Chapter 1

General Considerations

§ 1:1 Principles to Follow in All Cases

§ 1:1.1 Get into the Case as Early as Possible

§ 1:1.2 Balance the Client’s Timing Concerns with the Legal Considerations

§ 1:1.3 Use a Standardized Contract of Sale—Carefully Modified by You

§ 1:2 Background on Condominiums

§ 1:2.1 Type of Ownership

§ 1:2.2 Organizational Structure of the Condominium

§ 1:2.3 Tax Considerations on the Ownership and Sale of a Condominium Unit

§ 1:3 Background on Co-ops

§ 1:3.1 Type of Ownership

§ 1:3.2 Organizational Structure of the Cooperative Corporation

§ 1:3.3 Qualification of Cooperative Corporation Under I.R.C. Section 216

§ 1:3.4 Impact of Taxpayer Relief Act of 1997

§ 1:4 Important Steps in Every Transaction

§ 1:4.1 Obtain the Necessary Information

§ 1:4.2 Review the Documents and Inspect the Property

§ 1:4.3 Undertake Steps to Assure Financing

§ 1:4.4 Draft and Negotiate the Contract of Sale

§ 1:4.5 Obtain and Prepare the Necessary Documents for Closing

§ 1:4.6 Attend the Closing

§ 1:4.7 Handle Miscellaneous Postclosing Details

§ 1:1 Principles to Follow in All Cases

Attorneys who want to handle a condominium or co-op sale successfully should follow three basic principles: (1) get involved as early as possible, (2) balance the client’s timing concerns with the legal
considerations, and (3) use a standardized contract of sale, modified as necessary.

§ 1:1.1 Get into the Case as Early as Possible

The best piece of advice to your client in dealing with a condominium or co-op sale or purchase is to get you involved at the earliest possible stage. Unfortunately, if you are in a position to give your client that advice, he or she doesn’t need it because he or she has already started consulting with you.

Sad but true, the attorney is often not called into a case until some initial steps have been taken by the seller or purchaser—and sometimes more than initial steps. The seller may have already signed a brokerage agreement with unfair but fully enforceable terms regarding payment of a commission. The buyer may have signed a “binder” that, while not a full sales contract, has enough essential elements to stand up in court—or at least assure the buyer of a lawsuit to prove otherwise.

A real estate professional would not think of signing a contract until his or her lawyer had reviewed and approved it. Yet, the buyer of a condominium or a co-op, making what is usually the biggest investment of his or her life, often signs a contract of sale with immense personal consequences as if he or she were signing a charge card receipt.

Although the ideal is to be involved in the transaction before any papers have been signed, the reality is that many persons think of contacting an attorney only after they have made some form of commitment. Even under the best circumstances, it is most likely that the seller and buyer have already found each other, decided to deal with each other, and set a price agreeable to both sides. Expect to face this situation when you are called in.

The variations on brokerage agreements and binders are discussed in chapter 2. If your client has already signed a sales contract, discussed in depth in chapter 3, your role has been reduced dramatically, and you may simply be holding hands through the rest of the closing procedure, discussed in chapters 4 through 6.

§ 1:1.2 Balance the Client’s Timing Concerns with the Legal Considerations

As an attorney, you operate in a world of legal problems with optimal solutions for your client. Your client, on the other hand, is operating in a different world. He or she may have found the house of his or her dreams—or at least the best one available in his or her judgment—and wants to make a deal. Or, as seller or buyer, your client needs to close the deal quickly for compelling reasons—a business
transfer requiring a quick move, the imminent sale or purchase of the client’s current residence, or tax considerations.

In these circumstances, your desire to assure absolute legal security and the best possible terms for your client may well make your client wonder whose side you are on. Buying a new residence—a co-op, condominium, or private house—is an emotional event for most individuals, it is often the most expensive transaction in which they have ever engaged, and it is often the first time they have dealt with a lawyer.

Given the pressing time considerations that usually apply—since every sale of a home is usually part of a chain that is preceded and followed by a purchase of a different home—the last thing your client wants is for you to nitpick every legal point in a contract of sale. Nevertheless, your obligation is to look out for the best interests of your client, and a part of that obligation is to inform him or her of the pitfalls that different courses of action hold.

Your most important exercise of judgment, however, is to differentiate between those pitfalls that, on balance and considering your client’s needs and desires, present acceptable risks, and those that ought to kill the deal unless remedied.

A client may not always accept your assessment of the risks. Nor may you always win a special place in your client’s heart. But you needn’t end up on his or her wrong side, either. Keep in mind the significance of the transaction to your client, a significance compounded by the anxiety often created by the timing considerations. With that significance in mind, you should be able to advise your client thoroughly without being seen as an impediment to what is, after all, the goal of both parties to the transaction—to close the deal.

§ 1:1.3 Use a Standardized Contract of Sale—Carefully Modified by You

Virtually every jurisdiction has a standard contract prepared by a local industry group or bar association. The obvious drawback of these contracts is that they can reflect the interests of the group involved in their drafting. The principal virtue, however—and one that usually overrides the drawbacks—is that both the seller’s and the buyer’s attorneys are often familiar with the standard contract and have used it previously. It is therefore common ground from which both parties can negotiate to include or exclude terms. Also, these standard contracts reflect variations in local law and practice that it is important to take into account.

Whether a standard contract is used, or an original contract is being drafted, the terms included in the contract must be customized for the particular needs of the seller and buyer. Each term must be carefully
analyzed to assure that it reflects those needs. It is easy to let some standard terms remain unchanged that may be significant to the client—neglecting to insert a provision that certain warranties survive the closing of the deal, leaving in a “time is of the essence” clause when the buyer cannot assure the timing of his or her financing.

The practice followed almost universally is for the seller’s attorney to prepare the basic contract and present it to the buyer’s attorney for his or her review and approval. The buyer’s attorney can then decide which terms need to be revised, omitted, or added, and the negotiations on these provisions can commence.

§ 1:2 Background on Condominiums

§ 1:2.1 Type of Ownership

A condominium unit is real property and can be transferred and owned like any other form of real property. Thus, the following rules apply.

The owner of a condominium unit actually owns the four walls and the air space within them, unlike a co-op, for which the “owner” owns shares in the cooperative corporation that give him or her rights to the co-op unit.

The condominium unit owner also owns an undivided interest, as tenant in common with the other unit owners, in the common elements of the condominium (the common spaces or systems of the building or property of which the condominium unit is a part). The percentage of interest is determined on the basis of either square foot area or value.

Title to the condominium unit is fully transferable. Conditions restricting sale of the unit, such as the consent of the association, generally violate the laws of most jurisdictions that permit free transfer of property. See the Note on Legal Sources at the end of this book for a list of jurisdictions that permit conditions restricting sale in the condominium setting. Conditions giving the condominium association the right of first refusal on a sale do not restrict free transfer and are usually permitted.

§ 1:2.2 Organizational Structure of the Condominium

How a particular condominium is structured is usually governed by state law. Look at the Note on Legal Sources at the end of this book for a list of state laws. Several rules govern the structure and operation of condominiums in virtually all states.

A declaration or master deed regarding the condominium is filed in the county where the condominium is located, and should be available from the owner or the condominium association. The declaration or
master deed subdivides the property into units, specifies the percentage of interest in the common elements that goes with each unit, and also includes a description of each unit and of the common elements.

The by-laws of the condominium, setting up its structure and operation, are filed with the declaration or master deed. The by-laws set out the method of voting of the condominium owners, the procedure for meetings, and the structure of the organization, including the powers and duties of the board of directors of the association.

In most parts of the country, the condominium is managed by a not-for-profit corporation, called the association, in which all unit owners are members and elect the board of directors. Voting can be allocated by unit, by square footage, by value, or by some other method related to degree of ownership within the condominium.

In New York, the condominium is customarily managed by an unincorporated board of managers elected by the condominium owners.

The association or board has the right to establish common charges and impose assessments as needed to pay operating expenses and maintain the condominium as a whole and it has a lien on the units to secure the owners' obligations for payment of common charges and assessments. It can exercise its right of first refusal on any unit sales within the condominium. It establishes house rules on pets, the use of amenities, etc. It must carry adequate insurance with regard to the common areas and elements of the condominium. It cannot change the percentage of interest in the common elements, or the method of determining this percentage, without an amendment of the declaration requiring the consent of the owners (and their mortgagees). A unit owner's share of the common charges is based on the percentage interest in the common elements appurtenant to the unit.

Because each condominium unit is individually owned, each owner can obtain an individual mortgage for the unit; there is no mortgage on the property as a whole. This situation is different from a co-op, where the cooperative corporation normally takes a mortgage on the property, the prorated share of which is apportioned for payment purposes among the shareholders; while each individual shareholder may obtain financing on his or her unit, that financing is in the form of a personal loan secured by the shares and lease owned by the shareholder.

Each condominium unit is separately assessed for real estate tax purposes, and the unit owner pays his or her taxes directly to the tax assessor. A cooperative corporation's property, on the other hand, comprises one tax lot, and the real estate taxes payable by the corporation are apportioned by the corporation among the shareholders.
A unit owner has the right to deduct from his or her adjusted gross income for income tax purposes the real estate taxes on the unit and interest on up to $1,000,000 of principal on a mortgage obtained to purchase the unit or on a home equity loan of up to $100,000.

§ 1:2.3 Tax Considerations on the Ownership and Sale of a Condominium Unit

The Taxpayer Relief Act of 1997, effective May 6, 1997, repealed the old rules for deferral of gain from the sale of a residence when a new one is purchased. Instead, the new law (section 1.21 of the Internal Revenue Code) provides for exclusion from gain of up to $500,000 (for a taxpayer filing a joint return) and $250,000 (for a taxpayer filing a separate return) on the sale of a principal residence. The taxpayer must have owned and used the property as a principal residence for periods aggregating at least two years of the five-year period ending on the date of the sale. If a husband and wife file a joint return for the year of sale, the exclusion applies if either one meets the two out of five years requirement. If the sale is made by an unmarried individual whose spouse is deceased by the date of the sale, the exclusion will be up to $500,000 if the sale occurs not later than two years after the spouse’s death.

A taxpayer who cannot meet the two-year test may be eligible for a partial exclusion if the sale is the result of a change in the place of employment, health, or other unforeseen circumstances. The partial exclusion is based on the proportion of the period of ownership and use to two years. For example, if the taxpayer is transferred to a new job nine months after buying a new home, the exclusion would be 9/24 of the excluded amount.

The exclusion is available only once every two years.

As a result of the Taxpayer Relief Act of 1997, many taxpayers will be able to sell their homes, more than once in a lifetime, without having to pay capital gains tax, and all taxpayers will benefit from a reduced capital gains tax.

§ 1:3 Background on Co-ops

§ 1:3.1 Type of Ownership

The owner of a co-op is actually a shareholder in the cooperative corporation that owns the building in which the co-op unit is located. Ownership of the shares gives the shareholder the right to reside in the unit to which the shares are allocated, pursuant to a long-term proprietary lease or occupancy agreement between the cooperative corporation, as landlord, and the shareholder, as tenant.
Unlike the condominium, most co-op proprietary leases and occupancy agreements prohibit assignment or subletting without the prior written consent of the cooperative corporation, which may be withheld with or without cause, subject to the laws against discrimination. The requirement for consent is not violative of the prohibition against restraints on alienation because the shareholder is the owner of a leasehold, not a fee interest, in the property.

§ 1:3.2 Organizational Structure of the Cooperative Corporation

A cooperative corporation is usually formed under laws pertaining to business corporations. A certificate of incorporation is filed with the Secretary of State of the state in which the property is located. The cooperative corporation is governed by its by-laws, which provide, among other things, for the number of directors, the method of voting by the shareholders, procedures for meetings and the duties of the directors and officers.

The board of directors has the right and obligation to establish maintenance charges and impose assessments needed to pay operating expenses, including real estate taxes assessed against the property owned by the cooperative corporation and debt service on any mortgage on the cooperative corporation’s property, and to maintain the building in a good state of repair. The certificate of incorporation or by-laws usually grant the cooperative corporation a lien on the shares of a shareholder who defaults in the shareholder’s obligations for payment of maintenance charges and assessments. A shareholder’s share of maintenance charges and assessments is based on the percentage of shares owned by him or her.

The directors must carry adequate insurance on the building and establish house rules on pets, the use of amenities and other matters. The board has the right to mortgage the cooperative corporation’s property for a valid corporate purpose without the consent of the shareholders.

§ 1:3.3 Qualification of Cooperative Corporation Under I.R.C. Section 216

If the cooperative corporation qualifies under section 216 of the Internal Revenue Code, a shareholder will be allowed to deduct from gross income his or her proportionate share of real estate taxes and mortgage interest paid by the cooperative corporation. The following are the requirements for qualification:

(1) The primary purpose of the cooperative corporation must be to provide homes for its shareholders.
There can be only one class of shares.

The shareholders may not receive any distribution from the cooperative corporation except from profits.

The cooperative corporation must meet one of the following requirements for the taxable year in which the taxes and interest are paid or incurred:

(a) 80% or more of the cooperative corporation’s gross income is derived from shareholders;

(b) 80% or more of the total square footage of the cooperative corporation’s property is used or available for use by the shareholders for residential purposes or purposes ancillary to such residential use;

(c) 90% or more of the expenditures of the cooperative corporation paid or incurred are for the acquisition, construction, management, maintenance or care of the cooperative corporation’s property for the benefit of the shareholders.

§ 1:3.4 Impact of Taxpayer Relief Act of 1997

Since the federal tax law treats the sale of a co-op residence in a co-op that qualifies under section 216 of the Internal Revenue Code in the same way as the sale of a condominium unit, the Taxpayer Relief Act of 1997, discussed above in section 1:2.3, will also benefit the co-op seller. If the taxpayer has owned and used the co-op as a principal residence for periods aggregating two years of the five-year period ending on the date of the sale, up to $500,000 (for taxpayers filing joint returns) and $250,000 (for taxpayers filing separate returns) will be excluded from gain.

§ 1:4 Important Steps in Every Transaction

Every transaction involving the sale of a condominium or co-op unit involves the same standard elements, with variations depending on the particular transaction. The important steps include those discussed below.

§ 1:4.1 Obtain the Necessary Information

The attorney must obtain the information necessary to represent the client. This information includes the basic facts about the transaction, obtained through the initial interview of the client. A checklist of necessary facts applicable in every case is important to use; sample checklists are included below in section 2:2. The attorney must also
obtain certain required documents, such as the condominium declaration or the articles of incorporation and form of proprietary lease of the co-op and, if the purchaser is buying from a sponsor/developer, the offering plan or prospectus required by the law of the state in which the property is located, to be filed with the governmental agency having jurisdiction. [See below section 2:1.5]. Checklists of these documents are also included in section 2:2.

§ 1:4.2 Review the Documents and Inspect the Property

The attorney must carefully review the documents provided by the client, an often time-consuming step with regard to such items as the condominium or co-op by-laws and house rules, and the offering plan or prospectus. The step is essential for proper representation, however. It is important, also, for the purchaser to arrange for an inspection of the premises by an architect or engineer, to assure that it is in condition suitable for sale, or that any deficiencies at least are known for purposes of negotiating the purchase price. Other inspections may be necessary under specific circumstances, such as termite inspections, or lead paint, asbestos, and radon inspections. The purchaser and his or her attorney should also conduct a personal inspection of the unit to ascertain the personal property that the parties intend to transfer with the sale and to look for any visual defects in the unit or the property as a whole. The seller’s attorney will also want to investigate whether any defects exist requiring correction prior to sale. A discussion of the usual inspections is included below in section 2:2.

§ 1:4.3 Undertake Steps to Assure Financing

The purchaser’s attorney will inevitably be expected to help in obtaining financing, including reviewing financing documents and advising on the best financing alternatives. The time necessary to obtain financing varies from area to area, and from time to time. During periods when interest rates make refinancing of already-mortgaged properties desirable, lending institutions often experience a backlog in processing financing requests. The financing steps should be commenced immediately, therefore, to assure closing within a reasonable period of time suitable to the seller. Financing is discussed in section 2:3.

§ 1:4.4 Draft and Negotiate the Contract of Sale

As already noted, the seller’s attorney customarily drafts and presents to the purchaser’s attorney a contract of sale, which is then the basis for negotiation between the parties. The terms of several standard contracts of sale, and an analysis of the negotiating positions of each party regarding these terms, are discussed in chapter 3.
§ 1:4.5 Obtain and Prepare the Necessary Documents for Closing

A number of documents must be obtained or prepared for the closing, including various tax forms, title insurance, financing documents, and the deed of sale. Some of these documents are routinely obtained or prepared by the seller’s attorney and some are generally obtained or prepared by the buyer’s attorney. A checklist of these documents and other preclosing steps is included in chapter 4.

§ 1:4.6 Attend the Closing

In the eastern United States, there is usually a closing meeting attended by the buyer and seller and their attorneys, together with representatives of the title insurance company and the financing institution. At this time, the necessary paperwork is completed, documentation exchanged, and moneys paid for the balance of the purchase price, apportionments, and other fees and taxes. In California and many western states, the closing is completed by the escrow company or other agent, which collects the closing documents and checks and on the designated date completes the necessary paperwork and disburses the funds and papers. A description of the closing as it occurs in various jurisdictions is included in chapter 5.

§ 1:4.7 Handle Miscellaneous Postclosing Details

The attorney will be expected by his or her client to handle various details after the closing, including the receipt of final documents such as the recorded deed and the title insurance policy. Postclosing matters are discussed in chapter 6.