

Collecting Arrears and Cutting Costs in the COVID-19 Era

By Andrew J. Wagner



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Massive business closings, layoffs and furloughs have rendered many co-op shareholders and condo unit owners unable to pay their mortgage as well as their maintenance or common charges.

This diminished income stream places great stress on co-ops and condos, which have financial obligations of their own, including (but not limited to) insurance premiums, payroll, utilities, and in the case of co-ops, mortgage payments and real estate taxes, just to name a few.

Normally, co-ops would resort to serving rent demands and prosecuting nonpayment proceedings in housing court, and condos would commence foreclosure actions to collect arrears from defaulting unit owners. However, given the humanitarian demands of the moment — not to mention the effective closure of the court system and the moratorium on foreclosure auctions and evictions for the foreseeable future — co-ops and condos must resort to alternative methods for collecting arrears and maintaining their financial stability during this crisis.

But, given the reality at hand, it is important to remember that condo and co-op boards have fiduciary obligations to their associations and corporations and therefore cannot waive or discharge the financial obligations of their members, since doing so would result in shortfalls that would have to be made up by the non-defaulting unit owners. However, a balanced, multi-faceted and holistic approach can and should be taken to address this issue, both globally and on a case-by-case basis.

1. Individual Unit Owners

When individual unit owners fall behind on their maintenance/common charge payments, typically a predicate letter is sent before formal legal proceedings are commenced. This practice should not change so that a record is made that the unit owner is in default, and payment is due. However, this letter should be tailored to the present situation, and should invite the defaulting unit owners to contact management as soon as possible to explain and document their individual circumstance, and to propose a payment plan.

It is up to boards to determine whether or not they will require the defaulting unit owner to provide actual proof of financial hardship (e.g., unemployment, diminished income), or to simply provide a payment plan to anyone who requests it. Imposing standards for qualifying for a payment plan creates an administrative burden on the board or its managing agent. On the other hand, simply allowing anyone who requests a temporary suspension of payment obligations may create a greater short-term deficit that will have to be addressed.

Our recommendation is to enter into an out-of-court agreement, comparable to forbearance agreements utilized by banks. Generally, in the agreement, the unit owner acknowledges the amount owed and is granted a three-month suspension on monthly carrying charges, at which point the owner will resume making monthly payments when due, plus an additional sum toward the balance owed until paid in full. The exact terms can be negotiated or tailored on a case-by-case basis, but we recommend that the balance be paid off within one year. Importantly, it



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must be understood and agreed that the obligation to pay arrears is only deferred, not waived.

As an incentive, waive all legal fees, interest and late charges, but only if payment obligations are met.

If there is a default, the co-op or condo won't be able to enforce the agreement in court until the court system is reopened. And even then, there will likely be a large logjam that will make enforcement a lengthy process. But the process will be relatively smooth, since the defaulting unit owner will have already acknowledged the debt in the agreement, making ultimate collection of the debt inevitable.

A Note About Reverse Mortgages

By Andrew J. Wagner and Devin W. Ness



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An option to consider for condo unit owners who are senior citizens is a reverse mortgage, which can provide much-needed cash flow

and payment of common charges. This option could allow elderly unit owners to remain in their homes for the remainder of their lives in financial security. Presently, however, this option is not available to co-op shareholders, as a result of Gov. Cuomo's veto on last year's legislation that would have provided this opportunity to seniors. Now, more than ever, political pressure should be applied to reintroduce the legislation and override another veto, if necessary. Unit owners can and should contact their state senators, assembly members, and the governor's office directly. They can also reach out to the National Reverse Mortgage Lenders Association (NRMLA), the Council of New York Cooperatives & Condominiums (CNYC), and the Federation of New York Housing Cooperatives & Condominiums (FNYHC), which have been spearheading this effort for the last several years. ▲

2. Commercial Tenants

Many co-op buildings have commercial tenants that are similarly unable to meet their rent obligations as a result of the COVID-19 pandemic.

While, in principle, boards may wish to enter into comparable rent-deferral agreements with its commercial tenants, we recommend that requests be more strenuously vetted. Specifically, the financial health of the tenant should be thoroughly assessed, so a determination can be made as to the likelihood of the tenant surviving this crisis or filing for bankruptcy protection.

To that end, the type of security deposit should be reviewed, since its recovery by the co-op (the landlord) may be difficult if the tenant files for bankruptcy. For example, although letters of credit issued by third parties can be drawn down by the landlord and fall outside bankruptcy proceedings, security deposits may not be touched without court approval. Therefore, in the event of a default, it may be advisable to apply the security deposit toward arrears as soon as possible. Note further that payments made toward arrears on account of "unsecured" obligations may be vulnerable to recoupment by the debtor's estate if applied within 90 days prior to the date the bankruptcy petition is filed.

Most commercial leases are secured by a personal guaranty, so any agreement can and should be conditioned upon the guarantor's express acknowledgement of their obligation to satisfy the arrears. Obtaining updated financial information from the guarantor is also recommended.

Another consideration is whether or not the tenant has business interruption insurance that covers the COVID-19 pandemic. Today, insurance companies are almost universally rejecting these claims on the basis that the virus does not cause "property damage," which is a common requisite for coverage. However, this issue is unresolved, and will likely only be settled by the courts or government action (see articles written by my colleagues Finley Harckham and Rhonda Orin et al. on insurance companies' overly broad assertions of no coverage for such losses). That said, tenants should be required to at least file claims or put their carriers on notice as a condition of entering into an agreement with the co-op.

The board can also demand, as a condition of entering into any such agreement, that the tenant



obtain a Paycheck Protection Program (PPP) loan or Economic Injury Disaster Loan (EIDL) (or provide proof that it sought one and the application was denied), or state why it does not qualify for these types of loans.

Finally, since agreements with commercial tenants regarding rent payments are, in fact, lease modifications, a review of the underlying co-op mortgage by legal counsel is essential because lease modifications may require consent from the bank holding the mortgage on the building. Generally, a lender will require that it approve any rent-deferment, reduction or abatement agreements, and failing to do so may trigger a default.

3. Cost-Cutting Measures

In order to meet their own financial obligations, co-op and condo boards can negotiate payment plans with their own vendors, banks and utility providers. They may also engage in cost-cutting measures, such as suspending unnecessary amenities that require staffing resources, and delaying nonessential and discretionary capital improvement projects.

If the financial situation is dire, boards can also seek to refinance existing mortgages, tap into their lines of credit, or even enter into loan agreements with unit owners who are financially equipped to do so.

4. Insurance

Co-ops and condos should have their own insurance policies extensively reviewed by legal counsel to determine if there is coverage for lost income under business interruption or related coverage. Even if it appears that the policy does not cover this type of event, or if it contains a potentially applicable exclusion, the carrier should promptly be placed on notice to preserve the claim. Imperfect, even premature notice is better than late notice or no notice. In some instances, coverage can be adversely affected by late notice.

Conclusion

Formulating the best strategy for collecting arrears and maintaining the financial health of your co-op or condo in this challenging environment requires a review of the building's governing docu-

A Note About PPP Loans and EIDLs

By Andrew B. Freedland and Andrew J. Wagner



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In a recent article *COVID-19 Update: The Paycheck Protection Program and Co-ops/Condos/HOAs*, we stated that co-ops and condos do not qualify for Paycheck Protection

Program (PPP) loans as they currently exist, although this may change in the future. Economic Injury Disaster Loans (EIDL) are another potential option, although not necessarily an attractive one. Basically, EIDLs are available to businesses (including co-ops and condos) that have suffered substantial economic injury as a result of the COVID-19 pandemic. However, unlike a PPP loan, an EIDL is not forgivable and must be repaid. In other words, it is not a grant, which is what a PPP loan becomes if the requirements of the program are met. Also, the program requires personal guaran-

ties for amounts in excess of \$200,000, which could be an issue for a co-op or condo.

However, if a co-op or condo later qualifies for a PPP loan, an existing EIDL may be refinanced into a PPP loan. Notably, if an application for an EIDL is made by the end of the year and the applicant is eligible to receive it, they can receive an emergency \$10,000 grant that does *not* need to be repaid. However, the grant will be subtracted from a PPP loan if one is obtained at any time. Another attractive feature of the EIDL program is that the first loan payment can be delayed for as much as one year.

Ultimately, it might be advisable at this point to wait and see if the regulations governing the PPP loan are revised so that co-ops and condos are also eligible. But if there is a desperate need for liquid capital, we advise to proceed under the EIDL program now and possibly refinance it into a PPP loan (that ability ends on June 30, 2020). ▲



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ments, leases and insurance policies. We welcome the opportunity to address each board's unique circumstances, so that the best outcome can be achieved. ▲

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