

Cornell Law School Lecture  
"Real Estate Transactions"

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TRANSACTIONS:

Preliminary Note:

Lawyers Role: Contract Drafting, negotiating terms, resolving disputes, avoiding litigation, protecting client from too many representations, assisting the client with finding the right bank, getting bank approval, loan commitment conditions, Co-op Board approval and Condo approvals, leaseback agreements if needed.

On New Construction deals: getting the sponsor to be a little flexible, waive charges, give credits, make reasonable changes in a Rider to keep the deal alive. Sponsor/Developers need to have a bank that will be on board with the building. Usually a preferred broker and a preferred bank. The banks and brokers fight hard to get into these buildings. Tons of business.

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1. Offer and Acceptance, Consideration:

\*Broker sends attorney and "offer/acceptance" or "deal" sheet with all relevant transaction information including: parties, price, closing date, mortgage contingent or not, managing agent, broker info, attorney info, any inclusions or exclusions, maintenance and/or common charges and taxes. Name of the Co-op is essential for lien searches, etc.

Attorneys make contact: STATUTE OF FRAUDS-Must be in writing-Oral representations are inadmissible-Parole evidence rule bars them.

- seller attorney prepares contract. Sends four to buyer attorney/ or fax/ or e-mail.
- offer is made when a contract is signed by purchaser and returned with a down payment check (consideration).
- acceptance occurs once the seller signs and places the fully executed contract in the mail to purchaser's attorney ("mail box rule").
- Seller must relinquish dominion and control, showing clear intent to accept the offer.
- Depositing a down payment check shows acceptance of the offer.
- Down Payment check can be a personal check payable to the seller's attorney, as escrow agent.
- Negotiate for as small of down payment as you can.
- Counter-offer: When seller makes a material change to the contract. Purchaser may reject and get out of the deal.

(It is always best to tell the client that a deal is not a deal until seller signs it and it is returned without changes to the attorney. Only then should the client incur expenses in connection with the transaction) \*\*CONTRACT SHOULD NOT BE RELEASED TO SELLER UNTIL DUE DILIGENCE IS COMPLETED.

## 2. ATTORNEYS "DUE DILIGENCE":

- In Co-ops: that usually entails reviewing the building: \*financials-2 years (depreciation as expense item, makes the building look like its negative cash flow, but not true) \*budget-present year \*offering plan -usually outdated although it has by-laws, proprietary lease,house rules, building specs \*amendments to the plan -changes in terms of offering. \*minutes-read six months back, pitfalls, expenses, litigations, disputes,future expenditures
- to make sure the building is not in financial distress (so as to avoid future assessment surprises).
- Also, need to confirm number shares, maintenance, assessments, flip tax. Is the board discussing implementing a "flip tax"? Due diligence is to avoid financial pitfalls for client. Is the building planning a major renovation? Is the building mortgage expiring soon? Are they discussing assessments in the minutes?? Are they re-financing?? Will the building have a pre-payment penalty.

In New-construction deals: "Due diligence"

- "Special Risks" section of plan. Must explain each to client.
- "closing costs and adjustments" important areas to focus on.

Brief description to client of: Transfer taxes, sponsor attorney fees, superintendent apartment, 421-tax risks, re-sale restrictions, lease restrictions. Non-mortgage contingent. 40% owner occupancy restrictions of banks, etc. Control of the building for 5 years. Sponsor should get a bank to agree to lend in the building. A preferred lender so that the 40% rule won't be an obstacle to purchasers getting loans.

- Make sure you have all amendments to the plan. Common charges change, etc!!
- In Condos, review the plan, any financial material, know the taxes, common charges amount and any restrictions imposed by the board of managers on re-sales or renting, etc. and the percentage of common interest attributable to the unit.

Condos need to be financially sound because if an owner defaults, a bank will not step in and pay the common charges as is the case of a co-op. That causes cash flow problems for the building. As such, more Reserve Funds are preferred in Condos.

Co-op has to give the bank a chance to pay the outstanding "maintenance" before the co-op can foreclose on its lien. The banks keep the building stable. As such, Reserve Funds are less important in a Co-op vs. a condo. Co-op lien for unpaid maintenance is paramount to bank loan.

Normally, the real estate agent/broker plays a fundamental role in getting the documents to the attorney office so that due diligence can be completed. That facilitates a quicker contract signing. All players are important. Everyone needs to cooperate with each other.

- In commercial buildings, must review leases and violations, environmental issues, as part of due diligence.

3. CONTRACT TERMS: Standard Contracts “boilerplate” or “form contract” with Riders 2 to 10 pages. Riders are very common-many repetitive terms. Attorneys seem to borrow riders. Riders modify form contract and clarify issues. Rider terms preempt contradicting boilerplate terms. Must check Rider carefully.

Co-op Contract General Terms: Parties, Personalty, Closing date, financing, representations (buyer and seller), Consents, Risk of Loss, Closing location, closing fees/taxes/apportionments, broker, defaults, removal of liens/judgments, seller's inability, notices, financing, inspections, assignments, escrow, lead paint.

Condo Contract General Terms: Property Description, personal property, price, representations, documents, adjustments, right of first refusal, fees, possession, defaults, notices, escrow, FIRPTA, title, risk of loss, broker, financing

Lawyer must always make sure of the basics (Common sense): heat, electric and plumbing work, to extent in seller's control; no leaks, noise/nuisance within 12 months; no litigations; seller to pay transfer taxes and flip taxes; right to cure default, all violations and title clear (seller to pay some money before any right to cancel). Make sure common charges, shares, maintenance are correct and any assessments. In commercial, must know all of the leases and any building violations.

#### 4. CONTRACT CONTINGENCIES:

1-Mortgage approval (unless all cash offer) Will address in more detail (see 11).

2-"Unconditional" Co-op board approval. a. Business Judgment Rule- Co-op can deny without stating any reason-Court won't second guess. (exception fraud, collusion, discrimination, etc. hard to prove) b. escrows required-gives buyer a way out. c. guarantees required-gives buyer a way out.

3-Waiver of right of first refusal in Condos. a. Usually seller and broker obtain-can delay a closing!! b. Real estate Brokers have to make sure their agreements include a commission if the right of first refusal is used.

- Mortgage Contingency periods are normally 30 to 45 days-negotiable.
- Extensions of contingency periods must be in writing.
- Waiver of contingency, “all cash” deal once commitment date passes; must diary this date to avoid malpractice and make sure client knows the date as well.

- Board packages (explain) for Co-ops are due three days after a commitment letter is issued to buyer or within ten days of signed contract when it is an all cash deal. Brokers assist with board packages-not attorneys. Buyer can default by delaying and seller can seek expenses which are incurred.

#### 5. ATTORNEY AS ESCROW HOLDER:

- Attorney holds money as “stakeholder” and can place same into Court at attorney discretion. (Interpleader action)
- Escrow funds can not be released without court order or stipulation of parties in writing. Sellers need to know this!!
- Normal escrow for a deal is ten (10%) percent. If less of a deposit is taken, the contract should state in the event of default, “liquidated damages” shall be ten percent. Explain with example. 100,000 5% vs. 10%

“Liquidated damages” is the pre-agreed amount of damages that seller would be entitled to if purchaser fails to perform. Do not have to prove actual damages at trial.

Usually non-interest bearing IOLA accounts. State Judiciary Committee gets interest. In new-constructions- interest income goes as a credit to the buyer at closing and buyer is taxed for the income (w-9). Interest follows money otherwise.

6.FLIP TAX- Imposed in many Co-ops and Condos (as a condition to the waiver of right of first refusal) to raise capital funds for buildings.

- It can be a percentage of the total sale price.
- A percentage of the profit
- an amount per share (\$8.00 per share)

It is negotiable who pays, but usually seller. Some times it is split; sometimes the co-ops require it to be split.

The broker must know what restrictions exist in the building and what transfer costs. The managing agent of the building has all of the detail and must cooperate. You do not want surprises!!!

\*\*\*\*Banks need to know the flip tax if any. They reduce the loan by this amount since they know they can not get it back in the event of a loan default. The Building gets their flip tax before the bank can get recovery of the loan proceeds.

7.“AS IS”- Can mean at time of contract or at time of closing. The condition of the premises could change during the executory period. Contract should be clear.

In most instances, the contract requires:

- Working appliances- (limit to credit of \$200 per broken appliance)

- Heat, electric and plumbing in working order "to extent in seller's control" in Co-ops.
- Co-ops must remedy anything within the walls
- Premises free of leaks and has been for last 12 months.
- Riders are used to limit the seller's responsibility.
- These terms do not survive the closing. Merger doctrine.
- If seller is not going to spend any money at all to remedy a problem-broker must be very clear when accepting the offer.
- Seller usually agrees to pay up to \$3000 to clear violations, etc. before any right to cancel the agreement or in a home up to 1,500 to cure termite issues and get certification.
- Banks won't lend unless their is certification that Termites and asbestos is removed.

## 8. TRANSFER TAXES:

- State- \$4 on every thousand. Ex. \$500,000 (500 x 4=2000.00) Tax is \$2000.
- City 1% up to 500K then 1.42%
- Mansion tax-1% (over a million)
- Non-resident tax of 6.85% (sale price less costs minus purchase price plus improvements).House or Condo (title picks up based on Identification given and title company takes care of paying, if a CO-OP, attorney for seller must send in to New York State Department of Taxation)
- Capital Gains tax- single filer for 250,000 profit , joint filer 500,000 profit at Federal and state rates (15%/7%) Mortgage recording tax of 2.05 up to 500K then 2.175%.. Must have as primary residence 2/5 prior years--no more rollovers!! Always advise the client to speak to an accountant.
- FIRPTA- 10% withheld by purchaser and sent to IRS if seller is foreigner without social security number.
- Acris- automated city register information system (tp-584,rpt,smoke detector affidavit,carbon monoxide detector)

## 9.UCC-1 And UCC-3- Co-ops

- UCC-1: "financing statement" filed by bank to show that they have a lien on ths shares of stock for the amount of the loan. This is done prior to closing. The bank will not lend the funds unless the loan appears of record as a lien on the shares.

Note: The Co-op has a first lien (above the bank loan) for unpaid maintenance. Co-op executes "recognition agreement" giving bank the chance to remedy the shareholder default (which the bank does). In fine print on the back of the shares of stock. "pursuant to article 6 section 6 of the by-laws the board has a first lien"

- The Bank has twice the time period of the shareholder to cure the default in maintenance. Default in maintenance is also a default under the loan security agreement.
- The Bank holds the original stock and lease as collateral for the loan. Must have copies.
- If no bank loan, must make sure buyer gets original stock and lease, since if it is lost, must be bonded and it becomes very expensive.
- If collateral is lost by bank, **MUST OBTAIN LOST STOCK AND LEASE AFFIDAVIT.**

- UCC-3: a termination of a lien on shares of stock, or amendment to lien. This is delivered by the Payoff bank attorney at the closing.

#### 10. POSSESSION AGREEMENTS:

- Allows Seller to remain in possession post-closing. Usually for older sellers and sellers moving out of state. Becoming frequent.
- ranges from 5 days to 180 days.
- Normally, five days without charge (no rent) but seller remaining in possession adjusts for buyers per diem mortgage and taxes, etc.
- Normally, there is an Escrow \$3000.00 and 250.00 per day if it goes beyond 5 days as deterrence for holdover sellers. Ranges up to 10,000 and 500 per day.
- no landlord tenant relationship created- license to occupy only.
- Seller must keep insurance in place.
- possession agreements are useful to help prevent a loss of a loan rate and from imposition of "extension fees". Close and let seller remain in possession.

\*\*\*CAN ALSO HAVE POSSESSION AGREEMENTS PRIOR TO CLOSING FOR PURCHASER--INTERIM LEASE--RISKY. DEFAULT UNDER LEASE SHOULD BE MADE A DEFAULT UNDER THE CONTRACT OF SALE. THAT PROTECTS THE SPONSOR/DEVELOPER FROM A HOLDOVER TENANT.

#### 11.MORTGAGE CONTINGENCY:

- It still exists. It is fair to buyer and it creates a window of 30-45 days for buyer to get out of the deal.
- seller should not incur any expense in preparing to move until contingency period terminates and contract is no longer terminable by buyer. Important to tell them.
- owner occupancy requirements in new constructions-40% before bank will lend. Must see if any bank has approved the building or has a strategic alliance with the building to provide funding.
- Buyer has 7 business days after commitment date in contract to terminate based on failure to obtain a loan. If no action taken the contingency is waived.
- Need letter from bank declining the loan. Must show it was applied for in a timely manner (5-7 days from contract)
- contract date (fully executed), plus thirty days, plus 7 days equals at least 37 days before it essentially turns into an all cash deal that is "firm".
- Attorney can strike out clause that requires delivery of commitment within five days after issuance and attorney can strike out clause that it is a waiver if the buyer fails to send notice. Prevents a technical default.
- Consider shortening a contingency period to 10- 15 days to resolve a dispute between all cash or mortgage contingency so as to save the deal.
- That is a fair compromise and the period can be extended if good cause is shown. Must get the realtor and the developer to compromise on this issue to save a deal and salesmanship is important.

- Non-Contingent Financing: Purchaser remains at risk if he/she can not obtain a loan. It does postpone the time for the buyer to submit a board package in Co-ops(3 days after commitment letter issues)
- The lawyer should advise the client of the risk and suggest having a loan commitment letter before signing, or at least a pre-approval letter from a bank.
- Brokers often confuse this with an all cash offer. Must be clear whether buyer is financing or not.
- If it is an "all cash" contract and then the buyer decides to finance, the Co-op board must be notified since they have to execute a recognition agreement.
- The Co-op board will require a contract amendment.
- This can cause delays so it must be clear from the beginning whether it is truly an ALL CASH OFFER or merely non-contingent financing.
- The Real estate professional needs to communicate with the client to make sure he/she understands what the purchaser is intending to do.
- deals over a million are usually non-contingent.
- ALL CASH MEANS ALL CASH!!

## 12. LEAD PAINT ADDENDUM:

- 1961 TO 1978
  - NEED FORM FOR BUYER TO GET LOAN
  - usually waived unless young children living in premises, then it is safer to test.
  - Seller is not required to repair and can cancel contract.
  - Buyer usually waives test.
  - Certified lead paint removal is required and that is expensive.
  - Seller usually states "not aware of any lead paint" and buyer usually "waives the test."
- However, the client must be advised of the risk, and a pamphlet must be given to the buyer by the broker. Broker plays key role in satisfying this requirement.
- Anyone placing the property into the market can be sued and found liable.

## 13. ENGINEER AND INSPECTION REPORTS:

- Not usually done in Co-ops or Condos since the building has many responsibilities.
- In Townhouses or houses inspection is needed. Must check roof, plumbing, electric, heat, drainage, etc.
- Offer should be made subject to the inspection report or after the report is done.
- re-inspect 48-72 hours prior to closing and check everything: water pressure, stove, oven, outlets, hot water, faucets.
- Once you close, contract no longer exists "merger doctrine"-unless the clause states it is intended to survive the closing.
- broker must notify attorney of any issues that exist.
- Options if work is needed: 1) repair before closing, 2) escrow and repair post closing, 3) credit purchase price I think a credit is preferable since the purchaser can make sure of quality repairs.
- Property Disclosure Statements or 500.00 in lieu for houses. Not advisable to have a seller sign one!

#### 14. TITLE CLEARANCE/LIEN SEARCH:

All liens, judgements violation disposed of and indemnities obtained from Co-op on building violations. Bank attorney won't lend until everything is perfectly clear. Buyer's attorney must make sure no encumbrances remaining, title is passing free and clear—fee simple absolute. Estate tax paid, ECB liens, DOB liens, HPD liens. In Co-op lien search, in Condos-title search.

#### COOPS/EXAMPLES:

1. Judgments and violations against the building (HPD, sidewalk, etc) the bank will require an indemnity from the building to fund the loan, most buildings don't like to give specific indems to a bank, will only send something very vague that doesn't cut it.
2. Old UCC1s, previous owners who sold the place and the UCC3 was never recorded or was recorded incorrectly. If not cleared, then the stock can't be transferred free of liens.
3. Building/sponsor mortgages, they will have huge mortgages against the entire building or in the case of a sponsor whatever units they own. Need to make sure you get a release on the particular unit that you are closing on.
4. Names on stock and lease not matching up/more names on the stock & lease than on the contract. All sellers have to sign away the stock, usually cleared by death certificates (too many names) or wedding certificates (different last names) but can be a problem \*\*if there is a death certificate, must make sure the stock was held as jtwros or the death certificate is not good enough.

\*\*\*with death issues, have to make sure that estate taxes are in order and no lien will land on unit

#### CONDO EXAMPLES:

1. same issue as #1 for coops w/regard to judgments.
2. Building failing to waive the right of first refusal, w/o it you cant buy and the bank wont fund, the condo will usually send the letter waiving the right, you just have to wait and some buildings take forever.
3. Prior deed signed by power of attorney. Title company may require proof as to the power used was actually effective. "AFFIDAVIT OF FULL FORCE AND EFFECT"
4. Judgments against the seller. Parking tickets, tax judgements, back child support, etc all must be cleared to give clear title. Usually just picked up by the title company at closings or paid off prior to closing & satisfactions are brought to closing. Judgements against similar names but not on the head are cleared with an affidavit.

5. Mortgages against the unit but not against the seller, still need to be cleared up, can usually be cleared with the help of the title company that insured the seller when they bought the place, Alta policy.

#### 15.WHO IS AT THE CLOSING AND WHY?

- Seller or Attorney in fact-sign all documents
- seller attorney- provide all documents and counsel
- seller broker -address any issues that arise relating to the transaction/negotiation/terms
- seller's payoff bank rep(Co-ops)-pick up pay off of underlying loan on Co-op shares
- managing agent (Co-ops)-Provide stock and lease and terminate old stock and lease
- buyer or attorney in fact-sign all documents
- buyer bank attorney -fund the loan
- title agent (condos)-issue title policy and pick up payoffs on loans and taxes, etc. Record deeds.

#### 16.THE CLOSING DATE:

- on or about,
- on or before,
- time is of the essence. Double edged sword.
- usually on or about, meaning within thirty days of by either side.
- Buyer must lock in rate thirty days beyond contract closing date. Avoid Extension fees!!
- Bank Agent should negotiate "rate locks" that comply with the closing dates in the contract.
- Setting the closing date is usually the greatest point of contention.

Never mislead the client into thinking a closing date is set with out confirming with the attorney.  
-Many misconceptions about ready to close files.

- Mortgage brokers vs. underwriters/bank attorneys. Is title clear??? Bank Attorney controls
- Closings are supposed to be non-litigious and cooperation is required seeing that so many players are at the table.
- Both buyer and seller may have legitimate reasons to adjourn the closing.
- tell parties to be a bit flexible.
- Bank clearance needed by buyer.
- all title must be cleared by seller. May need to get new Certificate of Occupany. (Sheds, pools, decks, etc.)
- payoff amount, stock and lease cause delay by seller. Describe.
- Co-op can delay. (30 days). This is in the fine print of the contract.
- Hard to get Board meetings in summer months.

#### 17.REO TRANSACTION-

- Post-foreclosure. Bank is successful bidder at public auction and takes back property.
- Broker markets.

- Title must be clear and marketable.
- Bargain and Sale deed.
- If it is a Co-op, board approval is usually not required, but all maintenance will have to be paid for them to transfer the shares.
- In a Co-op. Non-judicial foreclosure, serve thirty day Notice of Sale
- publish three times in newspaper.
- Auctioneer sells at Court house steps.
- In Condo/house, etc. Judicial foreclosure -much longer process-Judgment of Foreclosure and Sale. Publish 4 weeks. Takes up to a year!!

#### 18. THIRD PARTY SALES:

- Successful bidder must give referee ten percent at auction and close within thirty days.
- No mortgage contingency.
- title must be clear and marketable--ie. a proper foreclosure.
- no chance for buyer to inspect property prior to bid.

#### 19. CLOSING STATEMENT:

- Copy of all documents--deed, acris documents (5 boroughs), equalization form
- Copy of all checks
- HUD statement
- Everything the accountant will need

#### 20. SELLER'S CONCESSION: Big Part of the sub-Prime problem!!

- 106% Financing. Right hand left hand. No Change to Seller. (Except Capital gains)
- Transfer tax issue. (Buyer to pay)
- Must be toward closing costs.
- not in Co-ops (must have restrictions 10-25% down)

#### 21.-OTHER TOPICS OF INTEREST:

- contacting the board
- get the board packages to client
- make sure clients submit checks and proper copies.
- leaks in co-ops. Co-op is responsible but not for internal leaks (faucets, etc.) Can get indemnity from Co-op or Condo or Escrow to close.
- get waiver of right of first refusal submitted quick.
- "Business judgment rule"
- Pets
- \*\*Co-op -know each buildings financial requirements including, amount down, asset requirements, income requirements, flip taxes.
- square footage- avoid reps

- \*\*FIRPTA- ten percent to be paid to IRS
- proper name of co-op. Buyer will hold seller to it when lien ordered.
- get two years financials and plan.
- Effect of defaulting owner in Co-op vs. Condo (In Co-op bank pays, in Condo loss of common charges-hurts financials)
- \*\*\*subleasing in condos vs. co-ops and RPL 226-b
- recognition agreements-submit to board with package. Bank won't loan without it. Must be accurate.
- Rider preempts contract form.
- interview tactics, smile, plain, don't offer info.
- \*\*\*-Estate sales. Must have plenty of time to clear title and give co-ops what they need.
- Net figures for loans come the day before closing and the buyer gets frantic!!
- Tell client to sign bank attorney letter for authorization to file UCC-1 but not to allow bank attorney to order title. Title is ordered by buyer attorney.
- Power of attorney. Must have right form, must be perfect, attorney and co-op must see before closing set
- Co-op buyer pays fee or as directed by Co-op otherwise
- Condo seller pays fee unless directed otherwise by condo board
- Mortgage tax- 2.05- up to 500K (2.175)
- fixtures
- tenants in common/tenants by entirety/joint tenants
- sublet to immediate family ok
- Avoid reps by seller
- reps by buyers to Co-ops- 25% mt. 35% mt. + mortgage (of Monthly income)
- access prior to closing-limit to 3 times
- interim leasing-need insurance and escrow.
- date proprietary lease expires-bank loans.
- non-resident tax-7.7% of sale price less costs minus original sale price plus improvements
- closing adjustments
- IOLA account
- checks for closing New Construction:
- \*\*\*Rider to contract usually works to negotiate terms : adjournments by parties, deposit checks, assignment, contingencies, certain fees, repairs, appliances, notice terms, etc are all negotiable (usually).
- transfer taxes and attorneys fees in new constructions.
- mortgage tax credit.
- \*\*\*421-A tax abatement -tax preference-not guaranteed!!
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