential unit-owner obstructions to completion of the marketing and closing of units.

For example, of possibly crucial importance may be organizational provisions in connection with the sponsor's authority to alter unsold units, to veto certain expenses and assessments, to use the condominium premises for marketing and sales, to provide for the leasing of unsold units and to avoid the application of proposed prejudicial amendments to the declaration and bylaws.

Special provisions regarding sponsor control periods and supplemental veto powers by specified unit owners (for example the owners of commercial space) may also be tested during this period.

[3]--Sponsor Defaults

The cooperative or condominium has been forced to foreclose upon its lien for unpaid maintenance or common charges and has become the owner of the apartment or unit formerly owned by the sponsor.

Cooperative Policy Statement #6 (CPS-6) (also applicable to condominiums), allowing a co-op or condo association to apply for special treatment which would enable it to take part in a public offering of cooperative shares or condominium units without requiring it to file amendments to the offering plan or submit documentation required of holders of unsold shares or units of sponsors (13 N.Y.C.R.R. §§ 18.3(w)(11)).

The apartment corporation or condominium association is required to file a broker-dealer statement pursuant to General Business Law § 359-e[NYCLS].

[4]--Condominium Issues

From the point of view of unit purchasers as well as the sponsor, the post-closing period provides the sternest test of the efficacy of organizational documents. While it is, of course, impossible to foresee all contingencies, certain problems can be anticipated, including those relating to:

restrictions on pets and enforcement procedures for violation of such restrictions; permissible uses of units; maintenance obligations of the board of managers as opposed to those of individual unit owners; limitations on powers of the board of managers; real estate tax assessment; the provision of local services to unit owners;

application and enforcement of liens against units to secure payment of common charges; provisions regarding waivers of first refusal right on unit transfers; and provisions regarding subletting.

Key Provisions in Organizational Documents

Condominium organizational documents, including the declaration, bylaws, house rules and power of attorney from unit owners to the board of managers, are of central and lasting importance to the day-to-day functioning of the condominium.

Unlike the contents of the offering plan, the impact of organizational provisions are not limited in duration to the period during which units are being offered for sale to occupants; rather they are designed to endure throughout the entire existence of the condominium.

[1]--The Declaration

[a]--The Use of Units and Common Elements

Contemplated and permissible uses of units and common elements should be set forth in detail.

In mixed-use deals, special attention to the "use" provisions is essential in order to confer upon potential purchasers the authority to use their units for the purposes intended, while also minimizing possibilities of conflicting uses or other potential problems with fellow unit purchasers and governmental authorities.

The court refused to enjoin the use because the condominium declaration and bylaws did not bar use of commercial units as fast food restaurants, but only barred disreputable uses or uses which would cause a nuisance. The court reasoned that absent proof that a nuisance was actually caused by the use, an injunction would not be granted.

[b]--Description of Units

This section of the declaration should include a detailed physical description of the units, depicting the airspace and the innermost layer of construction, such as sheet rock or plaster board, as well as all other structural components comprising a portion of the common elements.

The distinction between units and common elements is correlative with division of responsibility for maintenance and repairs between unit owners and the board of managers, and therefore of primary importance.

The matter of repair or replacement, even of simple items such as windows and doors, typically omitted from form descriptions, may cause problems where not readily identifiable as portions of the unit or common elements.

It may be advisable to include such items as roofs, walls, elevators, and other structural elements used exclusively by one unit as part of a unit rather than as common elements.

[c]--Common Elements; Limited Common Elements

Designation, choice and definition of limited common elements requires careful thought and a familiarity with the physical premises.

Balconies, terraces, patios and greenhouses are frequently designated as limited common elements. Items such as basements, garages, and, in cases of double units, intervening corridor space, are additional possibilities worthy of consideration in residential deals.

Responsibility for maintenance and repair of limited common elements should also be set forth in this section of the declaration.

[d]--Easements

Easements to the developer must be specifically reserved for such items as construction, sales, installations, ingress and egress and various other purposes consistent with the intent and provisions of the offering plan. The developer should also be granted the right to establish additional easements for such purposes as storm drainage, cable television and utilities.

Careful thought should be given to any additional easements necessary for use alteration, maintenance and sales and leasing of developer-owned units after the declaration has been filed. Consideration should also be given to foreseeable needs of potential purchasers of unsold units.

For example, in a recent transaction, it was necessary to provide for an easement in favor of restaurant space, part of the commercial unit, through the lobby of the residential unit in a coop-condo. The easement was necessary in order to enable the restaurant to meet zoning and occupancy requirements regarding secondary access in case of emergency.

In *69/70th Street Assocs. v. Board of Managers of Kingsley Condominium*, N.Y.L.J., May 1, 1991, at 21, col. 6 (Sup. Ct. New York County), the sponsor of a condominium offering plan provided in an amendment to such plan that the condominium would be obligated to pass through steam heat and hot water to certain adjacent parcels. However, no such requirement was set forth in the Declaration of Condominium.

The condominium sought to discontinue the "pass through" steam service. The court held that the offering plan provision relied upon did not bind the condominium to provide steam in perpetuity, either as a covenant running with the land or as an easement, and it granted summary judgment to the condominium.

[e]--Power of Attorney from Unit Owner to Board of Managers

Provisions should be made to require each unit owner to execute a power of attorney to the board of managers to allow, among other things, maintenance, management, sale, lease, or other disposition of units acquired by the board pursuant to first refusal provisions or the exercise of liens for non-payment of common charges.

[f]--Amendments

Clear provisions should be made for a stated vote of unit owners, by percentage of common interest, in order to amend the declaration. A typical provision calls for sixty-six and two-thirds percent. However, this percentage can be varied depending upon the needs of a particular transaction.

For example, in a mixed-use transaction it may be wise to consider a requirement for a minimum percentage from each class of unit owner before certain changes can be made. In any event, a provision should be included which prohibits any change adversely affecting the interests of the developer, its affiliates or any owner of unsold units, without the consent of such affected parties.

Of central importance is a provision which permits the developer to make unilateral amendments to the declaration in order to effectuate desired changes in unsold units. Failure to include a broad and pervasive provision for such changes may have a deleterious effect upon attempts to sell these units.

[2]--Bylaws

[a]--Sponsor Control of Board of Managers and Related Provisions

In accordance with Section 20.3(u) of the Regulations, the sponsor may exercise voting control over the board of managers for a period in excess of two years, provided that the right to such control is set forth in the offering plan as a special risk factor.

Although not specifically stated in the Regulations, the Attorney General can be expected to require, in addition, that no control over the board be exercised by the sponsor in the absence of the sponsor's ownership of a majority of common interest in the condominium.

Especially in smaller developments, consideration should be given to eliminating the necessity of listing this special risk factor by limiting the period of potential sponsor control of the board to two years.

In many cases, it can be reasonably projected that fifty percent of the units or more will be sold before the expiration of the two-year period. Indeed, such a sales achievement may be crucial to the financial viability of the project.

The duration of sponsor veto power is not specifically limited by the Regulations, which provide only that a veto period of greater than two years must be noted as a special risk.

[b]--Insurance

Section 339-bb[NYCLS] of the Real Property Law authorizes provisions in the condominium declaration and/or bylaws providing for insurance of the buildings against loss or damage by casualty, with premiums to be paid by unit owners as a portion of common charges. However, it became apparent early on that standard types of building casualty policies were not adequate to serve the needs of a condominium in the absence of certain special provisions.

For example, it was necessary to obtain a "waiver of invalidity due to acts of the insured" in order to ensure that the act of a single unit owner, technically an insured, did not endanger applicability of the insurance.

A "waiver of *pro rata* reduction of liability" was also needed in order to avoid the danger that insurance payments to the board of managers for losses to common elements might not be reduced by a claimed overlap in payments received by unit owners, perhaps from different companies, as a result of losses to their individual units.

A "waiver of subrogation" was needed to avoid the possibility that the insurer might sue an individual unit owner or owners for the purpose of recovering proceeds paid on account of losses to the board of managers as the insured.

Early and close communication with insurance representatives and agents should be established by counsel in order to ensure that the above provisions are contained in applicable insurance policies. This is often a difficult task inasmuch as most insurance companies have established forms not easily susceptible to change. A special multi-peril condominium insurance rider has been formulated and is in use by a number of companies.

However, such rider should carefully be checked to verify that it contains all of the necessary provisions. It is also recommended that the condominium's bylaws require that the provisions discussed be incorporated as well into any insurance policy covering the common elements.

[c]--Additions, Alterations or Improvements to Units and Common Elements

[i]--By Board of Managers.

It is customary to include in the bylaws a provision whereby the board of managers may, without the specific authorization of unit owners, expend a stated sum for the purpose of repairs, improvements or alterations to the common elements. It has been held that such a bylaw provision is valid and binding upon the unit owners.

In the event that changes are contemplated which require the expenditure of a greater sum than the maximum set forth, a typical provision would require a vote by more than fifty percent in number and common interest of unit owners to approve such an expenditure.

[ii]--By Unit Owners.

An effective bylaw provision should allow unit owners maximum freedom to make alterations and improvements to their units while at the same time ensuring that no such change will have an adverse affect upon the common elements or other unit owners.

Hence, many such provisions prohibit unit owners from making "structural" changes, changes which may affect the value of other units and/or changes in or to common elements without the consent of the board of managers.

A mechanic's lien filed against an entire condominium building will be limited to the unit on which the work was performed.

[d]--Amendments

As in the case of the declaration, the percentage of common interest generally required for an amendment of the bylaws is sixty-six and two-thirds, which, in the case of condominiums containing residential units, is the statutory minimum.

Also, as in the cases of the declaration, care should be taken that there be included in the bylaws a provision prohibiting charges that adversely affect the sponsor, its successors, or assigns without their consent.

[3]--House Rules

Although not required by the provisions of the Condominium Act, it is often advisable to include in the organizational documents a set of house rules governing the day to day operation, maintenance and use of the property, which may be changed, augmented or otherwise amended by the board of managers. Promulgation and amendment of the house rules should be provided for in the bylaws.

In addition, in order to remove even the slightest doubt in the minds of non-sponsor members of the board regarding the subordinate status of the house rules to the provisions of the bylaws and the declaration, the authorizing provisions in the bylaws should specifically state that no amendments to the house rules may be made which alter, vary or contradict the provisions of the bylaws or the declaration.

Typical house rules provisions might deal with prohibited uses of terraces and patios, pets, signs, restrictions on the use of units and the right of the board to enter a unit in case of emergency.

[4]--Power of Attorney

Unit owner powers of attorney to the board of managers are not required by the Condominium Act. However, such instruments, with an accompanying bylaw provision requiring execution of a power of attorney by all unit purchasers, can be useful in a number of respects.

For example, it can be foreseen that the board of managers may acquire ownership of units, either in connection with an exercise by it of its "right of first refusal" or as a result of the exercise of its lien for unpaid common charges. In the event of such acquisition, an authorization to the board by all unit owners to maintain, manage, lease, and dispose of or otherwise deal with such units is highly desirable.

Moreover, "implementation" provisions are often added to the power of attorney to provide, among other things, for rights to amend the declaration for limited stated purposes, to create utility easements or to carry out any of the provisions of the plan.

It should be noted that the power of attorney as discussed herein should specifically provide that it is a power coupled with an interest in order to prevent revocation of the power by operation of law in the event of the death or disability of the grantor of the power.