

## REAL ESTATE UPDATE

# A Prudent Investment

## Cooperative Leasehold Title Insurance Is Worth the Cost

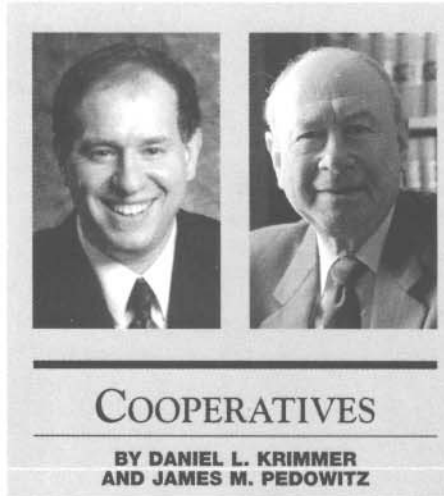
**T**itle insurance is considered mandatory on a home purchase or for a condominium apartment — but what about a co-op apartment? Many lawyers do not now obtain title insurance protection on the purchase of a co-op apartment. However, more lawyers are obtaining title insurance, especially on a high value purchase or when they consider the risks of non-insurance based upon known circumstances relating to additional risk. This is especially so in the case of a foreclosure of a UCC-1 on an individual co-op apartment or on the foreclosure of maintenance charges against an individual co-op apartment.

It is true that the purchase of a co-op apartment is not a purchase of real estate, but many of the risks attendant upon a real estate purchase may also apply to the co-op purchase. The Court of Appeals in the *Matter of State Tax Commission v. Shor* held that an interest in a cooperative apartment was not a chattel real and for the purpose of determining the priorities of judgment creditors should be treated as personal property.<sup>1</sup>

Although the co-op purchase is usually a purchase of stock in a corporation that either has a fee or leasehold interest in an apartment house, together with, or the right to, a lease of a designated apartment for a stated long-term lease (Proprietary Lease), the possessory rights, and their value are based in large part on the underlying real estate interest of the co-op corporation whose stock is being purchased.

It is worthwhile to explore some of the risks to the substantial investment involved in the purchase of a co-op apartment, and the extent of protection against loss that is available by title insurance. As with all insurance, it is not the frequency with which a possible loss may occur that is important, but the impact or extent of the loss, if it should occur. Some of the risks to the investment (usually hundreds of thousands of dollars or more) are:

1. Although the co-op corporation initially obtained title insurance at the time that it



acquired the property, defects, liens and encumbrances may have arisen since that time.

2. If the co-op corporation only has a leasehold, the title policy will insure that it is valid and enforceable, etc. The fact that the co-op is based on a leasehold is an important factor, and should prompt additional inquiry as to term expiration, possible rental escalation, whether there is an option to purchase and under what circumstances, if any, the lease could be terminated.

3. The policy will also disclose all underlying mortgages and such liens, restrictions and other encumbrances that may have been created by the co-op corporation after its acquisition of the property that may affect costs or continued quiet enjoyment.

Mere knowledge of the existence of many of these matters, may generate a need for additional inquiry in the nature of due diligence.

4. The tax search will disclose all outstanding taxes and whether or not the cooperative has kept current in its payments.

Any J-51 or 421a real estate tax abatements or exemptions will be shown.<sup>2</sup>

Maintenance charges may substantially increase when the existing mortgage or mortgages against the cooperative has to be refinanced and the interest rate on the new mortgage is higher or the existing tax abatement or exemption ceases and there is an increase in taxes.

5. All transfers of the co-op apartment itself

are subject to many of the same "hidden risks" that apply to a sale of real estate, such as fraud, forgery, impersonation, etc. Additional risks may arise if any of the transfers come through a bankruptcy, foreclosure, infancy, death, or mental impairment of an owner.

An undisclosed bankruptcy of the seller is an especially significant risk, because there may be nothing in the local bankruptcy records that may disclose the facts. While an innocent purchaser for value of real property from an undisclosed bankrupt is protected by Section 549-c of the Bankruptcy Code if there is no notice of the bankruptcy in the bankruptcy court in the district where the property is located or in the land records of the county, there is no such protection for the purchaser of a co-op, since it is not real property.

### Reliable Corporate Records

6. The corporate records of the co-op corporation and other records under control of a managing agent are dependent for completeness and accuracy upon the competency, accuracy and integrity of the persons who have maintained those records over the years. Total reliance on those records can result in misinformation and financial loss that may be difficult or impractical to recover.

Many times there have been numerous changes in the managing agent by the co-op corporation and therefore records are missing and incomplete.

7. The title search will show any UCC-1 (mortgages) filed against the owners of the individual co-op. When the mortgage is paid off at closing the existing lender will be present to deliver the UCC-3 (mortgage satisfaction) and the proprietary lease and stock certificate being held as collateral.

Although no deed, proprietary lease or stock certificate is recorded indicating ownership of the co-op apartment, transfer tax to the city and the state is due and owing.

Mansion tax<sup>3</sup> in the amount of one percent of the sales price must also be paid if the transaction involves a purchase price over one million dollars. In the event the transfer taxes are not paid the liability for same will become the responsibility of the purchaser.

8. The Estates, Powers and Trust Law,

**Daniel L. Krimmer** is regional chief counsel and vice president of Stewart Title Insurance Company in New York City. **James M. Pedowitz** is counsel to Berkman, Henoch, Peterson and Peddy PC in Garden City.

Sections 6-2.1 and 6-2.2 were amended to provide that on or after January 1, 1996 a husband and wife may own a co-op as tenants by the entirety.<sup>4</sup>

Previously a husband and wife could only take ownership as joint tenants or tenants in common. A transfer to a husband and wife without indicating another tenancy automatically results in a tenancy by the entirety as with real property.

Estate considerations may play a part in the decision on how to take title.

9. Sometimes the existing proprietary lease and stock certificate have been inadvertently lost or misplaced and after a due and diligent search the bank holding the UCC-1 or the owner (seller) if there is no mortgage against the apartment, cannot locate same.

An affidavit stating that the pertinent party has not transferred, assigned, pledged, hypothecated or in any way encumbered said lease and certificate and appropriate indemnities may resolve the situation.

10. The owner of the co-op apartment has been foreclosed upon either by the lender holding the UCC-1 because of nonpayment of the mortgage against the apartment or the co-operative corporation has foreclosed because of nonpayment of the maintenance charges.

Generally a co-op foreclosure is a non-judicial auction sale conducted in accordance with Uniform Commercial Code Article 9.

"Every aspect of the disposition including the method, manner, time and place and terms must be commercially reasonable."<sup>5</sup>

None of the foreclosure documents are filed in the County Clerks or Registers Office. Therefore, in the event the purchaser is obtaining title insurance the foreclosure documents must be provided to the title company in advance of closing for review.

An Owner's Policy of title insurance is obtainable at the lesser rate of 70 percent of the standard rate for fee insurance, and in addition to the usual insuring provisions of the American Land Title Association (ALTA), the Owner's Policy includes, unless specifically excepted, insurance against loss or damage by reason of:

(a) the title to the cooperative building(s) and the land of which the apartment/unit described in Schedule A forms a part not being vested in a duly formed Corporation/Partnership, formed for the purpose of the cooperative ownership of the land;

(b) the premises not being a part of a cooperative regime validly created pursuant to the laws of the State of New York, subject however to the terms and provisions of the offering plan, as amended;

(c) a final court order or judgment requiring the removal of any encroachment of the cooperative building(s) upon adjoining land(s);

(d) any forfeiture or reversion of title by reason of a violation of any provision which may be contained in covenants and restrictions recorded in the public records;

(e) real estate taxes, assessments and other charges which are due and payable liens against the cooperative building(s) and the land at Date of Policy, but the policy does not insure against any loss or damage by reason of any increase in maintenance charges due to the restoration of full real estate taxes, assessments and other charges by reason of any tax abatement rights held by the transferor of the apartment/unit.

(f) unpaid maintenance charges and assessments due and payable at Date of Policy.

(g) failure of title by reason of a right of first refusal to purchase the apartment/unit, which right was exercised or could have been exercised at Date of Policy.

The policy in addition certifies that a valid proprietary leasehold estate in the Apartment/Unit may be assigned by the current owner.

The policy insures that all mortgages recorded in the public records to which the Cooperative Corporation/Partnership is subject are set forth in the Schedule B Exceptions.

The ALTA Owner's Policy is converted into a Co-op Owner's Policy by amending several of the inconsistent boiler plate provisions and by the addition of the following two paragraphs:

*Valuation of Estate or Interest Insured*

If, in computing loss or damage incurred by the insured, it becomes necessary to determine the value of the estate or interest insured by this policy, the value shall consist of the then present fair market value of the estate or interest, undiminished by any matters for which claim is made, for the term of the

proprietary leasehold estate, but in no event greater than the amount of insurance stated in Schedule A.

*Miscellaneous Items of Loss*

In the event the insured is evicted from possession of all or part of the land by reason of any matters insured against by this policy, the following, if applicable, shall be included in computing loss or damage incurred by the insured, but not to the extent that the same are included in the valuation of the estate of interest insured by this policy.

(a) The reasonable cost of removing and relocating any personal property which the insured has the right to remove and relocate, situated on the land at the time of eviction, the cost of transportation of that personal property for the initial twenty-five miles incurred in connection with the relocation, and the reasonable cost of repairing the personal property damaged by reason of the removal and relocation.

The costs referred to above shall not exceed in the aggregate the value of the personal property prior to its removal and relocation. "Personal Property", above referred to, shall mean chattels and property which because of its character and manner of affixation to the land, can be severed therefrom without causing appreciable damage to the property severed or to the land to which the property is affixed.

(b) Maintenance charges or damages for use and occupancy of the land prior to the eviction which the insured as owner of the leasehold estate may be obligated to pay to any person having paramount title to that of the lessor in the Lease.

## Conclusion

The dramatic increase in prices over the past few years and numerous endemic risks associated with the purchase of a co-op apartment make it prudent to obtain cooperative leasehold title insurance.

(1) 43 N.Y. (2d) 151 (1977).

(2) New York City Administrative Code 11-243 and New York Real Property Tax Law Section 421(a) and 489.

(3) Tax Law Section 1402-9.

(4) Chapter 480, Laws of 1995.

(5) See U.C.C. Section 9-504(3).



**JUDICIAL RESEARCH CORP.**

888 Seventh Avenue, Ste. 300  
New York, NY 10106  
212-432-3272  
800-281-TITLE (8485)  
Fax: 800-FAX-9396

550 Mamaroneck Avenue  
Suite 202  
Harrison, NY 10528  
914-381-6700  
Fax: 914-381-3131