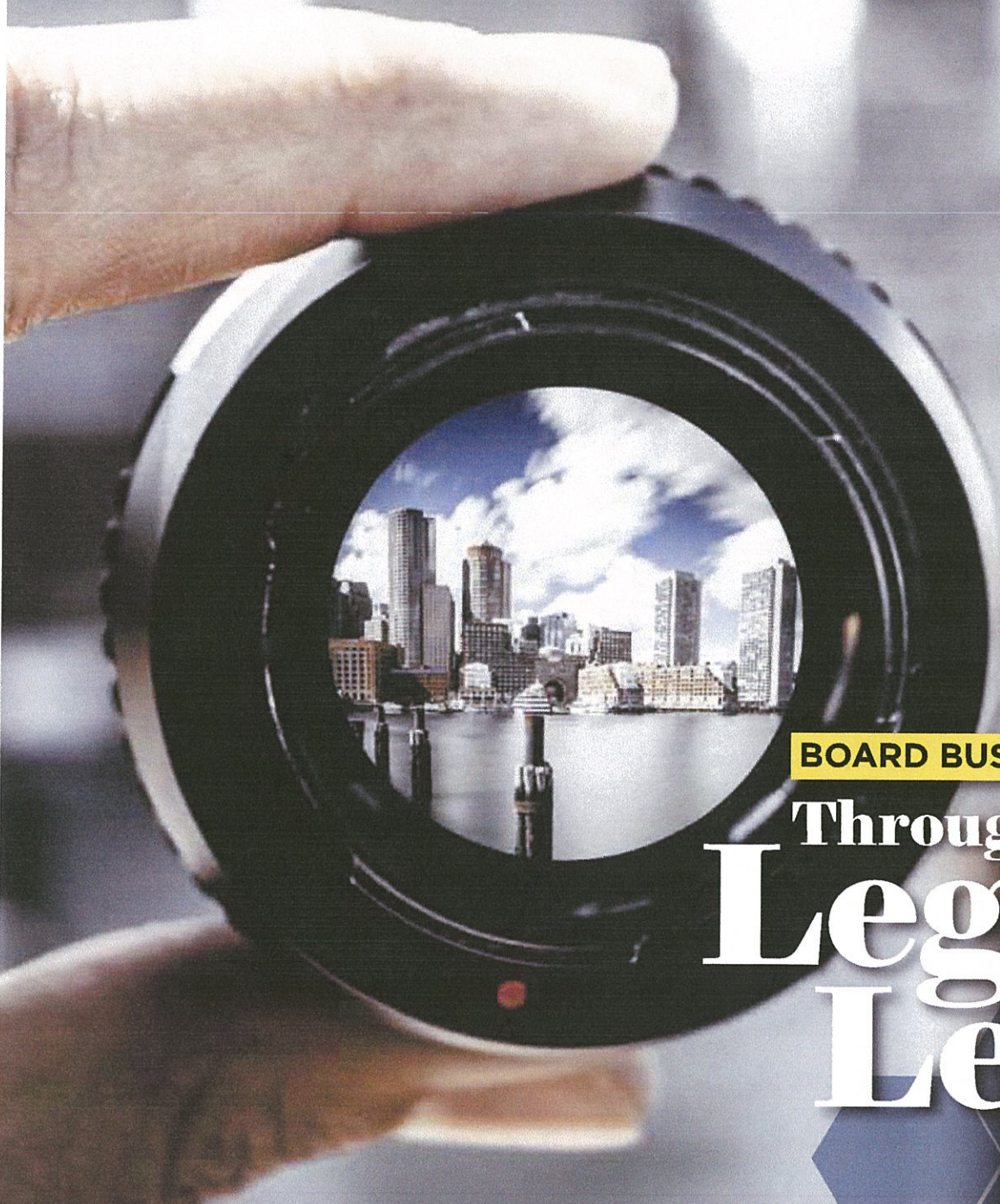


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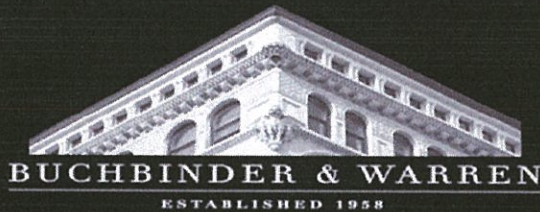
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COMMUNITY

Vetting the LLCs

THE LOW-DOWN

A co-op building retained us after approving a buyer who purchased in the name of a Limited Liability Company (LLC). Because the building had a very liberal sublet policy, it had a few shareholders who owned LLCs. Investors would buy into this building and rent out the units. Once there's precedent in the building for allowing this, the board doesn't want to take an extreme measure and all of a sudden disallow it for all future shareholders. Although it was our advice not to allow it in the future, the board was reluctant to do that.

THE WEIGH-IN

Boards should not allow LLCs to become shareholders. However, if they do, the following steps are mandatory. First and foremost, the owners of the LLC have to personally guarantee the proprietary lease obligations and the maintenance. In approving a sale to an entity, you have to ask: "OK. Where's the board's exposure and how do we mitigate that?"

Next, a proprietary lease usually limits occupancy to the shareholders and "immediate family." But an LLC is not an individual, it's an entity. Who is their immediate family? Once again, the beneficial owners of the LLC will sign an occupancy affidavit, stating that occupancy will be limited to persons X, Y, and Z, and that's it. No one else can live in the unit.

Pierre E. Debbas
Managing Partner,
Romer Debbas

Finally, we recommend that boards require the LLC to put one or two years of maintenance in escrow, to mitigate financial risk for the building and also to be prepared in case the board has to pursue legal action against the LLC. It's a lot more difficult to sue an entity than an individual.

THE OUTCOME

In a co-op, you're acquiring shares in a corporation, not ownership of real property. That's not something that's freely transferable. Board requirements and approval are necessary before new shares will be issued. If a shareholder owns an independent LLC, however, the members are not recorded immediately with the state. That gives the opportunity for the owner of the LLC to transfer LLC ownership without board knowledge or approval. That means the co-op board is completely exposed because it doesn't necessarily know who will be the actual beneficial owner of this LLC post-closing.

THE TAKE-AWAY

The board has the ability to reject a sales application without having to give any reason. However, because these sales to LLCs are becoming more commonplace, boards should educate themselves on the risk they could encounter and how to address it. ■

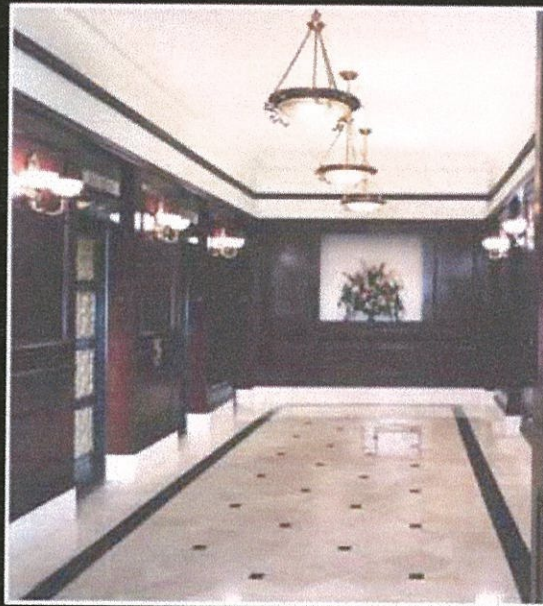


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