

Transitioning from Sponsor to Board Control

The Birth of a Board

By Liz Lent

Building a successful enterprise from the ground up involves the talent and commitment of dozens—if not hundreds—of people. It's no different with a co-op or a condo, especially in the earliest days of its existence when it makes that transition from sponsor-run to board-run. Sometimes that transitional road can be bumpy, and it can be a challenge turning the seeds of a co-op or condo into a full-grown, fully functioning community—especially if the sponsor and the board in question don't always see eye to eye. If all of the parties involved can maintain focus and keep the greater good in mind, however, the effort ultimately will pay off.

Where Do Boards Come From?

Just the way a constitution sets the stage for how a country will be run, a co-op's bylaws determine how it will function, and how it will change hands from the sponsor who created it to the residential board members who will guide it in the future.

"Basically, the transition is laid out in the bylaws," says attorney Leonard H. Ritz, of the law offices of Adam Leitman Bailey, PC in Manhattan. In most situations, the board will be comprised initially of friends, employees, or other designates of the sponsor. As more units are sold within the building, that number will slowly shift.

"On day one, all board members are designated by the sponsor," Ritz says. Elections are then held at the first unit owner meeting. Over time, the board will be filled with more actual residents and fewer members chosen by the sponsor until the residential members have a clear majority. Eventually, if all goes as planned, the sponsor will have little or no representation on the board.

In a conversion scenario, the sponsor is required to turn over control of the board after 50 percent of the units have been sold, or after five years—whichever comes first, says attorney [redacted] of the law firm of [redacted] LLP in Manhattan. In new construction, the sponsor has the right to designate at what percentage he or she must turn it over, but they must turn it over by the fifth year, just as in the conversion scenario.

Growing Pains

As with any new organization or management team, there may be missteps at the beginning as everyone works to learn their duties and responsibilities. One of the biggest challenges for a new board, says Ritz, is simply learning how to run a building. It seems obvious, but the truth is, learning how to lead and make decisions can be a significant challenge for people who may not be used to that role. After the board has transitioned away from the sponsor, it's now their turn to shoulder the responsibility on their own.



“They’re neighbors, and now they’re also managers,” Ritz says. “They’re learning how to balance the needs of the building. They might need to make assessments that they’ll have to pay and so will the people around them. It can be difficult.”

Manhattan attorney Adam Leitman Bailey adds that this transition can be especially difficult for people who are not used to making these types of managerial decisions in their everyday life. In Manhattan, for example, with its high concentration of A-type personalities and high-level business people, “many board members have been on boards before,” so they know how board meetings work and how decisions are made by committee, notes Bailey. In other instances, a building’s board members may have no experience at all and will need to be taught the basics, right down to how Robert’s Rules of Order work. Again, it’s a learning curve.

The Making of a Board

The most successful new boards are the ones that are not afraid to ask questions. “The best boards come to us before there is a problem,” says Bailey. “Problems happen when they go ahead and do something and don’t tell us.” Bailey’s past client boards have done everything from putting a new structure on the roof without getting permits to selling off or renting common areas—both big no-no’s and both things that could have been avoided with a quick call to their manager or attorney.

Other problems arise when the new board starts off skimping on protocol and procedure. “In smaller buildings, one of the problems is thinking that the board can run things informally,” says Ritz. Not adhering to a regular meeting schedule, not maintaining proper structure can all be a source of trouble.”

New boards panicking under the weight of their newfound responsibilities should also remember that “all boards have problems,” Bailey says. “Document these problems. Talk about them. A good board creates a Yahoo group or a Google group and communicates with its residents.” This is one way to find out if there are problems within the building, something of which they will want to inform the sponsor—if the sponsor is still involved in the management of the building.

Also, says , when the board first takes full control, “do not fire all the professionals, especially the managers. These new buildings are as complicated as a battleship,” he says. “Frequently, a new board will take over and say, ‘let’s get rid of everybody, which is fine if it’s the lawyers or accountants, but it’s not okay if it’s the managers.’ They are the folks who know how everything works, an important skill when it comes to keeping residents happy.

Be cautious at the beginning, advises. “For board members, they suddenly step into a fiduciary position,” he says. “At the outset, the board can make a lot of assumptions that may not be correct.”

Development Issues

Just like the neophyte board, a building’s sponsor or developer likely will face difficult issues with the creation of a new condo or co-op. Perhaps the biggest issue, in addition to ongoing difficulties over construction or renovation, can be selling units.

Not selling apartments can lead to potentially serious issues between the sponsor and the residents. Such was the case with a 66-unit co-op at 511 West 232nd Street that became embroiled in a decade-

long court case known as 511 West 232 Street Owners Corp. vs. Jennifer Realty Corp. When the building originally went co-op in the late 1980s, slightly more than 20 percent of the building's formerly rent-controlled units were sold, says attorney Mark N. Axinn of Brill & Meisel in Manhattan, who represented the sponsors.

In the early 1990s, the real estate market in New York began a long, dramatic slide, making it difficult to sell property. By the time things had stalled out, the sponsors had sold roughly 38 percent of the units. The sponsors then began to rent units, leading to unit owner unrest and soon, a lawsuit contending that the sponsors had breached the spirit of the governing documents by not selling a sufficient number of units to create a fully viable co-op.

The reason for the troubles, says Manhattan-based attorney Beatrice Lesser of Gallet Dreyer & Berkey LLP—who represented the residents—was the high percentage of rentals. “There was a lot of changing of tenants, leaving and moving in the middle of the night,” she says. “The building had an influx of people who likely would not have lived there if shareholders were in control.” There were also issues, says Lesser, with regard to upkeep of the building as well as the financial well being of the co-op. “Shareholders couldn't sell their units unless the buyer bought it in cash because the banks wouldn't finance,” she says. “And there was a big limitation on refinancing for the building because of sponsor presence.”

The case went on for 10 years, during which time the demand for housing in New York improved dramatically and “the sponsor started selling again, completely driven by the market,” Axinn says.

Settlement on the case was reached this year with the co-op and plaintiffs agreeing that the sponsor did not have an obligation to sell any unsold apartments, according to the settlement agreement. The co-op also partially reimbursed the sponsors for defense legal fees.

The case created ripples that have been felt throughout the co-op community, and many attorneys have taken it as evidence that there is an implied responsibility on the part of the sponsor to sell shares in a timely fashion.

Without good faith from the sponsor, though, co-op residents can suffer enormously at the hands of potentially unscrupulous sponsors, says Lesser, especially those residents who do not know that the situation could be better for them.

“Not everyone who buys a co-op is from Park Avenue,” Lesser says. “A lot of people are working class, immigrants, in the other four boroughs, people who are possibly not equipped to deal with these types of sponsors.” And sometimes, because residents might not know that alternatives exist, “you can't muster up enough people to take on the board and make things better,” Lesser says.

Ultimately, the relationship between a sponsor and the board can be a rocky one in the beginning. Conflicts can ensue and yes, things can get ugly. That's why good faith from both sides, a willingness to discuss issues and also, a willingness to talk to experts and understand each other's rights and responsibilities, are all vital to a harmonious transition.