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Flexibility and cost savings for commercial properties post-COVID-19 - by Judy Simoncic and Nathan Jones

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The COVID-19 pandemic and resulting lockdown restrictions designed to combat it have caused significant changes to the way in which commercial real estate owners and developers assess their properties, particularly with respect to existing or new spaces. As we all know, remote work and decreased needs for physical space have placed a novel burden on both tenants and commercial property owners alike to find solutions that help manage costs and continue revenue streams.

Commercial property owners and developers are looking for new ways to build or market existing spaces in an arena that demands flexibility while making these spaces financially viable. Not-for-profit businesses and industries, including but not limited to, hospitals, educators, charities, religious organizations, recreation and conservation, and even government agencies, are facing the same pressures with the traditional office space model. Traditionally, a typical not-for-profit would own their building and the land under it to qualify for real property tax exemption benefits. Commercial office space and not-for-profit office spaces were generally separate and apart from one another.

Now, in part because of the changes in the office landscape and demand due to the pandemic, commercial properties and not-for-profits are looking to partner and share building space. This benefits them both financially and gives them both the flexibility needed in the post-COVID-19 marketplace.

The principle behind this partnership is that commercial properties can take on not-for-profits as long-term tenants and not-for-profits can occupy only part of a space – a floor instead of a whole building – and the not-for-profit can still get the benefit of their real property tax exemption on the portion of the space they occupy. In turn, the tax costs for the property as a whole are reduced by that same proportion (including common areas).

The solution to the post-COVID-19 market is the non-residential leasehold condominium. New York Real Property Law Article 9-B permits a tax-exempt organization to occupy a portion of commercial property through a long-term lease and still be eligible for a real property tax exemption, as if they owned the property outright. The process involves converting a ground lease into a multi-unit leasehold condominium that meets certain criteria, including (a) minimum 30-year lease term; (b) exclusively non-residential use; and (c) unit owners must be responsible for property taxes. Each unit owner owns their unit, for the term of the lease, and a percentage of the common areas of the condominium (such as parking).

This legal mechanism first gained popularity in New York City, but has recently gained wider acceptance and momentum. On Long Island, we have successfully implemented several non-residential leasehold condominiums and achieved real property tax exemptions for their not-for-profit tenants.

One such project involved a large warehouse and two-story office building. The property was converted into a leasehold condominium comprising three units: the warehouse and each floor of the office building (with a large parking lot as a shared common area). The warehouse unit continues to support a taxable commercial business, while the office units are occupied by a not-for-profit hospital tenant with a tax exemption on those units and their common areas.

Another pending project demonstrates a different application of this legal mechanism. A commercial development with significant unimproved green space plans to convert into a non-residential leasehold condominium with several office buildings as units and the remainder of the property as outdoor and recreational units leased to a not-for-profit youth sports provider. The office space will house commercial tenants, while the green space (and its percentage of common areas) becomes a tax-exempt use.

Non-residential leasehold condominiums are a versatile tool to utilize in the post-COVID-19 real estate market.

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