
REAL ESTATE FINANCE BUREAU

M E M O R A N D U M

Re: Certificates of Occupancy and Part 20 Offering Plans

September 22, 2014

The Department of Law has received numerous comments on its memorandum regarding Certificates of Occupancy and Part 20 Offering Plans, dated August 1, 2014, including, *inter alia*: (i) commentary regarding the requirement to file a pre-closing amendment; and (ii) inquiries about sourcing the monies meant to secure a sponsor's obligation to obtain a permanent certificate of occupancy. The Department of Law is in the process of evaluating these issues and welcomes further comments on the memorandum through close of business on October 23, 2014. Comments should be e-mailed to Jeffrey.Rendin@ag.ny.gov.

Further guidance on Certificates of Occupancy and Part 20 Offering Plans is expected to be published in the coming months. The guidance and directives set forth in the August 1, 2014 memorandum are suspended until further notice. Nothing herein is to be construed as a waiver by the Attorney General of the obligations set forth in Article 23-A of the General Business Law or any regulation promulgated thereunder.

REAL ESTATE FINANCE BUREAU

M E M O R A N D U M

Re: Certificates of Occupancy and Part 20 Offering Plans

August 1, 2014

I. Background

New York General Business Law (“GBL”) § 352-e(2-b) requires that:

[A]ll deposits, down-payments or advances made by purchasers of residential units shall be held in a special escrow account pending delivery of the ***completed*** apartment or unit and a deed or lease whichever is applicable, unless insurance of such funds in a form satisfactory to the attorney general has been obtained prior thereto.

(emphasis added). The purpose of GBL § 352-e(2-b) is to prevent sponsors from using purchasers’ down payments for construction purposes, and to ensure that each sponsor completes its project. *See* L. 1977, c. 856, § 1, eff. Aug. 11, 1977, Departmental Bill, Sen. Intro No. 4402 (May 19, 1977).

For purposes of GBL § 352-e(2-b), in New York City, a completed unit is a unit for which the City’s Department of Buildings (“DOB”) has issued a permanent certificate of occupancy (“PCO”). The DOB issues a PCO, sometimes also called a final certificate of occupancy, when the building is completed and substantially conforms to the plans previously filed with DOB. New York City Administrative Code § 28-118.6.¹

Pursuant to his authority under GBL § 352-e(2-b) the Attorney General has promulgated regulations that provide that if a sponsor of a condominium closes title with unit purchasers without first having obtained a PCO for the building, sponsor must maintain ***all*** purchaser deposits and funds in a special escrow account. 13 NYCRR § 20.3(t)(13).

¹ A temporary certificate of occupancy (“TCO”) may be issued by the DOB before a building is completed, if occupancy will not jeopardize life, health or property. New York Multiple Dwelling Law (“MDL”) § 301[4]. A TCO expires 90 days after issuance, if not earlier. *Id.* Upon the expiry of a TCO, a condominium’s lack of a certificate of occupancy has substantial effects on its unit owners: without a certificate of occupancy, unit owners may find it impossible to renew their homeowner’s insurance policies, refinance or resell their units.

If an engineer, architect or other qualified expert certifies that a lesser amount than that being held in a special escrow is reasonably necessary to obtain a PCO, the sum exceeding the so-certified amount may be released from the special escrow account. Alternatively, a sponsor may deposit with an escrow agent an unconditional, irrevocable letter of credit or a surety bond, or other collateral acceptable to the Department of Law, in the amount so-certified, to secure its obligation to procure a PCO for the condominium. *Id.*

II. Troubling Trends and Practices

Recent investigative and enforcement action by the Department of Law has revealed several occasions where a sponsor caused all of its purchasers' deposit monies to be released from escrow before procuring a PCO, and subsequently abandoned efforts to obtain a PCO after the last unit sale. Such scenarios arise with disturbing frequency – the Department of Law regularly receives complaints from condominium unit purchasers regarding a sponsor's failure to obtain a PCO.

A. PCO Escrow Accounts

Sponsors frequently close title to unit purchasers when a TCO is issued by the DOB covering the contracted-for units. Sponsors commonly will deposit into a separate escrow account (a "PCO Escrow Account") its own funds (or other funds not sourced from purchaser deposits) in an amount sponsor's architect or expediter believes is necessary to obtain a PCO, then release all of a purchaser's deposit from the special escrow account at closing.

In practice, the funds in a PCO Escrow Account are sometimes held pursuant to an oral agreement between a sponsor and its attorney serving as escrow agent. Other times, the funds in the PCO Escrow Account are held pursuant to a written bilateral agreement between sponsor and the escrow agent. In either case, the terms of the escrow agreement are usually unenforceable by unit purchasers (who lack privity) and often are undisclosed to purchasers or the condominium's board of managers.

B. Amounts Certified as Reasonably Necessary to Procure a PCO

Another troubling trend has emerged in recent years whereby some sponsors are abusing the provisions of 13 NYCRR § 20.3(t)(13) by having persons whom lack any expert qualifications, or even a reasonable basis for determining the amount of funds needed for a sponsor to procure a PCO, certify that a *de minimis* amount of funds should be held as collateral to secure a sponsor's legal obligation to obtain a PCO. In other instances, duly-qualified professionals are certifying an amount necessary to secure a PCO in sole reliance of a sponsor's own estimate, without conducting any diligence. As a result of this practice, the amount of money held as collateral intended to secure a sponsor's obligation to procure a PCO for the condominium, *see id.* at § 20.3(t)(11), may bear no relation at all to the actual work and sums needed for a sponsor to procure a PCO.

C. Sponsor Control of Board of Managers and Procurment of a PCO

A related and problematic practice of Part 20 sponsors occurs when a sponsor discloses, pursuant to 13 NYCRR § 20.3(u), its intent to control the condominium's board of managers until such time as it procures a PCO. Procuring a PCO is solely sponsor's obligation, and its procurement is almost always within sponsor's exclusive control. A sponsor that sells all its units in a condominium but fails to fulfill its obligation to procure a PCO can manipulate such a disclosure to control a condominium's board of managers indefinitely, at its discretion.

D. Consequences to Unit Purchasers

There is often scant disclosure in many Part 20 offering plans about the amounts of money being held as collateral to secure sponsor's obligation to procure a PCO, who is serving as the escrow agent, or where those funds are deposited – to the extent that this information is documented at all.

Condominium unit purchasers in these circumstances are at risk that there is little or nothing securing a sponsor's obligation to obtain a PCO if it abandons all efforts to procure same. Upon the expiry of a TCO, the condominium units in a building will become illegally-occupied, uninsurable, un-resellable, and non-financeable. If sponsor is organized as a single-purpose entity (as most are), that sponsor often becomes assetless and judgment-proof shortly after the sale of its last unsold unit, leaving unit owners without a legal remedy.

III. General Guidance

To ensure that sponsors of Part 20 offering plans are fulfilling the requirements of GBL § 352-e(2-b), the Department of Law provides the following guidance and directives:

1. If a sponsor sells units prior to procuring a PCO covering the entire condominium, the formation, balance, and terms of the special escrow account created pursuant to 13 NYCRR § 20.3(t)(13), or a PCO Escrow Account (as described above) are and remain material information requiring updated disclosure to all offerees under the offering plan – including those unit purchasers who have closed title to their units – until such time as local authorities issue a PCO covering the entire building. Moreover, ***no*** monies should be released from the special escrow account unless sponsor either: (i) procures a PCO for the entire condominium; or (ii) the Department of Law has accepted for filing an amendment to sponsor's offering plan in accordance with the procedure and terms set forth below.
2. The disclosure that a sponsor will maintain control of a condominium's board of managers until it procures a PCO does not supply a reasonable investor with sufficient information with which to make an informed decision. *See State v. Rachmani*, 71 N.Y.2d 718, 726-7 (1988). A sponsor must provide a more finite

point in time when it will relinquish control of a condominium's board of managers – *e.g.*, a sponsor may disclose that it will cease controlling a condominium's board of managers within two years from the date of issuance of the first TCO.²

IV. Directives for Sponsors Opting to Close Title to Unit Purchasers with a TCO

Upon or after the issuance of a TCO by local authorities, but prior to the closing of title to the first unit in the condominium, sponsor must amend the plan to disclose and include the following material information and exhibits:

1. A representation that the Department of Buildings (or other local authority) has only issued a temporary certificate of occupancy for (portions of) the condominium. A copy of the temporary certificate of occupancy must be included as an exhibit to the amendment.
2. A representation from sponsor that either:
 - a. All of purchasers' deposits will be held in conformity with the provisions of GBL § 352-e(2-b) and 13 NYCRR § 20.3(t)(13) until sponsor procures a PCO for the entire condominium; or
 - b. Sponsor has funded a PCO Escrow Account from monies other than purchasers' deposits to secure its obligation to procure a PCO and to comply with GBL § 352-e(2-b) and 13 NYCRR § 20.3(t)(13).
3. A complete list of any mechanics' or materialmen's liens that encumber any or all of sponsor's interests in the condominium that must be satisfied before the relevant local authority will issue a PCO.
4. The identity of the escrow agent holding the funds in either the special escrow account or the PCO Escrow Account, and all persons with signing authority for that account. A complete copy of the agreement as executed by sponsor and escrow agent must be included as an exhibit to the amendment. Any amendments to the escrow agreement must be disclosed in a subsequent amendment to the offering plan.
5. The name, address and phone number of the financial institution holding the special escrow account or PCO Escrow Account, and description of any subaccounts. If sponsor has an interest in the financial institution, that interest must also be disclosed.
6. The current balance of the special escrow account or PCO Escrow Account as of the date of the submission of the amendment.

² MDL § 301[4] contemplates issuance of a PCO within two years from the date of issuance of the first TCO.

7. If sponsor's architect or engineer of record, in a professional opinion letter sealed by said professional, certifies that a lesser amount than that being held in the special escrow account is reasonably necessary to obtain a PCO, sponsor must attach that professional opinion as an exhibit to the amendment.
 - a. Only after (i) the amendment has been accepted for filing by the Department of Law, and (ii) a PCO Escrow Account has been created and funded in the amount certified by the architect or engineer of record, shall escrow agent release any monies from the special escrow account to sponsor or any other person or entity.
 - b. Only a certified professional opinion letter from sponsor's architect or engineer of record that closely conforms with the form attached hereto shall be acceptable for filing by the Department of Law. For the avoidance of doubt, the opinion of an expediter or any person other than sponsor's architect or engineer of record shall not be acceptable for filing with the Department of Law.

[Form of Professional Opinion Letter]

[LETTERHEAD OF ARCHITECT OF RECORD OR ENGINEER OF RECORD]

[Date]

[Escrow Agent]
[Address]

*Re: Professional Opinion Letter Regarding Sponsor's Costs to Obtain a Permanent Certificate for [Condominium] ("Condominium")
Offering Plan Filing No.: [_____]*

Dear sirs:

The undersigned is the [registered architect/professional engineer] of record with respect to the development of the Condominium. [Sponsor] ("Sponsor") has retained the undersigned to supply this professional opinion letter regarding the remaining costs necessary for Sponsor to obtain a permanent certificate of occupancy ("PCO") from [the Department of Buildings of the City of New York/[Name of relevant local authority] for the Condominium.

The undersigned hereby represents and warrants that it is a [registered architect/professional engineer/[professional corporation/limited liability partnership/professional limited liability company] of registered architects/professional engineers] duly licensed and in good standing in the State of New York. The undersigned acknowledges that he/she/it is responsible for complying with Article 23-A of the General Business Law and the regulations promulgated by the Department of Law in [13 NYCRR Part 20] insofar as they are applicable to this professional opinion letter.

This professional opinion letter is being made specifically to be relied upon by (i) [Name of Escrow Agent], as escrow agent, ("Escrow Agent"), (ii) offerees and purchasers under Sponsor's Offering Plan; and (iii) each of their respective counsel.

FOUNDATION FOR PROFESSIONAL OPINION

In rendering this professional opinion letter, the undersigned has examined, inspected and considered the following:

1. the current state of construction of the Condominium, including all major building systems and components;
2. all documents related to the costs of outstanding construction work or sign-offs necessary to complete construction of the Condominium, including without limitation, [the New York City Department of Buildings' "B-Scan List of Required Items"/relevant documents available from local authorities];

3. all documents related to all soft costs necessary to procure the PCO for the Condominium;
4. all documents setting forth an estimated date for the procurement of the PCO for the Condominium;
5. all known mechanics' or materialmens' liens encumbering any or all of Sponsor's interests in the Condominium;
6. all other reasonable and customary costs and fees likely to be incurred by Sponsor, including without limitation, all expeditors' fees and [Department of Buildings/local authority] fees, to procure a PCO from [the Department of Buildings/relevant local authority] covering the entire Condominium; and
7. all other documents or instruments the undersigned deems necessary or appropriate for rendering this certified professional opinion letter.

PROFESSIONAL OPINION

Based on the undersigned's examination, inspection and consideration of the foregoing, it is the undersigned's professional opinion that:

1. \$_____ is reasonably necessary to cover all work and costs associated with obtaining a PCO for the entire Condominium; and
2. The time reasonably required to complete all outstanding work and obtain a PCO should be no more than _____ (__) months from the date of this certified professional opinion later, which is _____ (__) months from the date of the issuance of the initial temporary certificate of occupancy; however, the undersigned does not represent or guaranty that sponsor will procure a PCO within this timeframe.

This professional opinion is limited to the matters stated herein. This professional opinion is not intended as a guarantee or warranty of the physical condition of the Condominium or that construction and ministerial acts will be carried out in the time specified.

This professional opinion letter is being made specifically to be relied upon by (i) [Name of Escrow Agent], as escrow agent, ("Escrow Agent"), (ii) all offerees and purchasers under Sponsor's Offering Plan; and (iii) each of their respective counsel.

CERTIFICATION

In addition to the professional opinions stated herein, the undersigned certifies that:

- (i) this professional opinion letter affords Escrow Agent an adequate basis upon which to release that portion of purchasers' deposits and funds which are in

excess of the amount set forth in Professional Opinion No. 1 above, to Sponsor prior to the procurement of the PCO for the Condominium;

- (ii) the amount set forth in Professional Opinion No. 1 above is an amount which represents all reasonable costs and work necessary for Sponsor to procure a PCO for the entire Condominium;
- (iii) the undersigned is not owned or controlled by and has no beneficial interest in Sponsor; and
- (iv) the undersigned's compensation for preparing this professional opinion letter is not contingent on the conversion of the property to a condominium or on the profitability or price of the offering.

Yours faithfully,

[CORPORATE NAME, P.C.],
a [New York] professional corporation

By: _____
Name of Professional, [P.E./R.A.]
[Corporate title]

[AFFIXATION OF PROFESSIONAL SEAL
OF REGISTERED ARCHITECT OR
PROFESSIONAL ENGINEER]

or

[COMPANY NAME, P.L.L.C.],
a [New York] professional limited liability
company

By: _____
Name of Professional, [P.E./R.A.]
Member

[AFFIXATION OF PROFESSIONAL SEAL
OF REGISTERED ARCHITECT OR
PROFESSIONAL ENGINEER]

or

[PARTERSHIP NAME, L.L.P.],
a [New York] limited liability partnership

By: _____
Name of Professional, [P.E./R.A.]
Partner

[AFFIXATION OF PROFESSIONAL SEAL
OF REGISTERED ARCHITECT OR
PROFESSIONAL ENGINEER]

or

[if a sole-proprietorship]

NAME OF PROFESSIONAL, [P.E./R.A.]

[AFFIXATION OF PROFESSIONAL SEAL
OF REGISTERED ARCHITECT OR
PROFESSIONAL ENGINEER]

