Is It Really Impossible For An Investor To Purchase In A Co-op?

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It has always been a common sentiment that investors looking to purchase residential real estate in New York City should only focus on condominiums and other types of real property and not cooperatives.

While this sentiment is justified because co-ops have an approval process for all purchasers and tenants, which at times can be rather stringent or even arbitrary coupled with the fact that the building rules concerning subletting are typically more restrictive in a co-op versus a condo.

However, it is important to keep in mind that there are some co-op buildings in Manhattan that have more flexible policies than others when it comes to investors and sublets.

This is especially important to look into and consider due to the current low inventory of apartments and the mere fact that 75% of the apartments in Manhattan are co-ops and only 25% are condominiums.

Also another incentive for potentially investing in a co-op is the difference in purchase prices. Co-op's typically cost 10% less than condominiums and at times that differential can be as high as 40%.

However, this discount in purchase price doesn't necessarily translate into a discount in the rent a shareholder can charge a tenant and thus is obviously an attractive option for an investor.

The most important item to look out for in finding a co-op that is investor friendly is the building's sublet policy. In condominium buildings, a unit owner can sublet their unit to essentially any tenant they desire and the only restrictions are the condominium's right of first refusal for the sublet and perhaps a restriction that the lease must be at least one year in length (some buildings do permit for transient occupancy or shorter term leases).

Co-ops that do allow for investors to purchase, usually have sublet policies such as one that limits the total number of years a shareholder can rent out their unit during their course of ownership or during a fixed period of time (i.e. two years of renting during a five year period of ownership).

Additionally, co-op's typically charge a sublet fee which can be based on one of the following: 1) an additional month's worth of maintenance; 2) a fixed percentage of the annual rent (i.e. 10%); or 3) a fee equal to a 20% increase in maintenance while the unit is being sublet.

These factors will change depending on the specific building you are looking into, but the requirement of the board approving the tenant will essentially be applicable for every co-op building.

The board oftentimes treats a tenant as a prospective purchaser in the sense that the tenant would be required to submit all of the financial information that a purchaser would have to submit and also may have to attend a board interview.

If the board elects to reject the tenant, this can cause a several month vacancy of the property and a loss of cash flow, which is a major risk that investors do not want to take.

Additionally, a board is going to be concerned with a high volume of units, which are being sublet. The reason being is that several banks will not lend to a building, which has 25% or more of the units in it being sublet. Therefore, it is extremely important not only to know the board's policy on sublets, but also how many sublets currently exist in a building.

An issue that is quite common in co-ops is when an investor wants to take title in the name of an entity or trust as opposed to their individual names.

Several co-ops are opposed to this because they prefer having an individual as the owners of the stock and lease in the event that the occupant of the property or the individual owner is ever in default of their obligations under the proprietary lease. It is easier for a co-op to pursue damages against an individual as opposed to a limited liability company (LLC) or trust.

Over the past few years, we have seen some co-ops become more amenable to ownership in an LLC or trust, as that has become more of a common request for estate/tax planning purposes and the fact that there has been an increase in purchasers buying for investment.

In the event the co-op is willing to consent to this, it will certainly require personal guarantees on behalf of the individual owner of the LLC or the trustee/beneficiary of a trust and potentially an escrow for maintenance.

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