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Preparing Condominium and Cooperative Boards for a Recession

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Boards of condominiums and cooperatives owe fiduciary duties to their unit owners and shareholders.

These fiduciary duties include not only the most obvious ones of ensuring that the buildings they operate are maintained and that their governing documents are followed and enforced, but also include an obligation to protect the fiscal well-being of the condo association or co-op corporation.

Each year, condo and co-op boards meet with their advisors to create budgets for the following fiscal year. They project the common expenses of running the building and then, in most cases, allocate the total common expenses among the owners based upon each owner's common interest or share percentage to determine such owner's annual common charges or maintenance payments due.

The goal is to have the revenue coming in match expenses going out. Budgeting can be challenging in the best of times, but in the face of economic uncertainty, can present a "do or die" scenario.

Pundits are forecasting recession. Some say it has already arrived. While people often disagree on how to define "recession," economic strain is clearly upon us and is forecasted to get worse.

The cost of doing business for New York condos and co-ops is going up. With inflation at 40-year highs, the cost of basic goods and services has skyrocketed. Energy costs also have significantly escalated.

Courtesy photos

Leni Morrison Cummins, left, is chair of the Condominiums & Cooperatives practice at Cozen O'Connor, and Jennifer Miller, right, of counsel for the Condominiums & Cooperatives practice at Cozen O'Connor.

Due to changes in the New York insurance industry, boards are currently forced to pay on average 15-20% higher insurance premiums than in years past. Building service worker wages also are through the roof in many buildings as a result of recent legislative changes to Section 467-a of the New York Real Property Tax Law.

If that weren't enough, Local Law 97's requirements for energy retrofits start to roll

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out in 2023, meaning increased expense for retrofits or payment of fines

At the same time that operating costs are going up, the residents whose common charge and maintenance payments make up nearly all or all of the revenue of condos and co-ops will likely be feeling economic strain. Inevitably, during a recession, companies cut back their employees' work hours or, even worse, eliminate jobs entirely.

Those actions will influence certain owner's ability to pay their common charges and maintenance, which will directly impact condo's and co-op's revenue and ability to meet their budgets.

An increase in costs coupled with a decrease in revenue is a recipe for trouble. In most instances, income is limited to the common charges or maintenance payments of the owners. If some owners don't pay, the others will have to pay more to make up the shortfall, imposing a significant burden on owners to foot the bill for their defaulting neighbors.

If default rates spike too high, some condos and co-ops may not be able to meet their expenses at all and may default on their obligations.

With that economic landscape in mind, what can boards do to be ready for a recession?

1. **Increase Reserves**. A reserve fund is essentially a savings account for a building. There is no New York or Federal statutory requirement for a minimum reserve fund. However, most attorneys and accountants recommend that Boards follow the Federal National Mortgage Association (FNMA), also known as "Fannie Mae'" guidelines. Fannie Mae requires a 10 percent reserve as a line item in a Condo's or Coop's budget. However, those guidelines do not factor in delinquencies in common charges/maintenance payments during an economic downturn. Increasing reserves to at least 20% of the overall budget will be better equip Boards during a recession.

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2. **Commission a Reserve Study**. The main purpose of a reserve study is to assess the overall components of a building (i.e., elevator, roof, HVAC system, etc.) to determine those assets' useful lives before they will need repair or replacement and the estimated costs of such upkeep. Understanding those costs, Boards can adequately budget for the coming years. The study is also a useful tool to determine whether a Board's reserve fund is on track with the Fannie Mae reserve guidelines or if the budget is in need of an adjustment. Those corrections are particularly important during challenging economic times to avoid large assessments and pushback from Owners when a building common element requires an immediate repair or replacement.

3. **Conduct a Vendor Audit**. A vendor audit is used by many corporate organizations to evaluate third-party contractors and their services. For condos and co-ops, third-party contractors may include elevator maintenance servicers, window washers, janitorial service providers, and landscapers. An audit can ensure that boards are

utilizing the services of third-party contractors at competitive rates, that the building actually requires those services, and that the vendor is providing the contracted services in compliance with the terms and conditions agreed upon between the board and that vendor.

4. Increase Late Fees and Interest. Late fees and interest are important tools to incentivize owners to timely pay their common charges/maintenance payments. Boards should review their by-laws and other governing documents to determine whether they have the authority to charge late fees and interest to those owners delinquent in the payment of common charges/maintenance payments. If not, such documents should be amended to provide the Board with such powers. Late fees and interest charges should also be increased to adjust for inflation while being mindful that such amounts cannot violate New York's usury laws. Under New York law, the maximum interest rate that can be charged is 16% annum.

5. Modernize Payment Systems. Adopting a system that is user friendly and allowing owners' payment by convenient and varied means is a surefire way to encourage timely receivables. Modernized payment systems, such as "ClickPay", are online platforms that bill and collect payments with the capacity to accept various payment methods such as credit cards, e-checks (ACH), and paper checks.

6. Commence Collection Efforts. Boards should review the building's financials on a monthly basis and identify which owners are delinquent in the payment of common charges/maintenance payments. Following such review, management should immediately send out collection notices to those parties. If payment is not received, Boards should engage an attorney to commence more formal collection efforts such as recording a lien against the unit or commencing a foreclosure action or non-payment proceedings. Section 339-z of the New York Real Property Law (Condominium Act) explicitly grants a board, on behalf of the owners, a lien on each unit for the unpaid common charges. Furthermore, the governing documents of a condo or co-op often will permit the board to charge an owner the legal costs incurred in connection with those collection efforts. If not, boards may consider amending their governing documents to provide for payment of such legal costs. In most cases, a simple legal demand notice will prompt owners to pay without the need for the board to commence a more formal foreclosure action or non-payment proceeding.

Condos and co-ops are not immune from hardship in turbulent economic times. Prudent boards will implement various safeguards to guarantee the fiscal health of the buildings they represent.