

Converting A Co-Op To A Condo: How Profitable Can This Be?

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Over the last decade, we have seen a surge in the prices of condominium units which have appreciated at a higher rate than co-op units, albeit that roughly 70% of apartment buildings (excluding rental buildings) in Manhattan are co-ops and not condos. This has sparked an interest for many co-op owners in that if they converted their buildings to condos, will they suddenly realize an immediate appreciation in value solely due to the conversion? A co-op building will first need to analyze whether a conversion under their circumstances is feasible. After this, each individual shareholder will need to ascertain their tax liability due to the conversion and determine if the conversion is as advantageous to them as it may have first appeared. Procedurally the items below are the main points to take into consideration:

1. Financing: The first step is to determine whether each shareholder possesses their stock and lease or whether there is a loan on their apartment. If any shareholder has a lien against their shares in connection with a loan, they will likely have to pay off the loan in order to relinquish their stock and lease and subsequently refinance their unit once it becomes a condominium unit. Second, it must be determined whether the co-op has an underlying mortgage on the property. If an underlying mortgage exists, the shareholders may have to each be assessed in order to pay off the underlying mortgage, as a condominium cannot have an underlying mortgage. The board may try to renegotiate the underlying mortgage with their lender to convert such a mortgage to a common interest realty association lending (CIRA loan), which is an unsecured loan that is given to a condominium association in a similar concept to an underlying mortgage on a co-op building (see my article entitled "What Are The Best Ways For a Condominium Board to Fund Capital Improvements? Answer is: Financing" from Mann Report Management – February 2014.)

2. Shareholder Consent: A supermajority vote of the shareholders will certainly be required for something of this nature and the by-laws will state what constitutes a "supermajority vote" (typically 2/3 of the outstanding shares). A conversion to a condominium may even require a unanimous vote of the shareholders; the by-laws will need to be reviewed in order to make this determination. If the requisite vote is obtained, a resolution will have to be passed effectively dissolving the co-op corporation.

3. No-Action Letter: An application will need to be filed with the Attorney General's office (AG) for a "no-action letter." This application is in lieu of filing an offering plan for a condo conversion, as

the current owners of the units will remain the same. The co-op will need to demonstrate to the AG that the shareholders do not require the protections of an offering plan under the circumstances. In connection with that application, the building will need to finalize the formation of a condominium association and draft all of the governing documents such as the condominium declaration and by-laws.

4. Tax Lots: Once the conversion from shares to real property is finalized, the condominium will need to coordinate with the NYC Dept. of Finance (DOF) to designate each unit as a separate tax lot. The DOF will subsequently reassess the valuation of each unit for property tax purposes.

5. Tax Implications: Perhaps the most important item to take into consideration is the tax implications that each shareholder/unit owner will face if the conversion is successful. In conducting such a conversion, each individual shareholder will be relinquishing their shares in exchange for real property which would be considered as value/consideration received for the transfer, triggering a taxable event. This will result in tax being owed by the shareholders individually; the corporation itself will not owe any taxes. The tax due will likely be based on the excess of the value of the shares at the time they are relinquished in exchange for a condominium unit over the original purchase price of the co-op apartment plus the cost of improvements and closing costs. A shareholder who used the co-op apartment as their primary residence will be able to utilize the exemption for the sale of a primary residence in the amount of \$500,000 for married couples and \$250,000 for individuals.

As the shareholders/unit owners may not sell their units immediately upon completing the conversion, the taxes will have to be paid from their current liquid assets as they are not receiving any cash consideration in a conversion/exchange of this nature. As attractive as the potential appreciation of your apartment can be from a conversion from co-op to condo, it can be a rather costly process which may require shareholders to come out-of-pocket for substantial sums of money in order for the conversion to be feasible.

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