Co-ops and Certificates of Occupancy

CAREFUL ATTORNEYS representing real property purchasers generally inspect the certificate of occupancy (the CO) of the property before allowing their clients to consummate the purchase. After all, the CO limits the property to the uses set forth on the certificate, and no client would want to close on a property only to find out that it could not be used for the client’s intended purpose.

Yet the same careful attorneys may rarely review the CO of a building containing a co-operative apartment unit that their clients want to purchase. The reason is not hard to understand. The client is purchasing stock and a proprietary lease, not an interest in real property, and the attorney may not focus on the underlying real estate. The typical Blumberg forms used for the purchase of a co-op are silent on the issue of the building CO. This article discusses the potential problems in the purchase of a co-op, when issues pertaining to the CO are not addressed prior to signing a contract.

Case Studies

In the first illustration, purchaser had a deal for a 12th floor penthouse apartment in an established co-operative apartment building on the East Side. Purchaser’s attorney reviewed the co-op’s financials, offering plan, and minutes, and found them all in order. Seller’s counsel submitted the standard Blumberg form contract with a rider, and purchaser’s counsel vigorously negotiated the rider until satisfied. Neither the contract nor the rider referred to the CO. The purchaser executed the contract and delivered a 10 percent deposit into escrow. Purchaser did not need financing, and the co-op board approval came easily.

Near the closing, a serious problem arose. After drafting plans for renovations, purchaser’s architect discovered a problem in the building’s CO and was unwilling to sign and submit plans to the Building Department without correcting the CO problem. When purchaser’s attorney then obtained a copy of the CO, it described the building as having a basement, a first floor for a lobby and apartments, and apartments on the next nine floors. According to the Building Department, the top two floors did not exist. The building’s offering plan contained only a passing reference to the building’s construction in the 1930s and no hint that the building had ever been anything other than a 12-story building with a basement.

The Building Department’s records provided no explanation. The original CO from the 1950s described the building as having 10 stories and a basement. Several subsequently amended COs reiterated the discrepancy. The original plans for the building might have been helpful, if they indicated that a 12-story building was approved and constructed, perhaps proving that the CO merely contained a clerical error. Not surprisingly, the plans could not be found. They were lost in 70 years of bureaucratic storage.

Presented with such a situation, any purchaser and her attorney would have to weigh the risks. Was there any practical harm? After all, the apartment in question had been used as a residence for decades and clearly did exist. Other apartments had been recently renovated, and the Building Department had issued permits. The building had an underlying mortgage issued by a lender, which either had not noticed, or was untroubled by, the CO. Should counsel still be concerned?

Review of the Multiple Dwelling Law proves sobering. Section 301 states: “No multiple dwelling shall be occupied in whole or in part until the issuance of a certificate by the department that said dwelling conforms in all respects to the requirements of this chapter, to the building code and rules....” Under §302, other potential problems exist if the building or use is not in conformity with the CO. The building’s lender might be able to declare the mortgage due. The Water Department might be precluded from supplying water. The co-op corporation might even be precluded from maintaining an action for rent or maintenance. Sections 304 and 306 are equally troubling, because they create potential criminal liability for purchasers, owners, builders, architects and others. No
wonder the architect was skittish about filing plans for a building permit for renovations to the apartment.

One might conclude it unlikely that these risks would blossom into problems in the ordinary course. The building had been this way for decades, and nothing had come of it. However, what assurance could a responsible attorney give to a client that this would always be the case? In the end, the parties settled the real-life dispute just discussed.

A second real-life illustration demonstrates the issue is not rare. Sprinkled throughout New York City are apartments, generally ground-floor apartments, which are reflected on the CO as “doctor’s apartments.” Sometimes they are described as a “doctor’s apartment and office.” When small doctor’s offices were more the norm, doctors could live in their apartments and see patients there as well. A builder may have sought this designation, because it created a community use that allowed the building to increase the overall square footage of the building when it was constructed.

In the second illustration, the purchaser signed a typical Blumberg form contract, No. 123, for the purchase of such an apartment, intending to use it solely for residential use. For many years, the apartment has been used solely as a residence and not for an office or a combined use. Indeed, the co-op’s rules and lease did not permit it to be used as an office. The purchaser made a large deposit and obtained a mortgage commitment. The deposit was forfeitable as liquidated damages, if the purchaser did not close.

Prior to closing, purchaser’s architect drafted renovation plans and discovered that the CO described the apartment’s use as “doctor’s apartment and office.” Could the purchaser proceed? Should he? Could he rescind and recover his deposit, or must he forfeit it to the seller if he did not close?

This illustration presented several problems for the purchaser seeking to use the apartment purely for residential use. Is the description “doctor’s apartment and office” merely an indication of the range of permitted uses of the apartment, one of which is a pure residential use? Is the combined use required? The answer is not clear from the face of the CO or as a matter of law. Would the Building Department approve a renovation plan for purely residential use as conforming to the existing CO?

In at least one recent case, the Building Department informally took the narrow view and insisted that use as a medical office was a necessary component of the overall residential use. This could occur whether or not the “doctor’s apartment and office” designation was a calculated evasion by the developer or an historical anomaly left over from a small home office practice that was abandoned 50 years ago.

Potential Courses of Action

In each of these illustrations, the problem with the CO did not come to light until after the contract was signed, and the contract did not address that contingency. Practical problems abound. Assuming the new use is not a permitted use under the existing CO, if one or both parties attempt to correct or change the CO, the Building Department requires issuance of a new CO legitimizing a “change” from the existing CO (even if the “changed” use had been in effect for decades).

The Building Department must review a proposed amendment to a CO to determine whether the proposed “new” use conforms to the building’s zoning and to all other applicable laws. Unless the prior use described in the CO was purposefully created to meet a zoning requirement (e.g., the developer built a doctor’s apartment to increase the building’s square footage), the “new” use may be permitted by the building’s current zoning and may be made “as of right.” Even if it is “as of right,” the board of the co-op would have to agree to apply for a change in the CO, and the Building Department would have to approve the change.

Pursuant to §27-214 of the Building Code, the Building Department will not issue a new CO unless the building also has “fully complied with all requirements of this code applicable to such existing building.” That means that the co-op board must commit to curing any outstanding violations and to closing out all open applications anywhere within the building. This can be an expensive, lengthy, and time-consuming process, requiring a willing Board and a good expeditor.

In the alternative, can the purchaser get out of the deal? Had the parties known about the CO, they most certainly would have made a different deal. The legal path is equally problematic for the purchaser. Does the contract itself permit rescission? Can the purchaser rescind the contract based upon a mutual mistake of fact or some other legal principle?

In the illustrations we have discussed, there was no fraud or concealment by the seller. The contracts contained no express representation concerning the CO, but did contain several provisions that excluded representations and warranties that were not expressly set forth in the contract. The contract’s silence should not be shocking. The Blumberg form No. 123 typically in use — either the older and still often used October 1989 version or the newer July 2001 version — does not mention the CO.

Case Law in New York

New York case law is not helpful to purchasers in these circumstances. The New York Court of Appeals long ago held that:

a person who makes an absolute promise to pay may not be excused from performance because of the happening of a contingency which destroys the value of the stipulated consideration for such payment where inference is reasonable that an express condition so providing would have been inserted in the contract had the parties so intended.... The test seems to be whether the event *** was or might have been guarded against. Raner v. Goldberg, 244 N.Y. 438, 441 (1927) (lease explicitly for use of property as dance hall cannot be rescinded when leasee could not thereafter obtain license to operate a dance hall).

In our illustrations, the CO is part of the public record, is easily obtained by a title company, and is equally available to both sides. Even if the apartment could not be used as a residence, the purchaser in our illustrations is unlikely to obtain rescission, since the purchaser could have guarded
against the existence of the problem CO.

New York continues to adhere to the doctrine of caveat emptor and imposes no duty on the seller to disclose any information concerning the premises when the parties deal at arm's length. This is so even if the seller has some idea that there is a problem with the CO, unless there is some conduct on the part of the seller, which constitutes misrepresentation or active concealment. Platzman v. Morris, 283 A.D.2d 561, 724 N.Y.S.2d 502 (2d Dept. 2001) and 88 Blue Corp. v. Reiss Plaza Associates, 183 A.D.2d 662, 585 N.Y.S.2d 14 (1st Dept. 1992).

In Platzman, the contract specified a legal one-family dwelling and a CO. The actual CO certified the house was a legal one-family dwelling. The contract stated that the purchaser was not relying on representations of the seller concerning the condition of the property. After closing, the purchaser learned that certain rooms violated the local zoning ordinance. Such

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information, however, had been equally available to both sides and was not within seller's exclusive control.

The Second Department held that there was no breach of contract and no fraud and dismissed. In 88 Blue Corp., the purchaser contracted to acquire a building, which it thought had 78 legal apartments (as shown on seller's rent rolls). After signing the contract, purchaser discovered that the CO specified only 76. The First Department held there was no misrepresentation of fact and no fraud, because the buyer had the means available to discover the CO or the actual facts by the exercise of ordinary diligence.

Thus, a purchaser cannot rescind the contract, unless a sympathetic judge creates an implied warranty in the contract that the CO must permit the use of the apartment as a residence. To do so, however, the court must find that such an implied warranty is not proscribed by the contract's language purporting to disclaim all implied warranties, by the parol evidence rule, or by the cases holding that merger and disclaimer clauses are effective in precluding implied representations. See Danann Realty Corp. v. Harris, 5 N.Y.2d 317, 320, 184 N.Y.S.2d 599, 601 (1959); Barnes v. Gould, 83 A.D.2d 900, 442 N.Y.S.2d 150 (2d Dept. 1981). In our view this would substantially modify New York's doctrine of caveat emptor and applicable contract law.

While the problem of a defective building CO is largely a co-op purchaser's problem, the seller's attorney cannot afford to ignore the issue. In a proceeding arising from facts similar to the doctor's apartment illustration, one New York Supreme Court justice, in response to summary judgment motions by both sides, concluded that based on the proprietary lease and the purchaser's representation of his own residential use, there was an implied representation by seller that the unit was legally occupiable for residential purposes.

However, the court found that there was a factual dispute as to whether the premises could be used solely for residential use. The court did not address the cases that uphold contract language disclaiming all warranties and representations not expressly set forth in the contract. What the trial result would have been and whether this ruling would have survived an appeal are unknown, because the case settled shortly after the ruling.

Reducing Risk

A co-op purchaser's attorney who overlooks the CO does so at a great peril to herself and her client. Before signing the contract, a co-op purchaser's attorney needs to review the building CO as part of purchaser's investigation of the building and to demand that the CO either be affixed to the contract or that the seller include a representation with respect thereto.

The risks to a co-op seller arising from a defective CO are less significant than the risks to the buyer, but a seller's attorney who wishes to reduce such risks even further will include language in the contract that expressly negates seller responsibility for the CO and shifts responsibility for its investigation squarely onto the buyer. If a seller does have knowledge before the contract is signed, we suggest that it be disclosed to the purchaser before purchaser's execution. Although silence finds support in the case law, a court may be unsympathetic to non-disclosure and seek to find a way to rule against the seller.

While representation of purchasers and sellers of co-ops is so routine that we customarily use standard forms for such transactions, the failure to focus on the CO, which is ignored in the printed forms, could pose a serious problem for a buyer or a seller, and, ultimately, their respective counsel, if the CO varies from the construction of the building or the intended use. While disclosure of the CO may not be mandated by contract, the failure to disclose the CO may not constitute fraud, and divergence between the CO and the building or use may not be a ground for rescission, better practice would be to take the precautionary measures outlined above.

(1) Section 27-217 of the Building Code provides: “No change shall be made in the occupancy or use of an existing building which is inconsistent with the last issued certificate of occupancy for such building ... unless a new certificate of occupancy is issued by the commissioner certifying that such building or part thereof conform (sic) to all of the applicable provisions of this code, and all other applicable laws and regulations for the proposed occupancy or use.”

(2) Even without the creation of a new seller implied CO warranty, the CO issue remains a seller concern. A defective CO may allow a purchaser with financing to rescind, if she executes the newer Blumberg form No. 123 (7-01 version). Neither version mentions the CO. The 7-01 version does, however, contain Paragraph 18.3.1.3 which states that if the contract is contingent on the issuance of a loan commitment letter to the purchaser and the purchaser has complied with other provisions of the contract, the purchaser may cancel the contract if “any requirement of the Loan Commitment Letter other than one concerning the Purchaser is not met.” If a defect in the CO violates a requirement of the loan commitment letter, the violation would appear to be grounds for a termination.

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