

## Understanding Due Diligence: Co-op And Condo Boards Need To Be Proactive

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Too often, cooperative and condominium boards approve the release of financial statements and minutes from board meetings without understanding the potential red flags that might be included therein. It is imperative that such boards and, more importantly, the management companies they retain review and understand the materials that are circulated to

the representatives of potential buyers.

As a part of their fiduciary duties, boards and management companies need to act in the best interest of the co-op and condominium buildings they represent. One of their most important duties is to ensure that units in the building remain an attractive investment to potential purchasers. Simply put, retaining market value should always be on the minds of those that represent the building's interest. The best way to accomplish this is to problem-solve in advance in the hopes of producing an answer or solution to any red flag posed by a potential purchaser or his/her representative.

A seasoned residential real estate attorney should be doing the following as part of due diligence: a) analyzing the building's financial statements; b) reviewing the offering plan and amendments; and c) reviewing the minutes of board meetings. It should be assumed that any buyer will be briefed on these documents and that he will be advised as to any potential risks set forth therein before signing a Contract of Sale. Many attorneys will even provide this analysis in the form of a detailed memo to the purchaser.

### Financial Statements: Breeding Ground for Red Flags

The first piece of due diligence that a buyer's attorney often reviews is the financial statements of the cooperative or condominium. The attorney will want to see a minimum of two years' worth of statements. These documents are a breeding ground for red flags and it is imperative that any board or management company understand what they are before releasing to prospective buyers.

Generally speaking, a buyer or his attorney will want to see the following: a) that the building has been operating at a surplus for the last few years; b) that there is a sufficient reserve account; c) that a cooperative building qualifies under 80/20 for income tax deductions; and d) that capital improvements are budgeted for.

In addition to above, most lenders will want to see: a) that condominium's budget has a line item that 10% of operating expenses will go into a reserve fund; b) that a cooperative's underlying building mortgage does not mature in less than six months; and c) that there are no active, threatened or pending instances of litigation.

If a building in question has an issue referenced above or otherwise, it is imperative that the management company be prepared to temper the concerns raised by a diligent buyer's attorney. For ex-

ample, if the financials reference upcoming capital improvements then be ready to establish how such improvements will be paid for. If the financials reference litigation, have the building's attorney on standby to prepare a basic letter explaining the case and the risks associated therewith.

### Offering Plans: Becoming Less Important Over Time

Every validly formed condominium and cooperative building has an original offering plan housed at the offices of the management company. In many cases, especially in older buildings, these offering plans or approval documents have been amended several times. As a result, the original plan becomes less relevant over time. However, it is important for a board and its representatives to understand what special risks the building might be subject to. One of the most common special risks that alert purchasers is reference to lot line windows. In this day and age, few buyers want to worry about potentially losing the view they just spent a good fortune on.

Other areas of concern are often the building's by-laws and house-rules/regulations. Ensuring that these remain relevant and updated is key.

### Board Minutes: Often Overlooked by Boards

Generally speaking, board minutes kept by cooperative and condominium boards are as vanilla and non-descriptive as possible. But, every so often, simple references are made that will alarm a purchaser's attorney. When there is a problem or potential issues in the building (i.e. bed bugs, noise violations, disturbances, water infiltration/leaks, owner disputes, litigation etc.), it is imperative that they be described in general terms. For example, using the term infestation when referencing an insect or rodent situation will alarm any potential buyer. Use of the words litigation or threatened litigation when referencing a dispute will do the same. Boards are obligated to keep adequate minutes; however, board secretaries need to be careful about how issues are couched. More importantly, management companies need to review the minutes before making available to prospective purchasers.

In order to preserve market values and protect the unit owners, boards and management companies alike need to be prepared and proactive. It is crucial that boards and management companies understand the potential concerns of a purchaser and act accordingly.

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