



## **New York Lien Priority and Collections Strategy – Cooperative vs. Condominium**

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### **What is a Lien?**

A lien is an interest in or a legal claim to a piece of property, which allows the holder of the lien to legally seize and dispose of the property secured by the lien when a debtor fails to fulfill its financial obligations. Liens are commonly placed against property to secure repayment of a loan such as a home loan mortgage. If the borrower defaults on the loan payment, the lender, as the holder of the mortgage lien, can take back the property in a foreclosure action and sell it to repay the loan amount.

In addition to a mortgage taken to purchase a property, some properties have additional liens on them such as a home equity line of credit, judgment liens, homeowner's association and condominium association liens, and mechanic's liens. When a property has more than one lien filed against it, lien priority determines the lien holders' rights and the order in which the lien holders get paid if there is a foreclosure sale. If one lien has priority over another lien, then the lien with priority is superior and generally gets paid first upon a sale of the property before the other junior liens. Under New York law, the general rule is that liens have priority in the order that they are recorded first in the public land records which is known as the "first in time, first in right" rule, but there are many exceptions to the general rule.

As discussed below, in New York, a cooperative housing corporation has a first lien on the shares and appurtenant proprietary leases securing maintenance payments payable by the cooperatives' shareholders, which lien arises statutorily without being recorded. As a result, in a lien foreclosure sale where the cooperative corporation is owed maintenance from the apartment's owner shareholder, the cooperative will generally be the first in line to receive payments for the unpaid maintenance from a foreclosure sale before any payments are made towards a loan balance owed to a mortgage lender or other junior lienors.

However, unlike a cooperative, a condominium association does not have a first lien for unpaid common charges against a condominium unit, and its lien has to be recorded and is junior to a lender's first mortgage on the unit. Therefore, in a condominium lien foreclosure action, a lender's mortgage has priority and will generally be paid before a condominium lien for unpaid common charges. The legal differences between ownership of a cooperative apartment and a condominium unit and how they impact lien priority will dictate how the board and management of a cooperative or a condominium association should handle collection matters when a shareholder or unit owner fails to pay his or her maintenance of common charges.

## **Cooperative Lien Priority and Collection Strategy**

From a legal perspective, ownership of a cooperative apartment is considered personal property, and not real estate. When someone purchases a cooperative apartment, he or she is not buying an individual piece of real estate; rather, the purchaser is buying shares. As a result, the purchaser becomes technically both a shareholder and a tenant in a landlord-tenant relationship with the cooperative housing corporation. The cooperative apartment shareholder's interest in the cooperative housing corporation is created through the issuance of cooperative stock shares evidenced by a stock certificate and a proprietary lease, which govern the shareholder's rights and obligations. The cooperative housing corporation charges monthly maintenance fees to shareholders covering their pro-rata portion of the expenses of maintaining and operating the building, including the property taxes and the underlying mortgage for the entire building.

In addition to the landlord-tenant relationship, because a cooperative apartment is considered personal property in New York, the statute known as the Uniform Commercial Code ("UCC") governs cooperative lien priority. Article 9 of the UCC provides that if a cooperative proprietary lease contains specific basic language requiring a shareholder to pay maintenance then the cooperative corporation automatically has a lien against the stock and lease for any unpaid maintenance. A cooperative corporation, unlike a mortgage lender, is not required to file anything further with the state or county to secure its lien interest. More importantly, under Article 9 of the UCC, the cooperative corporation's security interest for unpaid maintenance has priority over almost all other lien interests against a shareholder's stock and lease such as a lender's mortgage lien.

When someone purchases a cooperative apartment and obtains a loan from a lender to finance the purchase, the loan is secured by a lien against the purchaser's ownership interest in the cooperative corporation, i.e. the stock certificate and proprietary lease. Cooperative loan documents consist primarily of a promissory note and a cooperative loan security agreement known as a UCC-1 Financing Statement, which when filed, creates a lien. In addition to filing the UCC-1 Financing Statement lien, the lender will take physical possession of the cooperative stock certificate and proprietary lease as collateral until the loan debt has been paid off.

Because a lender's UCC-1 Financing Statement lien will be subordinate to the cooperative's unpaid maintenance, the lender will require the cooperative corporation to execute an agreement known as a recognition agreement. Pursuant to the recognition agreement, the cooperative corporation will notify the lender of any notice of the cooperative corporation's intention to terminate the shareholder's proprietary lease and provide an opportunity for the lender to cure the shareholder's default, including payment of maintenance owed by the shareholder. As a result, through the terms of the recognition agreement and the cooperative corporation's lien priority over the lender, a lender is incentivized to pay off a cooperative shareholder's unpaid maintenance arrears owed to the cooperative corporation in order to maintain the lender's security interest in the apartment, which would be extinguished if a cooperative corporation forecloses on its lien for unpaid maintenance. Consequently, a cooperative corporation should notify lenders of shareholder maintenance defaults as a primary part of its collection strategy.

If a lender fails to pay maintenance to a cooperative corporation after receiving notice from the cooperative corporation of a shareholder's maintenance default, the cooperative corporation can evict the shareholder in a landlord-tenant proceeding and then sell the apartment at an auction or via a real estate broker.

### **Condominium Lien Priority and Collection Strategy**

Unlike a cooperative apartment where the cooperative housing corporation owns the building and gives the shareholder the exclusive right to lease a particular apartment located in the building, ownership of a condominium unit is ownership of real estate. A condominium building is divided into individual units, each with its own tax lot. Each unit owner is responsible for paying his or her own real estate taxes. Common charges collected by the condominium association are used to pay for the expenses to maintain and operate the common areas of the building. As a result, there is no landlord-tenant relationship between unit owners and the condominium association, and the unit owner does not receive a stock certificate or proprietary lease. Instead, ownership of a unit is conveyed via a deed and the unit owner's relationship with the condominium association is contractual and governed by the condominium's declaration and by-laws.

Since a condominium unit is considered real estate, New York Real Property Law ("RPL") Article 9-B also known as the New York Condominium Act governs a condominium's lien interest for unpaid common charges in relation to other lien interests such as a lender's lien. Unlike the purchase of a cooperative apartment, when someone obtains financing from a lender for the purchase of a condominium unit, the lender secures its interest through the filing of a mortgage, which then becomes a lien against the property. More importantly, unlike a cooperative corporation, a condominium association, as provided under RPL § 339-z, does not have a first lien for unpaid common charges against a condominium unit, and its lien is junior to a lender's first mortgage on the unit.

Pursuant to RPL §339-z, a condominium association's lien for unpaid common charges takes priority over all other liens, except for (i) real estate taxes including applicable school and special district taxes; (ii) sums unpaid on a first mortgage of record; and (iii) sums on a subordinate mortgage of record by certain state development agencies. When a unit owner defaults on his or her common charges, RPL §339-z and §339-aa allows the board of managers of a condominium to file a lien for common charges, which is filed with the county clerk's office, which is a public record and secures the condominium's lien interest for unpaid common charges. The recorded lien for unpaid common charges is valid for six years from the date of filing, and it is a continuing lien, which provides that the lien amount continues to accrue if no payments are made. Additionally, filing a lien not only secures the condominium association's lien interest, but it is a prerequisite to commencing a condominium's lien foreclosure action.

Once a condominium association's common charge lien is filed, the next step would be to commence a joint money judgment and lien foreclosure action against the unit owner in the county's Supreme Court. Commencing a condominium lien foreclosure action is most effective in cases where there is no default by the unit owner on his or her first mortgage of record.

Frequently, when there is a default payment in the payment of common charges, the unit owner is also in default on the mortgage payments, resulting in the mortgage lender commencing its own foreclosure action against the unit owner. Because RPL §339-z provides that a lender's first mortgage lien takes priority over a condominium association's lien for unpaid common charges, the lender's outstanding mortgage balance will generally get paid first from a foreclosure sale before payment is made to the condominium's lien for unpaid common charges. Therefore, commencing a condominium lien foreclosure action is most effective and beneficial when there is no existing first mortgage on the unit or no existing mortgage foreclosure action because under those circumstances, the condominium would be able to foreclosure and sell the unit and use the proceeds from the foreclosure sale to typically fully satisfy its unpaid common charge lien. Nevertheless, even if there is an existing first mortgage or an existing mortgage foreclosure action against the unit, commencing a condominium lien foreclosure action may still be beneficial if (1) the value of the unit exceeds the outstanding balance of the first mortgage; (2) the remaining balance of the first mortgage is minimal; and (3) the mortgage foreclosure action is in its early stages while the condominium's lien foreclosure action is near to completion for an auction sale. As a result of the potential overlap between a condominium's lien foreclosure action and a lender's mortgage foreclosure action, a condominium should also pursue a money judgment simultaneously with its lien foreclosure action, so that the condominium can still obtain a money judgment against the unit owners personally in the event the condominium's lien foreclosure action becomes secondary to the mortgage foreclosure action.

## **Conclusion**

In conclusion, lien priority is an important factor that board members of a cooperative or a condominium should take into consideration before determining how to handle collection of unpaid maintenance or common charges in New York. In a cooperative setting, where the cooperative's secured interest for unpaid maintenance is superior to the lender's interest, lenders are inclined to pay shareholders' unpaid maintenance to the cooperative corporation, so this should be a primary method of collection. However, in a condominium setting, where the lender's lien is superior to the condominium's lien for unpaid common charges, the lenders are not inclined to pay unit owners' unpaid common charges to the condominium. For this reason, it is beneficial for condominiums boards to conduct a thorough evaluation of the value of a unit in arrears, its mortgage balance and lender's foreclosure status, and overall lien priority to determine the most cost effective collection strategy.