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Commercial condos are being used more frequently

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Commercial condominiums are being used more frequently to legally divide up commercial or mixed-use properties including for the following purposes:
1. To provide separate tax lots to non-profits entitled to real property tax exemptions;
2. To create an easily tradeable asset to facilitate tax deferred exchanges under Section 1031 of the Internal Revenue Code;
3. To permit space users who, for cultural or investment purposes, prefer to own the space they occupy rather than lease it;
4. To start to sell off pieces of an asset ,which may appreciate over time, while retaining significant portions of the property as a long term hold;
5. To permit an owner to rid themselves of a business they may not want to manage while keeping other preferred portions of the building, e.g., selling the residential operation while retaining the retail;
6. To divide a single real estate project into smaller separate projects to facilitate the syndication and/or combination of various federal and state tax credits, such as low-income housing, historic and new markets tax credits;
7. To permit an owner of real property to retain or take back a portion of a development parcel while the developer creates an additional structure on the balance of the property.

These are examples where the additional costs of creating a condominium regime and the potential headaches of dealing with co-owners of the building are out-weighed by the benefits of the condo structure. While there are numerous articles and books on the legal aspects of condominiums, the point of this article is to highlight several practical issues involved in the purchase or master lease of a commercial condo unit:

A) Reality often does not match the legal documents - owners often don't use the property as drawn up originally by the lawyers and architects. For example, when you buy or lease a specific unit, the unit consists of the space set forth on plans filed with the land records but many times the actual use of the space conflicts and storage rooms are incorporated into the wrong unit or demising walls have been changed;

B) It's much harder to finance building wide capital improvements in a condominium. New York's condo statute permits borrowings by the board of managers but its unwieldy. If a building needs significant work, be prepared to pay your share of the cost out of your pocket or from a mortgage on your unit alone;

C) If the unit is leased to space users, review the leases to be sure they reflect the differences inherent in a condo regime. I can't tell you how many commercial leases of a portion of a condo unit recite, for example, that "landlord" shall repair after a fire when the "landlord" is merely a condo unit owner and only the board of managers of the condominium has the right or obligation to repair after a casualty;

D) Read the fine print to see how costs are allocated and the condo is governed. Does a ground floor retail owner pay for an elevator used only by the upstairs office unit owner? Who collects trash and cleans the sidewalk? Are you entitled to a board seat? The questions are endless and only a review of the condominium's declaration and by-laws will answer the questions;

E) Are there buy/sell rights such as a right of first refusal (ROFR) which could reduce the market value of the unit? ROFR's are common but are often ignored in residential condos where exercise is rare but in a commercial context, they could significantly damage market value since its more likely that a ROFR in commercial condo will be exercised;

F) Was the condo declaration properly drafted to reflect that the lien for condo charges has priority over unit mortgages? The general rule in residential condominiums is that the lien of a unit mortgage has priority over the lien of the condominium for unpaid common charges. While that rule can lead to unfair results in residential condos, it can be a disaster in a commercial condo. Fortunately New York's statute permits the declaration to reverse this lien priority in commercial condos but the reversal must be express in the condo declaration.

The commercial condo structure can bestow significant benefits to its owners but buyers or master lessees of such units need to be careful of the practical and legal issues inherent in the structure.

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