Understanding A **Condominium** Offering Plan

BY STUART M. SAFT

AT PRESENT, New York City is experiencing a building and renovation boom, matching or surpassing many of its previous surges in multifamily development. However, unlike prior periods of real estate growth, the majority of residential buildings presently opening or under construction/redevelopment are condominiums. For the thousands of purchasers of this type of home there is a complex document, the Offering Plan, which needs to be reviewed prior to the acquisition of the unit.

No attorney can allow his or her client to purchase a condominium unit without an analysis of the salient provisions of the offering plan, a challenging task considering the length ranges from 200 to 400 pages of documents elaborating on the transaction, building and the relationship among the unit owners, the board(s) and the sponsor. The following article serves as a road map to the most significant aspects of the offering plan for a vacant condominium building.

There is a cartoon of an attorney standing in front of a law library and exclaiming "to think, all of this started with the Ten Commandments!" The same can be said of the modern offering plan; it all arises from the following sections of the Martin Act [New York General Business Law §352 et seq, which is New York's Securities Law]. GBL §352-e 1(a) states, "it shall be illegal and prohibited ... to make or take part in a public offering or sale in or from the state of New York of securities constituted of participation interests in real estate ... including cooperative interests in realty, unless and until there shall have been filed with the department of law, prior to such offering, a written statement ... which shall contain the information and representations required by paragraph (b) of this subdivision...."

GBL §352-e1(b) contains a detailed list of the required information and ends with "and such additional information as the attorney general may prescribe in rules and regulations promulgated ... as will afford potential investors, purchasers and participants an adequate basis upon which to found their judgment and shall not omit any material fact or contain any untrue statement of a material fact."

The Martin Act provides the Department of Law with the authority to oversee the sale of real estate securities which includes the sale by a sponsor of interests in cooperatives and condominiums.[1] In response to the Martin Act's mandate, the attorney general has issued a series of regulations including the one entitled Newly Constructed, Vacant or Non-residential Condominiums, which is Part 20 of Title 13 NYCRR, containing more than 100 pages of requirements for an offering plan "to be accepted" for filing by the attorney general.

For the average New Yorker, the review process at the attorney general's office for the purchase of a cooperative or condominium apartment is the most important function of the department of law, since purchasing a home is often a buyer's largest investment, and in most instances the buyer is incurring a substantial amount of debt in order to afford the home. As a result, the reviewing attorneys and engineers at the department of law take their role very seriously, which is part of the reason for the lengthy process and highly detailed offering plans.

Although purchasers may ask how the attorney general could have "approved" the offering plan, the fact is the office does not and could not approve or disapprove of plans. Rather the office's authority is limited to accepting the plans for filing if the reviewing assistant attorney general believes the plan contains the full disclosure required by the Martin Act. Accordingly, if the offering plan states the building is in deplorable condition, the attorney general cannot withhold its acceptance until the property is repaired, but can only mandate disclosure of that condition.

There have been several regulations the courts threw out, because the attorney general exceeded his authority by refusing to accept the plan until the sponsor took a certain action, rather than just disclose the condition. This is the first lesson for anyone reviewing an offering plan: Do not assume since the plan was accepted by the attorney general, that the building or transaction is sensible or fair.

Section 20.1(b) of the regulations provides the standard of compliance with the law's full disclosure requirement by stating, "An offering plan must, at a minimum: (1) contain in detail the terms of the transaction and be complete, current and accurate; (2) afford potential investors, purchasers, and participants an adequate basis upon which to found their judgment; (3) not omit any material fact; (4) not contain any untrue statement of a material fact; (5) not contain any fraud, deception, concealment, suppression, false pretense or fictitious or pretended purchase or sale; (6) not contain any promise or representation as to the future which is beyond reasonable expectation or unwarranted by existing circumstances; and (7) not contain any representation or statement which is false, where the sponsor or the person who made such representation or statement: (i) knew the truth; or (ii) with reasonable effort could have known the truth; or (iii) made no reasonable effort to ascertain the truth; or (iv) did not have knowledge concerning the representation or statement made."

Fundamental Topics

The requirement for full disclosure is directly responsible for the size of the offering plans, since attorneys who write the plans believe the more disclosure the better. Although the desire to describe every material issue has led to voluminous plans, the attorney general has made the purchaser's review easier by requiring that the first section of the plan contain a list of special risks.

Although this section aims to highlight all of the areas of concern for a purchaser, an attorney cannot assume the section contains every issue the buyer may find disturbing, but only those the sponsor's attorney or an assistant attorney general believe to be unusual. The special risk section of plans does not necessarily list risks, but rather issues the drafter wants remembered. Nevertheless, the special risk section provides the purchaser with direction.

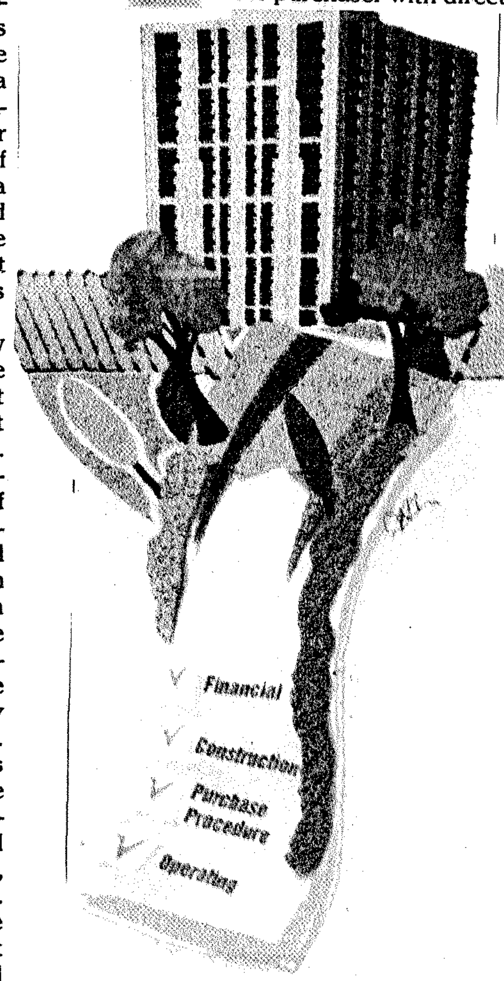

ILLUSTRATION BY ALEX LEARY; NYLJ

The offering plan is divided into two parts: Part I contains a description of the building, the condominium's finances, the sponsor's rights and obligations and the relationships between the various parties; and Part II contains certifications and copies of every material document. Most statements in Part I are supported by the documents in Part II. The fundamental topics of the plan, aspects of which are spread throughout, are: financial; construction; purchase procedure; and operating.

The substance of the financial components are described in Schedule A (purchase price and projected monthly carrying charges and real estate taxes) and Schedule B (projected budget for the first year of condominium operation.) Not surprisingly, the most important part of the schedules is the footnotes. Schedule A contains the apartment size, number of bedrooms and bathrooms, and the projected monthly common charges and real estate taxes. Although the purchasers may believe the only relevant information in Schedule A is the price of the apartment and the projected monthly payments, the percentage of common interests allocated to the apartment is the only enduring number in the plan.

This figure is the basis for the unit owner's common charges and assessments to the condominium and real estate taxes to the city or other taxing authority. Pursuant to Real Property Law §339-i, the percentage of common interests must be based on either: i) the proportion of value of one unit to all the others on the date the declaration is filed; or ii) the proportion that the floor area of one unit bears to the others on the date the declaration is filed; or iii) all the units having equal value; or iv) upon the floor space giving value to the relative value of other space, the uniqueness of the unit, the availability of common elements and the overall dimension of the unit.

Therefore, the reviewer should consider why the unit in question has a higher or lower percentage than other similarly sized units. Another matter of importance in condominiums containing commercial and garage space, is the analysis of the percentage of interests allocable to the commercial and garage space to ensure it is in proportion to the residential unit.

Since Schedule A describes the projected real estate taxes, the footnote should be studied closely to find the basis for real estate tax calculation. Unfortunately, determining the post-construction or renovation real estate tax is not an exact science. It is based on the manner in which the city ultimately assesses the property, the tax rate at any point in time and whether the developer has been granted any tax abatements.

The monthly common charges shown on Schedule A are based on the budget and footnotes contained in Schedule B, which examines the projected operating expense and includes an explanation for the numbers and their basis. This is the core of the offering plan and must be carefully examined to determine whether any of the income or expenses will remain constant, or change in the future. Since the budget only covers the first year of operation, income or expenses in the first year that are not repeated could result in higher common charges in subsequent years.

The second important consideration is construction issues, including a general description of the building and in particular, what is in the apartment being purchased. In this regard, what is written in the offering plan is more important than the sales agent's description to the purchaser. Part I of the plan contains a section outlining the sponsor's rights and obligations, and Part II contains a description of the property and the units by the architect as well as floor plans. These sections are significant because they detail everything the sponsor guarantees, and should be consistent with the information the purchaser has been told and seen. If a statement is inconsistent with the plan, an inquiry should be made and a reason for the discrepancy should be obtained. It is the terms of the offering plan that are binding on the sponsor, rather than the purchaser's desires.

The third area of examination is the procedure to be followed in contracting for, and closing on the purchase of the unit, with a description of the fees and expenses to be paid at the closing, tied to the purchase agreement contained in Part II. This section also discusses the process established by the attorney general for handling disputes over down payments, with Part II containing the necessary forms if the purchaser is unhappy with the inability to obtain a return of the down payment. It is a common requirement for the purchaser to reimburse the sponsor for incurred fees and expenses in closing the sale, including the sponsor's legal fees. The attorney general's regulations require these fees and expenses be fully disclosed, and the client should be advised of the sums due at the closing, so they are prepared to pay them.

The fourth area of analysis deals with the operation of the property and includes a list of the sponsor's continuing operational rights, and the point when the unit owners can obtain control over the board and condominium. This element is complicated in condominiums with commercial units because an analysis must be made on whether residential owners, who hold the vast majority of the space, can make decisions over the entire building. Imagine a mixed-use building where the commercial unit, which comprised 15 percent of the space, pays less than 2 percent of the operating expenses, but elects 50 percent of the condominium's board of managers. The result is that no decisions can be made without the commercial unit owner's cooperation, even if the commercial unit owner pays little or no part of the cost and the situation does not involve the commercial unit. This is one reason many condominiums have three boards: a residential board, a commercial board and a condominium board to deal with the shared issues.

The sections of the plan describing the declaration and bylaws in Part I and the documents themselves in Part II, must be strongly considered in the purchase decision. It is not uncommon for the sponsor to protect its ability to sell the balance of the apartments and use the commercial or garage space without involving the residential unit owners.

The sponsors' concern is that the residential board may enact rules or amend the bylaws to inhibit the use of the unsold space, so specific protections are built in and disclosed in every plan to prevent this situation. Also included are the disclosure of any contracts that will become the responsibility of the condominium after the closing, including the property management agreement and working capital fund. The management agreement, which usually has initial terms of several years, provides the manager with a base management fee, with certain costs payable by the unit owners.

Many plans now also contain the sale of licenses to use storage or parking areas, rather than turn those areas into units and sell them as the apartments. Licenses are used in order to avoid the necessity of allocating percentages and real estate taxes to those non-habitable spaces. The license is described in the plan and provides the purchaser with the permanent right to use the space without the necessity of creating additional units.

Finally, there are significant miscellaneous sections to the offering plan, including a description of the parties including the sponsor and its professionals, and the reports that are available to the unit owners. Part II contains certifications from the sponsor and its professionals to validate the accuracy of the information contained in the offering plan. The importance of these documents should not be overlooked, as they provide recourse in the event information contained in the offering plan is misleading or incomplete.

Conclusion

The sale of condominium units is a securities offering in New York, the same as publicly held stock in a corporation, and the offering plan, like the prospectus for a public company, is an important disclosure document. The sponsor is obligated under the Martin Act to abide by its terms, and any failure to include a material fact within the offering plan is a violation and actionable by the attorney general.

The Martin Act provides the attorney general with a great deal of authority in the enforcement of the law, and the office has never been shy about utilizing its authority or enforcing the law, which is considered not only a securities law but also a consumer protection statute. However, since there is no private action under the Martin Act, if the attorney general does not pursue a claim, the unit owners are limited to common law fraud and breach of contract. Over the years, there have been many legislative attempts to provide a private right of action or make the Martin Act more than just a disclosure law, but none have been successful. Nevertheless, due to the comprehensive information provided in the typical offering plan, a practitioner can reasonably reach a full understanding of what the purchaser is acquiring.

1. Probably the best discussion of the powers of the attorney general and the history of the Martin Act was written and is updated in McKinney's Volume 19 by Walter Goldsmith.