

## Condominium Conversion Reserve Fund Obligations

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While sponsors of new construction condominiums have extensive obligations regarding the physical construction of their projects, Sponsors of condominium conversions really only have one material obligation (other than actually converting the form of ownership) — to provide sufficient funds to create reserves for capital repairs, improvements, and replacements required for the residents' health and safety.

If sponsors do not properly fund these mandatory reserve funds, condos may not have sufficient capital to perform necessary remedial construction work, leaving buyers with potentially uninhabitable homes.

Discovering and prosecuting the underfunding can result in the recovery of hundreds of thousands, if not millions, of dollars to unit owners and boards. Sponsors who file offering plans for the conversion of rental buildings to condominium ownership in New York City must comply with the so-called Reserve Fund Law.

This law mandates that sponsors of condominium conversion projects provide condominiums with reserve funds at least equal to statutorily calculated minimums.

Sponsors must provide a reserve fund in an amount no less than three percent of the total price of all of the units offered for sale, specifically, “[t]he sum of the cost of all units in the offering at the last price which was offered to tenants in occupancy prior to the effective date of the plan regardless of number of sales made.”

In order to properly calculate “Total Price”, a sponsor must (1) include the offering prices of all units offered for sale by an offering plan, and (2) use the offering prices according to the formula prescribed by the statute. The first part is self explanatory.

The second part of the calculation is more complicated, which makes it possible for a sponsor to use artificially lowered offering prices to reduce its reserve fund obligations, without the condominium board or unit owners ever realizing that a deception is taking place.

“Last price which was offered to tenants in occupancy prior to the effective date of the plan” literally means that sponsors must use the price it offered to tenants in occupancy the day immediately prior to the date the sponsor declared the offering plan effective.

There is no ambiguity in the statutory phrase — the words of the statute are clear and must be given their natural and plain meaning.

Rather than follow the literal and proper calculation of Total Price, sponsors may try to limit the amount of the reserve funds they deliver to condominiums by calculating Total Price based on the last discount price offered to tenants in occupancy instead of the actual last price.

Due to regulations regarding threshold sale requirements for offering plans to be declared effective, sponsors frequently offer tenants in occupancy discount rates during the mandatory ninety day exclusive sales period, during which only tenants in occupancy may sign purchase agreements for their units.

However, it is common that sponsors fail to meet the threshold sales requirements during the exclusive sales period with the result that the discount prices expire prior to the date the offering plans are declared effective. In these situations, the last price offered to tenants in occupancy is not the discounted exclusive insider price, but rather the price offered to outsiders, which is usually substantially higher.

Actually finding this discrepancy requires a bit of detective work. A typical condominium conversion goes thru numerous amendments. Any one of these amendments can reveal what the very last set of prices immediately prior to the effectiveness of the plan really was.

Although it is a criminal act to do so, sponsors looking to make their reserve fund obligations as small as possible base their calculations on the lower insider price tables, figures which are actually obsolete in most cases prior to the effectiveness of the plan.

Thus, they are relying on board attorneys' and purchasers' attorneys' lack of thoroughness in checking all of the amendments to keep their low balling calculations hidden in plain sight.

The Reserve Fund Law provides sponsors of conversion projects with two different methods of funding the reserve fund of a condominium: (1) funding the entire reserve fund within 30 days after the first closing, or (2) funding the reserve fund over the course of five years with a “mandatory initial contribution.” The mandatory initial contribution must be established as a minimum of one percent of the Total Price.

In New York City condominium conversions, unit owners and boards should scrutinize their reserve funds to ensure that the condominium's sponsor complied with the Reserve Fund Law because discovering and prosecuting underfunding can result in the recovery of substantial dollars to the condominium.