

### Don't Fall in Love Before Doing Your Due Diligence

**S**o your bid was accepted on the property of your dreams. Congratulations! Now what? Before signing on the dotted line, the answer is due diligence.

Over the next few issues of this newsletter, we will be focusing on the due diligence that must be performed prior to contract execution, as well as the due diligence required when purchasing a 1-4 family home, a cooperative or condominium unit or prior to consummating a commercial transaction. This issue will focus on due diligence in the residential cooperative and condominium setting.

There are three basic elements of cooperative and condominium due diligence, (i) Review of the Offering Plan, Amendments and Cooperative ("coop") or Condominium ("condo") minutes, bylaws and house rules; (ii) Review of the Financials; and (iii) Inspection of the Apartment Unit.

#### **Review of Offering Plan, Minutes, Bylaws and House Rules**

The primary focus is to determine the following:

- ◆ When was the building converted?
- ◆ Is the building self managed or managed by a professional managing agent?
- ◆ What is the maintenance or common charges for the apartment unit?
- ◆ Are there any assessments?
- ◆ Are any future capital improvement projects planned? If yes, how is the building planning on paying for the improvements?
- ◆ What are the fees or other costs associated with the closing?
- ◆ Does the Sponsor own any units?
- ◆ What is the owner occupancy rate?
- ◆ Are there any pet restrictions?

- ◆ What is the alteration policy?
- ◆ Is there ongoing litigation?
- ◆ Have there been any issues with the unit or shareholder/unit owner in the past?
- ◆ Is there any history of leaks into or from the unit?
- ◆ Does the apartment unit include any rights to a storage unit, roof deck or parking space?

#### **For Coops:**

- ◆ What is the tax deductibility of the maintenance?
- ◆ Is there a flip tax?
- ◆ What is the sublet policy?
- ◆ Does the coop impose any financing restrictions?

#### **For Condos:**

- ◆ Does the sale require the condo to waive its right of first refusal?
- ◆ What is the procedure?
- ◆ How much time does the condo have to respond before it loses its right to purchase?

#### **Review of Financials**

In a coop, the focus is on the economic viability of the coop; attempting to determine the building's income prior to depreciation and the building's reserve fund; determining whether the coop has a fee or leasehold interest; determining when the mortgage on the building matures; what is the interest rate; and if there is a prepayment penalty. In addition, it is important to determine if

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there is any income derived from any commercial space in the building to ensure that the building meets the "80/20" test.

In a condo the focus is to determine the condo's reserve fund; if there is any real estate tax abatement, exemption or certiorari proceedings in effect; and reviewing the operating costs.

In connection with the review of the financials, BBW&G's policy is to urge prospective purchasers to have their own financial advisor review the coop or condo financials.

**Inspection of the Apartment Unit**

Perhaps the most important part of the due diligence process is the proverbial "kicking of the tires." It is imperative that the prospective purchaser check the kitchen and bathroom faucets, shower heads, fixtures, appliances, the floors, walls and windows in the unit to determine the current condition. The standard New York Contract of Sale provides that the unit will be transferred in "as is, where is" condition on the date of closing, thereby limiting the recourse a potential buyer may have if, between the time of contract signing and before closing, he or she discovers that a defect exists in the unit that was not specifically addressed in the

contract. A prospective purchaser may consider hiring a professional building inspector for a minimal fee. In a coop or condo setting this may be unnecessary as prospective purchasers can often discover glaring problems simply by being diligent.

Nonetheless, due diligence is a complicated process that typically requires the assistance of an attorney. In the purchase of a cooperative or condominium, the due diligence is performed prior to signing the purchase agreement. In fact, the results of your due diligence will not only determine whether or not you buy but also will dictate some of the provisions in the contract.

*This article was written by Craig L. Price, an associate in BBW&G's Transactional Department. If you have any questions regarding due diligence in a coop or condo transaction you may contact Mr. Price, or any of the partners in our Transactional Department.*



Craig L. Price

**Carbon Monoxide Detectors Now Required in NYC**

**M**any questions have already arisen regarding the New York City Carbon Monoxide Detecting Device Act of 2004 (the "Carbon Monoxide Law"), which was only recently enacted by the City Council and is to be administered by the Department of Housing Preservation and Development ("HPD"). Although the Carbon Monoxide Law goes into effect on November 1, 2004, and affects a multitude of New York City property owners, many property owners remain uncertain as to whether the Carbon Monoxide Law applies to their type of housing.

The Carbon Monoxide Law applies to the majority of cooperative shareholders and condominium unit owners; and, in certain instances, homeowners. (For more information on compliance with the

Carbon Monoxide Law, see "Owner's Must Install Carbon Monoxide Detectors By November 1, 2004" by Kara Rakowski, *September 2004 BBW&G Update*)

First, the Carbon Monoxide Law only applies to owners in buildings with a fossil fuel burning furnace or boiler. Fossil fuel is defined as coal, kerosene, oil, wood, fuel gases and other petroleum products. The Carbon Monoxide Law applies to every dwelling accommodation owned as a condominium or as a cooperative, whether owner occupied or not. In addition, the Carbon Monoxide Law applies to one-family and two-family homes only when they are **not** owner occupied. Therefore, there is an exception when a one- or two-family home is occupied by

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## Warehousing and the Conversion of Occupied Buildings to a Coop or Condo

One of the most frequently asked questions in connection with the conversion of an occupied building to condominium or cooperative ownership is “what is warehousing”? The term “warehousing” is not used in the statute or regulations governing conversions. Instead, the statute and regulations prohibit the Attorney General from accepting an offering plan for filing where the Attorney General finds “excessive long term vacancies.”

The governing statute, New York General Business Law §352-eeee, separates the concept of “excessive long-term vacancies” into two components:

- A “long term vacancy” is a dwelling unit not leased or occupied by a bona fide tenant for more than five months prior to the date of submission of the proposed offering plan (commonly known as a Red Herring because of the red typeface on the cover of the Plan), to the Attorney General’s office.
  - “Excessive” means a vacancy rate that is the greater of (i) ten percent of the number of units in the building, or (ii) a percentage that is twice the normal average vacancy rate for the building for two years prior to the January preceding the date of submission of the proposed offering plan.
- Some people believe that a building that has

a historically high vacancy rate could exceed the initial 10% rate set forth in the statute and not be deemed to have excessive long-term vacancies by the Attorney General’s Office. However, this is not the way the Attorney General interprets the statute. In order to discourage the warehousing of dwelling units, the Attorney General’s office will only accept an offering for a building with a vacancy rate in excess of 10% if the sponsor of the plan can demonstrate that the vacancies were due to some factor, beyond the control of the sponsor, which rendered the dwelling units unrentable. For instance, if the building sustained fire damage and had to be partially vacated, the Attorney General would not find an excessive amount of vacancies with respect to the vacated units and view such circumstances as not constituting warehousing.

As a result, barring unusual circumstances rendering units unrentable, a building that had a vacancy rate of 10% or more for the five month period prior to the submission of the Red Herring to the Attorney General’s office would be found to have “excessive long-term vacancies.” Consequently, the offering plan for that building would, in all likelihood, be rejected by the Attorney General’s office as having excessive long-term vacancies.

Notably, under certain circumstances, vacan-

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### **Carbon Monoxide Detectors . . .**

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the owner (the “Exception”).

Despite numerous inquiries to HPD, the City of New York and the New York City Fire Commissioner, much confusion surrounding the Exception remains. There seems to be neither rhyme nor reason as to why the Carbon Monoxide Law applies to owner occupied cooperative and condominium owners, but not to owner-occupiers of one- and two-family homes. Perhaps the Legislature and HPD will re-examine or will clarify the reason for this distinction once the rules implementing the new law are issued.

*This article was written by Barry Lenson, an associate in BBW&G’s Transactional Department.*



Barry Lenson

*Warehousing and the Conversion . . .*  
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cies that occur during the five-month period prior to submission of the Red Herring may not cause the Plan to be rejected. For instance, if an owner has an apartment vacant for part of the five-month period, but rents out the apartment during the five-month period, the apartment may not be considered vacant in calculating the 10%, depending on when the apartment is rented out. In another example, if an owner rents out an apartment before the commencement of the five-month period, but it becomes vacant during the five-month pe-

riod, rendering the vacancy rate in excess of 10%, that may also be acceptable. The Attorney General's office rules on these situations on a case-by-case basis.

Those contemplating conversions, must carefully consider the amount, timing and cause of vacancies prior submitting a Red Herring to the Attorney General's office.

*This article was written by Robert Jacobs, a partner in the firm's Transactional Department. For questions on condominium and cooperative conversions, please contact Robert Jacobs or Errol Brett.*

## Triggering Transfer Taxes on Lease Transactions

**A** lease transaction, whether it is a long term net lease, a surrender of lease or an assignment of lease, may cause a New York State Transfer Tax to become due. In accordance with NYCRR, a transfer tax is due under the following leasing scenarios:

- (a) If a lease or sublease has a term, including any options, which exceeds 49 years; substantial capital improvements are or may be made by or for the benefit of the lessee; and the lease is for substantially all of the real property;
- (b) A lease coupled with an option to purchase, regardless of the term of the lease;
- (c) an assignment of a lease; and
- (d) a surrender of a lease.

For the purposes of determining whether a lease is for substantially all of the premises, the "premises" includes (i) an entire building, except a condo and coop unit, (ii) a coop or condo unit or (iii) as to a lease or sublease of vacant land only, any portion of such vacant land.

The transfer tax is based on the taxable consideration for the transfer in question. For a grant of a lease with option, the taxable consideration is the present value of the net rental payments under

the lease plus the consideration paid for the option. For assignments and surrenders of leases, the taxable consideration is the amount paid by assignee or landlord accepting the surrender. No tax is due upon consideration paid by the assignor to the assignee to induce the assignee to accept the assignment; similarly, no tax is imposed upon a tenant paying a landlord to accept a surrender.

These types of leasing transactions are typically complicated, with significant financial ramifications. We suggest that you consult with our Transactional Department to help guide you through this process.

*This article was written by Daniel Altman, a partner in BBW&G's Transactional Department. If you have any questions regarding the payment of transfer taxes regarding leasing or other transactions, please contact Mr. Altman, Craig Ingber or Robert Jacobs of our Transactional Department..*



Daniel Altman