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Expert Analysis

Legislative Recognition Of Co-ops Has a Downside

For decades, with few exceptions, the New York State Legislature has paid little attention to the ever increasing number of apartments falling under the category of cooperative units. There were massive conversions in the 1960s, 70s and 80s when owners of rental buildings found a windfall by converting to cooperative status. While there had always been many co-op buildings in Manhattan, significant conversions occurred in the outer boroughs of New York City as well as Nassau and Suffolk.

The primary recognition by the New York State Legislature of the growth of cooperative living is found in Article 9 of the Uniform Commercial Code (UCC). The revision of 2001 as well as the prior law had customized sections pertaining specifically to co-ops. The UCC provided a means to place a lien on the shares of the cooperative corporation as well as interest in the proprietary lease.¹ Such provisions were necessary since the UCC financing statement is a means of attaching and perfecting liens against personal property; however, the code specifically excludes leases.²

With the growth of the co-op market, there was a need for "title type" insurance for purchasers as well as lenders. Title insurance companies are now providing coverage for title to the shares of stock and interest in the proprietary lease. Such coverage provides comfort to the lenders that their lien is not only secured by proper recording but also insured.

In addition, a co-op policy can afford the buyer insurance against loss or damage from claims such as: when a person other than the insured buyer claims rights of ownership in the co-op; the selling



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entity does not have the authority to sell; or there is the existence of a lien creditor to any portion of the cooperative interest.³

As the "real estate bubble" started to burst in 2007 it would soon be apparent that the ever growing co-op sector would not be immune from the financial crisis. New York State took initial action in 2007 to assist traditional homeowners who were losing their homes based upon foreclosures from "subprime home loans."⁴ Various provisions

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came into play which provided a 90-day notice period before the secured party could proceed with the foreclosure action. The form of notice was created and it accompanied the requirement of a conference that would attempt to negotiate terms to resolve the default. The conference is to take place within the first 60 days of that notice period.

Traditionally defaults on loans for cooperative interests had followed the standard provisions of Article 9. As with any personal property defined under the code, the statute called for requirements including only a 10-day minimum

notice.⁵ Accordingly, a foreclosure on a cooperative apartment unit could be accomplished in as few as 90 days. However, due to recent legislation effective Jan. 14, 2010, the speedy foreclosure proceeding for cooperative apartments has been slowed substantially.

Chapter 507 of the Laws of 2009, signed by Governor David Paterson on Dec. 15, 2009, amended the Real Property Actions and Proceedings Law, the Uniform Commercial Code, the Civil Practice Laws and Rules, the Banking Law and others as to foreclosures on home mortgage loans. These changes were to impact loans secured by cooperative interests as well.

Changes in Requirements

The 90-day foreclosure notice is now expanded to include all home loans, not just subprime loans. Statutory provisions now included a similar form notice on foreclosure actions against cooperative interests.

Subsection "(f)" ("Additional pre-disposition notice for cooperative interests") has been added to UCC Section 9-611 ("Notification before disposition of collateral") by Section 2 of Chapter 507, effective Jan. 14, 2010, the 30th day after the date on which the chapter was enacted. The subsection applies to notices required on or after such date.

In addition to notices required to dispose of a cooperative interest under subsection (b) of UCC Section 9-611 and UCC Section 9-613 ("Content and form of notification before disposition of collateral: Generally"), UCC Section 9-611 has been amended to require that a pre-disposition notice be sent, after default and not less than 90 days prior to the disposition. The statute provides the form and wording of the notice. This has raised an issue as to whether proceedings by the cooperative corporation for unpaid common charges fall under these new restrictions.

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The form notice contains the following sentences:

You are in default of your obligations under the loan secured by your rights to your cooperative apartment. It is important that you take action, if you wish to avoid losing your home.

The owners of cooperative interests normally have two financial obligations. They are the payment due on the mortgage as well as the common charges due the cooperative corporation. Whether intended or not, by using the word "loan," the provision makes specific reference to a secured interest created by a financial institution. Accordingly the argument can be made that the cooperative corporation can proceed under the shorter 10-day notice period stated in the standard default provisions of the code.

Financial institutions financing cooperative interests had relied on the short foreclosure proceeding under the UCC. With this revision, the owners of the co-op interests now have a considerable additional amount of time to maneuver and protect their interests. Such financial institutions may reconsider the terms of such loans which may increase their cost. In addition, if both the mortgage and common charges are in default, the financial institution may opt to allow the cooperative corporation to proceed with foreclosure on the shortened notice provision and recoup its loan upon the resale of the unit.

With this change in the various statutes, the owners of cooperative apartment units received recognition that they are entitled to the same protection in foreclosure as owners in other residences. Unfortunately this validation has prompted the first move by the legislature to seek a financial benefit from such recognition.

Mortgage Tax

Significant revenue is generated by the mortgage recording tax imposed on the sale of real estate in New York. Now that cooperative units are receiving certain protection afforded other residential units, that protection may come at a price in the form of a new tax.

The initial proposed budget by Governor Paterson contained provisions that would have amended Section 253 of the tax law as well as section 9-502 of the uniform commercial code. As a result of the amendment of the tax law, the financial transaction and loan as secured by the cooperative interests would have been subject to the same mortgage recording tax as a real estate mortgage.⁶

Under current law, a security interest against a cooperative interest is achieved pursuant to the UCC by filing a financing statement in the county where the cooperative is located. If a standard financial statement is used, a statutory period of five years is assigned.⁷ If the cooperative addendum form is used, the statutory period is extended for a total of 50 years.⁸ The amendment to the UCC would have required the filing of the cooperative addendum form that shall provide "the amount of the principal debt that is secured by the security agreement evidenced by the financing statement...."

Following substantial opposition to this proposal from various sources including the New York State Bar Association, the proposed new tax has been dropped in new versions of the budget. However, historically when a proposal such as this is raised and in its first effort withdrawn, it normally continues to find its way into future drafts and eventually becomes law.

It is believed that representatives of the Tax

Department (the authors of the legislation) will seek to propose the tax in future years. If and when this tax is approved, the result will be that every co-op sale will be recognized by a transfer tax on the sale of the cooperative shares as well as a corresponding mortgage recording tax on the amount financed.

The size of this tax would be substantial. The impact would be readily obvious as buyers reflect on the additional expense associated with their purchase. The resulting negotiations will impact selling prices as the amount of the tax due will be recognized as part of the total consideration paid.

Cooperative apartments flew under the legislative radar for many years. And while owners will appreciate the new foreclosure provisions giving them additional protection, that recognition may come with a price in the creation of a new mortgage tax.

The authors anticipate that the resulting delays in the ability of lending institutions to foreclose may make financing of the units more expensive. Should the recording tax be implemented, it will no doubt impact the selling price of units as well.

To be continued.

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1. UCC 9-502(a)(4) and 9-502(e).

2. UCC 9-104(j).

3. See www.FirstAmNY.com, www.eagle9.com or www.ModernAbstract.com.

4. The "Help for Homeowners in Foreclosure" notice under RPAPL 1303 was first required by Chapter 308 of the Laws of 2007 for mortgage foreclosures commenced on and after Feb. 1, 2007 on property improved by a 1-4 family dwelling.

5. UCC 9-611(c)(B).

6. NYC mortgage recording tax for residential property where the mortgage is under \$500,000 is 2.05 percent and 2.175 percent where the mortgage is over \$500,000. Mortgage recording tax in Nassau and Suffolk counties are currently 1.05 percent of the mortgage amount.

7. UCC 9-515(a).

8. UCC 9-515(h).



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