

The Paper Chase

Understanding Governing Documents

BY LIZ LENT 2011 JUNE

LAW & LEGISLATION



With homeownership comes great responsibility. For co-op and condo residents, part of that responsibility means sorting through the seemingly mile-high stacks of documents handed to you before, during and after the purchase process begins. Those documents can be confusing, especially for first-time buyers. Becoming familiar with each piece of paper and what it means is an important part of that responsibility that comes with homeownership, and that knowledge can save a lot of time and grief down the road.

Start at the Beginning

So what are the main governing documents of co-op and condo buildings? Each has two primary governing documents. For the co-op, "Those are the by-laws of the cooperative corporation and the proprietary lease between the corporation and each shareholder," says attorney Adam Leitman Bailey of the Manhattan-based firm Adam Leitman Bailey, PC, and author of *Finding the Uncommon Deal*. "In a condominium, the two primary documents are the condominium declaration and the by-laws of the condominium. In addition, both co-ops and condos have Rules and Regulations, sometimes called House Rules."

The proprietary lease "creates a landlord-tenant relationship between the cooperative and its shareholders and mostly governs maintenance and repair obligations as well as other issues affecting apartments such as permitted uses, subletting, alterations and transfers," says attorney Stephen M. Lasser a partner at the Manhattan-based law firm of Barton & Plotkin, LLP. "The bylaws mostly cover issues of corporate governance such as elections and meetings of the shareholders and board of directors, and the scope of

the board's powers. The bylaws also usually contain some provisions relating to shares and apartment sales and transfers." Bylaws in condominiums serve the same purpose.

Lasser also notes that co-ops will have a certificate of incorporation, the document filed with the New York Secretary of State to form the cooperative corporation. This document will contain the basics about the co-op such as the name of the corporation, the purposes for which the co-op was formed, the number of shares to be issued and the address of the cooperative corporation.

In a condominium complex, "The declaration is loosely analogous to a co-op's proprietary lease in that it defines and governs the rights and obligations of the condominium association and its unit owners relating to the owners' use of their units and the common areas," Lasser says. The declaration is recorded with the county clerk's office in the county where the condo is located. The document is then "incorporated by reference into the unit owners' deeds," he adds. "As a result, when a unit owner takes title to his or her unit, he or she is agreeing to be bound by the terms of the declaration."

For both co-ops and condominiums, the house rules serve to govern day-to-day quality of life issues such as prohibited behaviors in common areas and the appropriate usage of the building's amenities.

Differences and Similarities

There is one main difference to documents that govern co-ops and condos and they address the major difference between co-ops and condos themselves. "The governing documents of co-ops create a landlord-tenant relationship while condominium governing documents grant each unit owner title to their individual unit and a shared ownership interest in the common elements with the other unit owners," Lasser says. "This is a significant difference because it gives co-op boards greater powers and remedies to cure defaults by shareholders, including the power to evict shareholders from their apartments."

This is why co-op owners do not receive a deed to their unit as condo owners do and instead receive a proprietary lease. "A co-op apartment is not real estate," says attorney Thomas D. Kearns of the law firm of Olshan Grundman Frame Rosenzweig & Wolosky LLP in Manhattan. "The building is owned by a corporation which issues shares and a lease allocated to specific apartments."

“Every shareholder,” adds Bailey, “in the building gets the same lease. A cooperative owner doesn’t really own his or her specific apartment. Each ‘owner’ is really a shareholder of the cooperative corporation and a tenant, pursuant to the proprietary lease, of their particular apartment. Because they own only stock in a corporation and do not own any real estate, co-op shareholders’ evidence of ownership is a stock certificate issued by the corporation, not a deed. A condominium unit owner actually owns the apartment plus a percentage of the common elements.”

One other document which should be familiar to purchasers of space in new co-op and condo enterprises is what’s known as an offering plan, a disclosure document filed with the state Attorney General’s office and issued by the sponsor of either a co-op or a condo before the sponsor can begin selling apartments. Offering plans “contain representations and obligations” that the sponsor has to do certain things with regard to the building in which he or she is selling units. “Although many of these obligations are time limited,” says Lasser, “courts will sometimes refer to offering plans to determine whether a sponsor has fulfilled its obligations or to determine other legal rights even if it is many years after the first generation of residents have moved into a newly-constructed building.”

“As long as the sponsor is selling apartments,” Bailey says, “the offering plan must be updated annually. As a building matures, and certainly after the sponsor no longer owns any apartment, the offering plan becomes less relevant.” Still, though, it can serve as a valuable reference document. “Certain information, such as the allocation of shares or percentage common interest to individual apartments, description of the building, special rights reserved to the sponsor or to certain unit owners, may not be found anyplace else,” Bailey says.

Knowing What to Look For

As the purchase process progresses, more and more documents will come the buyer’s way, often creating a flood of paperwork that can seem overwhelming. All of those documents, however, are important and none should be overlooked. “A careful buyer will insist on reviewing the governing documents before signing a contract,” says Kearns. Most people, he adds, “rely on their attorney to let them know if anything is unusual.”

For some buyers, the chance to see some of these documents can be lost in the blink of an eye. "A buyer of a co-op who obtains a mortgage will see his or her proprietary lease for just a fleeting moment," Kearns says. "The bank takes it immediately as collateral." Typically, though, the building's managing agent will be able to supply a copy of all governing documents at no charge or for a nominal fee later.

Reviewing of all documents is key. "As the general rule in New York continues to be caveat emptor, (i.e. buyer beware)—a purchaser needs to receive the building's documents before entering into a contract," Bailey says. "It is a vital part of the purchaser's attorney's due diligence to review these documents."

While every building and every purchaser's needs are different, Bailey says some of the key points attorneys will be looking for include "does the sponsor still control the board? Are there restrictions on leasing or subletting? What is the sales process? Is there a flip tax, and if so, who pays it? What is the pet policy? What are the rules for alterations? Are there any restrictions on use?" These are all questions that are better answered sooner rather than later.

Keeping Up With the Times

Certainly, a co-op or condo building's documents will be kept on file for years and years, but even the most well-drawn plans may eventually go out of date. If a board member or managing agent discovers something has gone amiss in one of the building's governing documents, they can consult with a professional on next steps.

"The board should consult with their attorney to determine what is legally required to make the revisions they desire and the best way to obtain shareholder or unit owner approval," says Lasser. "Sometimes revisions can be obtained by written consent of the shareholders or unit owners and sometimes a vote must be taken at a meeting. In any event, an informational meeting with the shareholders or unit owners in order to explain the proposed revisions will usually greatly increase the probability that it will be approved by the required percentage of affirmative votes."

In most cases, the procedures for amending the documents will be set forth in the documents themselves, Bailey says. Although each building is different, a typical procedure for changes to the bylaws or the proprietary lease would be for a notice to go out to owners describing the proposed change. The notice would include a date and time for a meeting at which a vote on the change will take place. The notice also should include a proxy form for those residents who cannot attend the meeting. A formal vote will then be taken at the meeting and if the required number of votes is obtained—typically two-thirds of the unit owners, although some buildings require more—then the change is approved.

For other documents, the process may not be as lengthy. “Note that very often, the board has the power to adopt or amend the rules & regulations without the approval of the owners,” Bailey says. “In those situations, the board simply approved the change and then sends notice of the change to the apartment owners.”

Although the vast number and importance of the documents involved in purchasing and living in a New York co-op or condo can seem overwhelming, becoming familiar with each of those documents can bring a comfort level that make that avalanche of paper feel less daunting. With that, it becomes just a little bit easier to enjoy that new home in the city, stress-free.

Liz Lent is a freelance writer and teacher and a frequent contributor to The Cooperator.