Condominium Act Addition Gives New York Boards of Managers Effective Borrowing Ability

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In 1997, the New York State Legislature added to the state's then thirty-three year old Condominium Act (Real Property Law article 9-B) a new section—section 339-jj—designed to enhance the theretofore virtually nonexistent ability of boards of managers of New York condominiums to borrow money.

The purpose of this article is for the authors—who were principal drafters of and spokespersons for the legislation—
to describe the need that prompted enactment of the new section, the thinking behind the specifics of the new provisions, and the authors' expectations as to how the new law will operate when it is put to use.

I. THE CONDOMINIUM FORM IN GENERAL

In order to provide a framework for the following discussion, it will be helpful to set forth at this point a brief overview of the condominium form of ownership in New York State. Upon its enactment in 1964, the Condominium Act was in many ways a major pioneering effort as a matter of substance, and it further served to popularize nationally this important form of common interest ownership. However, through the years, scrutiny of various provisions of the Condominium Act occasioned by specific matters that arose from time to time has uncovered areas of vagueness, ambiguity, or self-contradiction. Indeed, some practitioners have found that many statements, even those about basic tenets of the law and its application, are subject to plausible challenge. Nevertheless, the authors are comfortable with the following description.

As its etymology suggests, the term "condominium" refers to a certain kind of arrangement under which several persons do (or at least can) share control of specific property. In that sense, setting up a condominium is analogous to setting up a recognized entity that is treated as a legal person to own property, such as a corporation. That is, the establishment of the arrangement as to the subject property both delineates the respective ownership rights of the participants and also implicates a whole set of rules that govern the relationship of the participants inter se with respect to that property. There are, of course, differences. Most fundamentally, unlike a corporation (which can exist without owning property), a condominium arrangement can exist only in relation to specified property. In that sense, setting up a condominium is akin to setting up a tenancy-in-common. The terminology that is frequently used to express what happens when property is submitted to the condominium form of ownership—and which will be used in this article—is that a
condominium “regime” is established as to that property.\(^4\)

The tripartite essence of a condominium regime is as follows: (1) conceptually, the subject property is divided into parcels, (2) each participant severally owns one or more of such parcels, and (3) the remainder of the property is co-owned in fixed proportionate shares by all the participants and is jointly administered by a governing body operating under a defined set of rules.\(^5\)

A. Establishment of Regime

In New York, a condominium regime is established as to certain property by its owners recording a document (the “declaration”) that, among other things, describes the property and states that the owners intend to submit it to the provisions of the Condominium Act.\(^6\) Such submitted property must include real property (or, in certain special cases, a long-term leasehold) and may also include “other property, personal or mixed.”\(^7\) The recordation of the declaration is the act that divides the submitted property into pieces and provides designation of them. Those certain portions of the property that are described in the declaration as the “units” are the subject of separate ownership and possession.\(^8\) The balance of the submitted property constitutes the “common elements.”\(^9\) A vital point is that the common elements are owned by all the unit owners together, somewhat like tenants-in-common with an agreement not to partition. The condominium declaration is required to set forth for each unit either a percentage or a fraction (the aggregate of which must be 100 percent (if percentages are listed) or one (if fractions are listed)), and each unit has appurtenant to it that proportionate undivided interest in the common elements.\(^10\) The Condominium Act provides that, except as oth-


\(^6\) “The characteristics of condominium ownership are individual ownership of a unit, an undivided interest in designated common elements, and an agreement among unit owners regulating the administration and maintenance of the property.” All Seasons Resorts, Inc. v. Abrams, 497 N.E.2d 33, 38 (N.Y. 1986).

\(^7\) Id. § 339-e(11).

\(^8\) N.Y. REAL PROP. LAW §§ 339-e(7), -(f), -(n) (McKinney 1989).

\(^9\) Id. § 339-e(14), -(h), -(n)(4) (McKinney 1989 & Supp. 1999).

\(^10\) N.Y. REAL PROP. LAW §§ 339-e(3), -(i) (McKinney 1989).

\(^10\) See id. §§ 339-e(5), -(i), -(n)(5). The same term “common interest” (of a unit) is
erwise provided, "[t]he common elements shall remain undivided and no right shall exist to partition or divide any thereof." The Act also provides that "[e]ach unit owner may use the common elements in accordance with the purpose for which they are intended, without hindering the exercise of or encroaching upon the rights of the other unit owners."

B. Administration of the Submitted Property

The Condominium Act clearly contemplates that the submitted property (i.e., the units and the common elements) is normally to be administered by a group known as the "board of managers" chosen as set forth in a set of "by-laws" that must provide, among other things, for "[t]he nomination and election of a board of managers," presumably by the unit owners (although the statute does not say that), and "the powers and duties of the board." Although a board of managers has certain powers over the units, such powers are of a limited nature. It is for this
reason that, for example, courts have puzzled over whether it is the unit owner rather than the board that is responsible for code compliance within the unit. In order to provide the board of managers with the necessary funds to carry out its functions, the Condominium Act confers on it a power to assess “common charges” against the unit owners (generally in accordance with their respective proportionate interests in the common elements) in order to meet the “common expenses.” Suit may be maintained, evidently by the board as a representative for all the unit owners, “to recover a money judgment for unpaid common charges.” As an additional enforcement mechanism, the Condominium Act provides that “[t]he board of managers, on behalf of the unit owners, shall have a lien on each unit for the unpaid common charges thereof,” which is then, some-

during reasonable hours to the extent necessary for the operation of the property.”].

It may be noted that, rather unhelpfully, the heading of the section in which the provision appears is “Common elements.”

Cf. id. § 339-h (granting each owner “exclusive ownership and possession of his unit”).

See, e.g., William B. May Co. v. Department of Health, 475 N.Y.S.2d 224, 226 (Sup. Ct. 1984) (involving a requirement to install window guards and holding that the board of managers was “not responsible for bringing the units into compliance with... the Health Code”).

New York Real Property Law section 339-e(2) says that “[c]ommon charges’ means each unit’s proportionate share of the common expenses in accordance with its common interest,” and New York Real Property Law section 339-m provides that, subject to certain limited exceptions, “the common expenses shall be charged to... the unit owners according to their respective common interests.” New York Real Property Law §339-e(4) says that “[c]ommon expenses means and includes... [e]xpenses of operation of the property” and any other amounts so designated by or pursuant to the provisions of the Act, the declaration, or the by-laws. New York Real Property Law section 339-e(9) says that “[o]peration of the property means and includes the administration and operation of the property and the maintenance, repair and replacement of, and the making of any additions and improvements to, the common elements.” The use of the phrase “means and includes” in certain places, as opposed to merely the word “means,” would seem to indicate that the stated content is not meant to be exclusive. If that is so, then other amounts might also constitute “common expenses” that must be paid by the unit owners.

N.Y. REAL PROP. LAW §339-aa (McKinney Supp. 1999). This presents the anomaly of a delinquent unit owner being both a plaintiff (albeit acting in the name of a representative) and the defendant in the action. It is also noteworthy that the personal liability provision is found only in a section headed “Lien for common charges; duration; foreclosure.” Id.

Id. § 339-z. The statute also provides that “[s]uch lien may be foreclosed by suit authorized by and brought in the name of the board of managers, acting on behalf of the unit owners.” Id. § 339-aa. The section also provides, oddly, that under certain circumstances the “unit owner shall be required to pay a reasonable rental
what confusingly, said to “be effective from and after the filing” of a verified notice thereof.\textsuperscript{22}

C. The Condominium Association

For decades, the Condominium Act avoided use of the word “association” when referring to the unit owners as a group,\textsuperscript{23} utilizing instead such awkward locutions as “the board of managers, on behalf of the unit owners.”\textsuperscript{24} Also, some New York practitioners on occasion contended that the unit owners of a condominium act only separately and never as an organization.\textsuperscript{25} Nevertheless, despite the Condominium Act’s avoidance of the word, a New York condominium’s unit owners would seem always to have been a classic instance of what is known in law as an “association.”\textsuperscript{26} The unit owners are a precisely known group of people having defined voting rights, and the Condominium Act requires that there be “meetings of the unit owners,” refers to votes by less than all of the unit owners that are binding on all of them, and requires that there shall be “a president . . . who shall preside over the meetings . . . of the unit owners,” “a secretary who shall keep a record wherein actions . . . of meetings of the units owners shall be recorded,” and “a treasurer who shall keep the financial records and books of

\textsuperscript{22} Id.

\textsuperscript{23} It has been held that “the statutory lien for condominium common charges (in favor of the condominium’s Board of Managers) is entitled to priority over a previously recorded second mortgage.” Washington Fed. Sav. & Loan Ass’n v. Schneider, 408 N.Y.S.2d 588, 588 (Sup. Ct. 1978). The court observed that “the language used . . . lacks a certain precision.” Id. at 590.

\textsuperscript{24} In an interview, David Clurman, Esq., who was one of the drafters of the original act, stated that the drafters were concerned that, under the tax law as it then stood, the very use of the word “association” might unnecessarily subject the unit owners to taxation as a corporation, a point that they wished to leave open to the extent that they could.

\textsuperscript{25} See, e.g., N.Y. REAL PROP. LAW § 339-z (McKinney Supp. 1999).

\textsuperscript{26} In most of the states that position is simply unavailable, inasmuch as their statutes refer specifically to the “association” of unit owners. See, e.g., N.J. STAT. ANN. § 46:8B-9(k) (West 1989) (“The master deed shall set forth . . . [t]he name and nature of the association.”). Section 3-101 of the 1980 version of the Uniform Condominium Act provides that “[a] unit owners’ association must be organized no later than the date the first unit in the condominium is conveyed.”

\textsuperscript{27} Although the phrase “unincorporated association” is frequently used rather than merely the single word “association”—and a true corporation is occasionally referred to as an “association”—we shall use the term to refer only to organizations that are not incorporated.
Moreover, other New York statutes do use the term "condominium association," and in 1998 the term finally appeared in the Condominium Act itself. Accordingly, the following discussion proceeds on the assumption that the unit owners of a New York condominium do constitute an association.

This is obviously not the place for a full discussion of the law of associations, but five points are worthy of special notice.

First, associations are hardly rarae aves in this State. For example, every New York partnership is a form of association. Of course, that is not to say that all of the law of partnerships applies to all associations; the New York Partnership Law contains many rules that have application only to associations that are partnerships, and it remains to be seen which of them will be imported into other areas.

Second, there are statutes that govern the procedural aspects of suits by and against associations, and there is no reason to think them inapplicable to condominium associations.

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27 N.Y. REAL PROP. LAW § 339-ν(1)(b), (c), (d), (e) (McKinney 1989).
28 See N.Y. GEN. BUS. LAW §§352-eee(3), -eee(3) (McKinney 1996); N.Y. PRIV. HOUS. FIN. LAW §471(8) (McKinney Supp. 1999); N.Y. PUB. SERV. LAW §38(1) (McKinney 1989); cf. N.Y. TAX LAW §606(g) (McKinney 1987) ("condominium management association").
29 N.Y. REAL PROP. LAW §339-κκ (McKinney Supp. 1999), added by Laws 1998 Chapter 422, which moved the substance (and the term) from former New York General Business Law section 352-e(2-d).
30 The statutory scheme makes clear that the governing body of such an association—the analogue of the board of directors of a corporation—is its board of managers, and, in the authors' view, statutory references to a condominium's board of managers acting on behalf of its unit owners are best understood as references to action by the association.
31 New York Partnership Law § 10(1) (McKinney 1988) reads as follows: "A partnership is an association of two or more persons to carry on as co-owners a business for profit." One should not be misled by the fact that numerous New York statutes refer to "partnerships" and "associations"—rather than to, say, "partnerships and other associations"—any more than a reference to "squares and rectangles" ought lead one to the false conclusion that a square is not a rectangle.
32 N.Y. GEN. ASS'NS LAW art. 3 (McKinney 1994); N.Y. C.P.L.R. 1025 (McKinney 1997).
33 New York General Associations Law section 13 provides that "[a]ny partnership, or other company of persons, which has a president or treasurer, is deemed an association within the meaning of this section," and the unit owners of a condominium have been held to be an association for this purpose. See Gillardi v. Country Village Heights Condominium (Group I), 461 N.Y.S.2d 972, 973 (Sup. Ct. 1983)
Third, because a condominium association is neither a limited liability company nor incorporated,\(^3\) the unit owners cannot count on it to provide protection against personal liability.\(^5\) In that connection, it should be noted that, even if a provision in the condominium documents stating a liability limitation were to be effective as to contract liability,\(^3\) there would seem to be no basis for any limitation of tort exposure of the unit owners.\(^3\)

Fourth, the mere fact that an organization is not incorporated does not prevent it from being treated as a corporation for income tax purposes.\(^3\) It can thus sometimes be vital to determine whether assets belong to the association or its members.

Fifth, notwithstanding the ancient doctrine that, unlike a corporation or a limited liability company, an association "is not an artificial person, and has no existence independent of its members"—from which it is at times said to follow that an association cannot own property—modern develop-

\(^3\) Although New York Real Property Law section 339-v(1)(a) permits a board of managers to be incorporated, nothing in the Condominium Act addresses the possibility of an incorporated body consisting of all the unit owners. In many other states, the association of unit owners must or may be incorporated. See, e.g., N.J. STAT. ANN. § 46:8B-3(b) (West 1989) (stating that the association "may be incorporated or unincorporated").

\(^5\) See N.Y. GEN. ASS'NS LAW § 16 (McKinney 1994).

\(^3\) Such a limitation, notwithstanding that it is a matter of public record, would seem to be of doubtful efficacy. Would a corporation be permitted to obtain for itself more time to pay its obligations by including in its certificate of incorporation a provision that all persons dealing with it are deemed to have agreed that any payment need not be made by it for a period of years after payment would otherwise have been due?

\(^3\) See, e.g., Paul E. Anderson & Thomas G. Cody, Tax Considerations of the Condominium Sponsor and Purchaser, 48 ST. JOHN'S L. REV. 887, 907 (1974) ("Despite the fact that the unit owners have formed an association, the available authorities maintain they remain jointly and severally liable for torts arising from the use of the commonly owned property."). But cf. Dutcher v. Owens, 647 S.W.2d 948, 951 (Tex. 1983) (holding, based on construction of Texas statute, unit owner liable for only a pro rata portion of the damages). The authors expect that this would become a very hot topic if a case arose in which liability greatly exceeded insurance coverage.

\(^3\) See, e.g., I.R.C. § 7701(a)(3) (1994) (including "associations" within the term "corporation").

ments have drained that statement of virtually all content. As noted above, the income tax law treats some associations as the owners of property. Also, even though the Partnership Law states that "[a] partner is co-owner with his partners of specific partnership property holding as a tenant in partnership," the same section goes on to make it crystal clear that such "ownership" is of no consequence. Among other things, it provides that, as to any single partner's "right in specific partnership property," it "is not assignable... is not subject to attachment or execution... vests [on his death] in the surviving partner or partners... [and] is not subject to dower, curtesy, or allowances to surviving spouses, heirs, or next of kin." The partnership, on the other hand, can alienate all the partners' nominally separate ownership interests in the property. Thus, in any meaningful sense it is the partnership, and not the partners, that owns such property. And, despite the absence of a specific statutory statement, the same can properly be said of the property of associations that are not partnerships. Indeed, this notion is so firmly ingrained that it underlies many statutes and judicial opinions. For present purposes, then, it will be assumed that a

40 N.Y. PARTNERSHIP LAW § 51(1) (McKinney 1988).
41 Id. § 51(2).
42 Id. § 21.
43 See, e.g., N.Y. GEN. ASS'NS LAW § 15 (McKinney 1994) (distinguishing between "personal or real property belonging to the association" and "personal or real property... owned, jointly or in common, by all the members thereof"); N.Y. NOT-FOR-PROFIT CORP. LAW § 403 (McKinney 1997) (distinguishing between property "owned by" an association and property "held for" an association); N.Y. U.C.C. § 3-105 (McKinney 1991) (referring to "the entire assets of a[n] unincorporated association").
44 In Martin v. Curran (wherein a sharply divided court held that an association may not be sued for libel without a showing that every member authorized or ratified the libel), both opinions indicated quite clearly that an association can own property. See 101 N.E.2d at 686, 690-91. The four-judge majority opinion referred to "the association's funds," id. at 689, and the three-judge minority opinion, after referring to "the property of the association" and "property belonging to the [defendant] association," made the unchallenged statement that "[t]he Legislature has provided that an unincorporated association may own personal or real property General Associations Law, §§ 2, 6, 8, 15." Id. at 690-91. But cf. Bradley v. O'Hare, 202 N.Y.S.2d 141, 153 (App. Div. 1960) ("[T]itle to assets held by an unincorporated association is not vested in the 'entity.' The association has no capacity to receive or hold title. Instead, title is vested in the form of undivided interests in the members") (citing 7 C.J.S. ASSOCIATIONS § 14; William J. Isaacson, The Local Union and the International, in NEW YORK UNIVERSITY THIRD ANNUAL CONFERENCE ON LABOR, 493, 504 (1950)).
condominium association can own property.

D. Ownership of Other Property

Questions remain, though, about which assets belong to a condominium association and can therefore be alienated or encumbered by its board of managers. Beyond the question of whether any of the submitted property (including any submitted personalty) could conceivably be thought to belong to the association, what of the common charges paid by the unit owners? What of any interest earned on such funds while in the hands of the board of managers? The situation is even less clear as to the “common profits” (i.e., “the excess of all receipts of the rents, profits and revenues from the common elements remaining after the deduction of the common expenses”), which the Condominium Act says “shall [with a possible exception for “non-residential units”] be distributed among ... the unit owners according to their respective common interests.” Views also differ as to units acquired by “the board of managers on behalf of all other unit owners” or “[the board of managers, acting on behalf of the unit owners.” It is interesting that many practitioners, including some counsel to title companies, take the view that any such unit belongs to all the unit owners outside of any association. However, even under that view, the question remains as to the identity of the owner of the income if such a unit is rented out. Other amounts—such as certain damage insurance proceeds—probably do not belong to any as-

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46 Id. § 339-m.
47 Id. § 339-x (allowing a unit owner to convey both his unit and its appurtenant common interest to the board to exempt himself from later accruing common charges).
48 Id. § 339-aa (McKinney 1989 & Supp. 1999) (allowing the board, subject to restrictions, to purchase a unit at a foreclosure sale pursuant to a lien for common charges).
49 It is for that reason that a power of attorney authorizing the board to deal with acquired units is normally required from every incoming unit owner.
50 One of the permissible provisions in the by-laws is “[t]he form by which the board of managers, acting on behalf of the unit owners ... may acquire and hold any unit and lease, mortgage and convey the same.” N.Y. REAL PROP. LAW § 339-v(2)(c) (McKinney 1989). Similar language is found in section 339-aa.
51 See id. § 339-cc (McKinney 1989). Somewhat confusing as to the issue of insurance is the requirement of section 339-bb that, if required by condominium documentation or the unit owners, it is the “board of managers” that is to insure the
sociation that may exist. In short, the Condominium Act seems to contemplate that (excluding, of course, the submitted property) at least some assets belong to an association and some may belong to unit owners outside of any association.

Whatever the correct theory, in practice all of the non-submitted assets (including any income from the common elements) are ordinarily treated as though they belonged to an association rather than to the unit owners. It is common knowledge that unit owners do not report on their own tax returns their aliquot shares of income from the renting out of a portion of the common elements, interest paid on a bank account controlled by the board of managers, or even any part of the profit realized on the resale of a unit acquired by the board of managers "on behalf of the unit owners." All such income has universally been reported by an entity, on financial statements as well as on income tax returns.

II. Boards' Borrowing Power Under Prior Law

Prior to the addition of section 339-jj, there was no explicit mention in the Condominium Act of any power that a board of managers might have to borrow funds. It is true that some declarations and/or by-laws purported to confer such a power—and it could have been argued that any subsequently-acquiring unit owner was bound by the statement of such a power—but, as a general rule, lenders were unwilling to rely on any such debatable authority.\(^5\)

Moreover, especially where the relied-upon document set forth a limitation of each unit owner's responsibility for repayment, lenders generally were unwilling to advance funds (even assuming arguendo that they could be satisfied that the board had the power, as agent for the unit owners, to bind them personally to third persons), inasmuch as recovering the loaned funds might necessitate pursuing numerous claims.

Such a concern could have been obviated, of course, if a building, without further specification as to the role of the board in this regard as representative of the unit owners or otherwise.

\(^5\) There might even have been an issue, especially if one questions the existence of an association, as to whether a given board of managers would have authority to enter into any agreement binding on a subsequently constituted board.
board of managers had any substantial collateral to offer. But that rarely, if ever, occurred. As noted above, the units belong to the unit owners, and it is indisputable that a board as such has no power to encumber them.\textsuperscript{53} A priori, one might have entertained a different view as to at least some of the common elements,\textsuperscript{54} but the statute is explicit on the point: unless consent is obtained from every unit owner, "no lien of any nature shall . . . arise or be created against the common elements."\textsuperscript{55} Even if boards had command of property that constituted neither units nor common elements (whether or not within an association), it would certainly have been the exception rather than the rule that a sizable amount could have been realized by utilizing the value in such property.

Prior to the enactment of section 339-jj, the Condominium Act did allow for one method of provision of security, which existed in order to assure payments to contractors to encourage them to provide materials and services prior to payment. This can be seen as a limited and indirect form of borrowing. Thus, section 339-l(2) has long provided that in the case of:

\begin{quote}
[L]abor performed on or materials furnished to the common elements . . . at the express request or with the consent of the manager, managing agent or board of managers . . . all common
\end{quote}

\textsuperscript{53} The statement in the text is not meant to cover the situation in which a board of managers acquires a unit. See supra text accompanying notes 47-49.

\textsuperscript{54} As to some of the common elements (e.g., a roof, a heating system, or an elevator), one can easily understand the Legislature's reluctance to permit a foreclosure sale. Nor is it likely that a lender would want to find itself in a position of forcing unit owners to pay a toll charge for the use of such items. A closer question is presented as to certain separable amenities, as, for example, an outdoor swimming pool.

\textsuperscript{55} N.Y. REAL PROP. LAW § 339-1(1) (McKinney 1989). Lest even that clear statement be subject to misconstruction, the statute goes on to say that "liens may arise or be created only against the several units and their respective common interests." Id. (emphasis added). The Legislature's intent is further evidenced by the Condominium Act's method of dealing with needed repairs to the common elements. See infra text accompanying note 56. Also, it would seem unreasonable to construe the language as permitting the prohibition to be overridden by a provision in the condominium documents, in view of the places in which the Condominium Act permits contrary provisions where authorized by the declaration or by both the declaration and the by-laws. See, e.g., N.Y. REAL PROP. LAW §§ 339-l(2) (McKinney 1989) (the declaration only; the declaration and by-laws), 339-m (the declaration and by-laws), 339-z (the declaration only). But cf. id. § 339-l(3) (including the statement that "[a]ny provision to the contrary shall be null and void").
charges received and to be received by the board of managers, and the right to receive such funds, shall constitute trust funds for the purpose of paying the cost of such labor or materials... and the same shall be expended first for such purpose before expending any part of the same for any other purpose.\textsuperscript{56}

The kinds of workers and suppliers dealt with in this provision would normally be providing services or materials to owners of real property where they would have had recourse to a mechanic's lien. However, the drafters of the Condominium Act decided to prohibit the liening of the common elements by a laborer or materials provider. It is thus clear that it was believed that such a provider would be willing to wait for his money so long as he knew that the members of the board of managers would be subjecting themselves to criminal prosecution for converting trust funds if they paid someone else first. In practice, though, few contractors (even assuming that they were aware of and had confidence in the trust fund provision) could be found who were in a position to fund major work and receive payment over a length of time comparable to the period over which a loan would ordinarily be repaid.

III. CONSEQUENCES OF INABILITY TO BORROW

In the real world, then, boards of managers, as a rule, simply could not borrow large amounts of money. How, then, were they to fund major expenditures? In theory, of course, they could rely on existing reserves established in connection with the condominium's creation or accumulated over the years by collecting more in common charges than had to be expended currently.\textsuperscript{57} However, that did not always happen and, even where it did, the funds on hand usually turned out to be inadequate to fulfill the needs presented. As a result, in all too many cases, large outlays were being deferred as long as possible and, when they became unavoidable, could be funded only by assessments against the several unit owners, which often imposed significant hardships and sometimes were simply uncollectible.

The prevailing situation thus led to both deteriorating

\textsuperscript{56} N.Y. REAL PROP. LAW § 339-1(2) (McKinney 1989).

\textsuperscript{57} See id. § 339-v(2)(b) (authorizing the creation of reserves if so provided in the by-laws). But cf. id. § 339-m (mandating the distribution of common profits).
physical plants and significant financial strains on people
who could little afford them. Matters worsened at an acceler-
at ing pace as periods of condominium ownership lengthened.

It was becoming increasingly clear that it would be
highly desirable for a board of managers to be able to raise
money by borrowing, particularly by obtaining an ordinary
loan from an institutional lender. However, as noted above,
there were two major obstacles. First, there was no clear
authority to borrow. Second, even if attorneys involved in a
particular transaction could responsibly conclude that a par-
ticular board of managers under the condominium documen-
tation involved had the power generically to engage in bor-
rowing and had the authority to enter into a particular loan
transaction, there remained the practical question of
whether any meaningful security could be granted to a
lender.

One possible source of security was the income stream to
be received by the board of managers, principally the com-
mon charges to be paid by the unit owners and in some cases
rentals to be produced by the common elements. Again, the
pre-1997 New York statute did not lend itself to a clear in-
terpretation that there was power vested in a board of man-
agers to assign this income stream.

Potential lenders also questioned how a lender could en-
force its interests in any collateral that might be pledged to
it. Perhaps more important was the concern of lenders that
they would be at the mercy of recalcitrant unit owners who
would fail to pay their common charges or of a recalcitrant
board that would simply refuse to levy the necessary charges
or to pay over the required debt service. As noted above, a
board of managers has a right to enforce the personal obli-
gation of a unit owner to pay his common charges, as well as
the powerful protection of a lien against the unit. However,

58 This kind of financing is readily available where the cooperative apartment
corporation form of ownership is employed, inasmuch as, in such a legal structure,
the corporation ordinarily can borrow because (i) a board of directors operates under
the well-known general powers afforded under corporate law and (ii) the borrower
owns meaningful real property that can serve as collateral. See Matthew J. Leeds,
Executive Summary of Proposed Condominium Lending Statute, in TITLE IN-
SURANCE 1996: THE BASICS AND BEYOND 749, 752 (PLI Real Est. Practice Course

59 See supra text accompanying notes 19-22.
the statute did not incorporate a mechanism for the assignment of these rights for the protection of a lender, even if one could be found that was willing to run the risk of having to enforce multiple small claims.

As to the issue of a defaulting board of managers, a lender would have had to take into account the fact that a board of managers is normally composed of non-professionals who are governing their own homes and those of their neighbors. The reality is that a board of managers can be expected to act as a parochial and political body responding to extremely personal needs and to the concerns of its constituency. Thus, potential lenders were justifiably reluctant to part with funds absent some means of assuring themselves that the repayment obligations of their borrowers would be enforceable in a practical manner.

IV. SECTION 339-JJ

Given this legal and political background, in 1996 the New York State Bar Association's Real Property Section Condominiums and Cooperatives Committee developed an initiative to propose legislation that would, by creating a statutory frame of certainty and protection for lenders who wish to engage in such lending, allow boards of managers to borrow money. This initiative received the endorsement of the Real Property Section and ultimately became a sponsored legislative proposal of the association itself. The proposal then gained the support of the Association of the Bar of the City of New York, Attorney General Dennis Vacco's Martin Act Task Force, and important industry groups such as the Council of New York Cooperatives and Condominiums. Bills based on this proposal were submitted by State Senator Roy Goodman and Assemblyman Daniel L. Feldman and were, in slightly amended form, passed without negative vote by both houses of the Legislature, but were then (for a reason discussed below) vetoed by Governor Pataki on July 15, 1997. However, a slightly revised version was shortly thereafter submitted as part of the Gover-

62 See infra text accompanying notes 74-75.
nor's own legislative package and was rapidly approved by a unanimous vote of the Legislature and signed into law on August 26, 1997.

The new provisions read as follows:

Section 339-jj. Borrowing by board of managers

1. To the extent authorized by the declaration or the by-laws, the board of managers, on behalf of the unit owners, may incur debt. In addition, subject to any limitations set forth in the declaration or the by-laws, the board of managers, on behalf of the unit owners, may incur debt for any of the purposes enumerated in paragraph (b) of subdivision two of section three hundred thirty-nine-v of this article, provided that (a) such debt is incurred no earlier than the fifth anniversary of the first conveyance of a unit and (b) the incurrence of such debt shall require the consent of a majority in common interest of the unit owners.

2. In connection with a debt incurred by it, the board of managers, on behalf of the unit owners, may (a) assign the rights in and to receive future income and common charges, (b) create a security interest in, assign, pledge, mortgage or otherwise encumber funds or other real or personal property that it holds, (c) agree that, to the extent of any amounts due under any of the provisions of the agreements under which the debt was incurred and subject to the provisions of subdivision two of section three hundred thirty-nine-l of this article, all common charges received and to be received by it, and the right to receive such funds, shall constitute trust funds for the purpose of paying such debt and the same shall be expended for such purpose before expending any part of the same for any other purpose, and (d) agree that at the lender's direction it will increase common charges to the extent necessary to pay any amount when due under any of the provisions of the agreements under which the debt was incurred. The preceding sentence shall not be construed to authorize the board of managers to create a lien on the common elements. Any such assignment may provide that, in the event of a default, the lender shall have the right of the board of managers to file liens in the lender's name on units for unpaid common charges pursuant to sections three hundred thirty-nine-z and three hundred thirty-nine-aa of this article and the right to foreclose such liens pursuant to section three

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A. Overview

Section 339-j has three subdivisions, each with its own function. The first subdivision is intended to provide clear legal authority for a board of managers to incur debt; the second is intended to allow a board to furnish to a lender meaningful assurances that the debt will be repaid; and the third is intended to ensure that the new legislation is not construed so as to diminish any borrowing power that might previously have existed. The three subdivisions are discussed separately in the following paragraphs.

B. Subdivision 1—Introduction

This subdivision has two sentences, each of which addresses a different situation—namely (1) the situation in which the condominium documents say that borrowing power exists and (2) the situation in which the documents are silent or insufficient on the point. The two sentences—which were intended to operate independently of one another—will be discussed separately below.

Preliminarily, though, it should be noted that the two sentences have something very important in common: each of them authorizes a board of managers, under certain circumstances, to “incur debt,” which incurrence is said to be “on behalf of the unit owners.” Each of those phrases deserves some discussion.

The phrase “incur debt” was meant to have a plain language meaning, which would normally be a reference to a conventional loan under which money is received either at the time of closing or as later drawn down, perhaps condi-

66 The drafters believed that the phrase “[i]n addition” would make it impossible to mistake that intention. However, some have expressed the view that all of the limitations set forth in the second sentence apply to the first sentence. Although there is no basis for such a position, it may be advisable, if the section is amended, to place each of the sentences in a separate subdivision.
tioned on the occurrence or non-occurrence of one or more future events. It would also apply to obligations to pay over a period of time or at a later date for property or services previously obtained.

It is entirely clear that both sentences permit a board to bind the unit owners to personal liability for repayment of the borrowed funds. It can be argued that, unless the lender agrees otherwise, such liability would be for the entire amount borrowed rather than for only a portion thereof. However, it is not entirely clear whether the reference is to liability on the part of an association (which, as noted above, would not provide a liability shield in any event) or on the part of the unit owners directly. It is to be expected that loan documents will not attempt to resolve the point, but will merely track the statutory language.

Notwithstanding that the unit owners would have the ultimate liability in either case, the point is an important one because, if the liability is that of an association in the first instance and that association is treated as a corporation for income-tax purposes (which is almost always the case), then existing law might deny deductions to the unit owners even if all other requirements were met.

Although the argument runs that the liability is that of the unit owners directly (and such an interpretation would be preferable in terms of defending income tax deductions), the authors expect that practitioners will often choose the easier reporting course and claim deductions for an association rather than have each unit owner claim his own deduction. Among other things, such a procedure would be consistent with the established practice under which income is reported by associations rather than unit owners.

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67 The mere fact of personal liability is not novel. As noted above, unit owners have always been personally liable for their own common charges, which include any amounts not paid by other unit owners, so that, conceivably, all common expenses could fall on a single unit owner if all other unit owners failed to pay their common charges.

68 If that is correct, then it will be of small comfort to a member of the board of managers (who is almost always a unit owner) that the statute makes clear that he is acting only in a representative capacity for the unit owners and will as such member have no personal liability to repay the debt.

69 Either way, there would presumably be a right of contribution against any unit owner who paid less than his proper share.
Although some attorneys have stated that they intend to take the position that the new law does not itself impose direct personal liability on the unit owners for whom a board is acting, it is unquestionably possible that such liability will be found to exist. Accordingly, some attorneys have suggested that, on the borrower side, they will request provisions limiting the exposure of each unit owner to his aliquot share of the borrowed amount. Notwithstanding the backup nature of such liability in the minds of lenders, it remains to be seen whether a lender will agree to a situation in which it becomes possible for the burden of a unit owner's default to fall on it rather than on the other unit owners (who would clearly have to supply the missing funds if the assessment route were to be taken).

There are yet other questions that some day may have to be answered. For instance, if the repayment liability is that of the unit owners directly (rather than through an association), can it be shed by a unit owner's disposing of his unit? Conversely, is an incoming unit owner directly responsible to repay a previous borrowing?

It deserves emphasis that all of the above issues arise regardless of under which of the two sentences of the first subdivision the debt is incurred.

C. Subdivision 1—Document-Based Authority

As discussed above, some condominium documentation purports to authorize the board of managers to borrow funds, but conservative lenders were fearful that such authorization might be ineffectual on the ground that it went beyond what the Condominium Act permitted. The first sentence of section 339-jj(1) was designed to put such fears to rest by stating unequivocally that, to the extent stated in the condominium's declaration or by-laws, such power does exist.

The statute clearly states that the authorization to incur debt may be found in either the declaration or the by-laws; it need not be in both. In view of the fact that in certain situations it might be easier to amend the declaration proper rather than to amend the by-laws (and, conceivably, vice-

\[70 \text{ See supra note 15 and text accompanying note 52.}\]
versa), the point may be an important one in some cases.

On the other hand, the first sentence of section 339-jj does nothing to help the situation where the declaration and the by-laws are both silent on the point. Hence, a power grounded in this first sentence may be referred to as "document-based" authority.

As suggested above, nothing in the sentence—or elsewhere—limits this grant of authority to documentation that pre-existed the effective date of section 339-jj. It follows that, in theory at least, existing documentation could be amended at any time to increase the board's power. It is a fact of life, though, that, especially because condominium documents are normally amendable only by a super-majority of the unit owners, inattention and/or inertia frequently frustrate the adoption of even wholly unobjectionable beneficial changes. That is the raison d'être for the second sentence of section 339-jj(1).

D. Subdivision 1—Statute-Based Authority

The second sentence of section 339-jj(1) was included in recognition of the fact that condominium documents frequently have no provision whatsoever about borrowing, whether to authorize it or to prohibit it. Hence, a board's power grounded on this second sentence does not depend on the existence of any language in the condominium documents and may be referred to as "statute-based" authority.

Although the drafters recognized the practical need to furnish a board of managers with borrowing power where it is not feasible to amend the declaration and/or by-laws to provide for such authority, they believed that it would be both unwise and unnecessary to grant unlimited authority. There are, therefore, four very significant limitations on a board's statute-based authority. Those limitations are discussed below.

71 New York Real Property Law section 339-u provides that "[n]o modification of or amendment to the by-laws shall be valid unless set forth in an amendment to the declaration," and New York Real Property Law section 339-v(1) provides that, except in a wholly nonresidential condominium, at least a two-thirds majority of the unit owners is necessary to amend the by-laws. New York Real Property Law section 339-n(9), on the other hand, provides merely that the declaration must set forth "the method by which the declaration may be amended, consistent with the provisions of [the Condominium Act]."
Before that discussion, though, it bears repeating that the limitations on statute-based authority are wholly irrelevant to document-based authority; a board that has document-based authority need not concern itself with any of the limitations on statute-based authority. There is, of course, nothing that would prevent a lender from imposing its own restrictions—including any that might have been inspired by the limitations on statute-based authority—but nothing in the statute requires that result.

a. The Not-Contrary-to-the-Documents Limitation. If the declaration or the by-laws set forth any limitation on the board’s borrowing power, that limitation must be respected. However, mere silence of the declaration and by-laws on this point should not be taken as a bar to borrowing based on statute-based authority; in fact, as indicated above, precisely the contrary result was intended by the statute.  

Similar to the possible extension by amendment of any document-based authority, it was intended that the unit owners (if they can assemble the necessary support) be able, by amendment, to curtail for the future even the statute-based authority of the board. It is recognized that this is of no comfort to a unit owner who both (1.) relied on the documents’ silence as to borrowing power and (2.) is unable to muster the votes for a limiting amendment. However, there can be no doubt that, absent a limiting provision in the condominium documents, every unit owner has always been subject to the board’s power to impose a lump-sum assessment, which in many ways is a more objectionable power. Also, a board’s statute-based authority is in any event circumscribed by the other three limitations.

b. The Purpose Limitation. The purpose or purposes for which statute-based debt is incurred must be among those enumerated in section 339-v(2)(b), which provides that the by-laws may contain “[p]rovisions governing the payment, collection and disbursement of funds, including reserves, to provide for major and minor maintenance, repairs, additions, improvements, replacements, working capital, bad debts and unpaid common expenses, depreciation, obsolescence and

72 Absolute silence is critically different from a conditional grant of a power. For instance, a grant of power conditioned on two-thirds consent is fairly read as a prohibition absent such consent.
similar purposes. It is recognized that, although section 339-jj was primarily intended to facilitate borrowing for capital work that must be performed, boards and attorneys will find broader application of the language of section 339-v(2)(b). All the same, this purpose limitation does prevent the second sentence from providing unlimited justification for a board to borrow. Also, lenders who are concerned that authorization remains too broad can draft appropriate provisions in their own lending documents. In any event, lenders will probably police (by affidavit, control of funds, or otherwise) the actual application of funds, using either mechanisms that develop in this area in the future or the time-tested mechanisms already in use with respect to lines of credit and construction lending.

c. The Not-During-the-First-Five-Years Limitation. Statute-based debt may not be incurred before the fifth anniversary of the first conveyance of a unit (the time not being measured from the date of recording the declaration, which can be prior to the time when the condominium is actually operating).

This limitation was the subject of considerable debate during the early stages of the drafting process. The participants whose viewpoint ultimately prevailed felt (either philosophically on their own behalves or in order to generate a proposal that they believed might be more attractive to the legislature) that the law should not provide a means by which condominium declarants, who might remain in control for a period of time, could commit any non-consenting unit owner to repay debt, regardless of the wishes of the other unit owners and the worthiness of the purpose. Those participants were concerned that declarants in control of a debt-incurring board might find some way to misappropriate the borrowed funds or that the sponsor of an offering plan could somehow hide a sin such as an infirmity in the original

73 N.Y. REAL PROP. LAW § 339-v(2)(b) (McKinney 1989). The reference in section 339-jj to section 339-v(2)(b) merely incorporates the list of items in that subdivision instead of repeating them in the new section. It would obviously be wrong to read section 339-jj as requiring separate amendment of the by-laws in order to authorize a statute-based financing. Also, obviously, it was not contemplated that a board (along with a majority in common interest of the unit owners, of course) could use section 339-jj statute-based authority to borrow money for some purpose for which the board is not otherwise authorized to expend funds.
budget. They believed that statute-based authority ought not be available to the boards of new condominium regimes, where, they argued, it would be less likely that financing would be necessary and more likely that inexperienced boards might mishandle the power. They also asserted that, absent a document provision, it would be undesirable to allow a board to increase common charges near the time of inception of the condominium regime, when common charges are initially established.

Once the decision was reached to deny statute-based authority to boards of newly organized condominiums, five years seemed like a reasonable length of time. It also tied in with the policies of the New York State Department of Law, which militated against allowing the sponsor of a condominium offering to exercise control for more than five years.\textsuperscript{74}

Unfortunately, the inclusion of this absolute limitation, even if well-intentioned, may force some boards with pressing legitimate needs and majority consent (and no declarant presence) to choose between the trauma of amending the condominium documents or subjecting the unit owners to lump-sum assessments.

On the other hand, the efficacy of the not-during-the-first-five-years limitation is open to serious question. First of all, it applies only where the declarant both (1.) was not clever enough to include borrowing power in the condominium documents and (2.) no longer has sufficient power to amend those documents to insert such power (it being the case that declarants who have document-based authority need not concern themselves with any limitation on statute-based authority. Moreover, even the worst-intentioned declarant-controlled board almost always has the power to achieve its ends by the more draconian means of levying lump-sum assessments.

\textit{d. The Majority-Must-Consent Limitation.} Statute-based authority does not exist unless the borrowing has been consented to by a majority in interest of the unit owners. It was recognized that, because in some condominiums the common interests appurtenant to the various units are not all the same, the statutory threshold might on occasion be met even

\textsuperscript{74} See N.Y. COMP. CODES R. & REGS tit. 13, §§ 20.3(u), 23.3(w) (1998).
over the objections of a numerical majority of the unit owners. However, in view of the fact that the burden of repaying a borrowing falls on the unit owners in proportion to their respective common interests, it was felt that a common interest test would be fairer than an absolute number test. In any event, a lender desiring to obtain a broader consensus is free to require consents from a higher percentage and/or to impose an absolute-number requirement of any dimension.

Use of the term "consent"\(^{75}\) was intended to make clear that a formal vote at a meeting of the unit owners is not necessary. It is expected that, in practice, management will solicit written consents from unit owners, and it is recognized that repeated requests will often be required. Certainly, a formal recorded vote at a meeting of unit owners would be ideal documentation of the necessary consent, but the required consent would still be that of a majority in interest of all the unit owners, not merely that of a majority in interest of those voting or even of those taking part in the meeting.

Because nothing in the statute requires that the necessary consent be obtained prior to the borrowing, it will be theoretically possible for a borrowing to be validated retroactively, analogously to how corporate shareholders occasionally ratify past acts of a board of directors. It is to be expected, though, that such after-the-fact consent will be employed only if doubt has arisen about the effectiveness of an earlier attempted consent.

A question may be raised as to whether the statutory requirement is met by a blanket consent to borrowing in general. A negative answer is suggested by, among other things, the statute's use of the term "such debt,"\(^{76}\) but there would seem to be no objection to a single consent to several described borrowings. Certainly, careful lenders will require unambiguous consent with respect to each loan transaction in which statute-based authority is relied upon.

The version of proposed section 339-ji that was vetoed by Governor Pataki contained a consent limitation that was less restrictive than the one that became law.\(^{77}\) Under the earlier version, consent was required only if the total borrowing by a

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\(^{75}\) N.Y. REAL PROP. LAW § 339-ji(1) (McKinney Supp. 1999).

\(^{76}\) Id.

\(^{77}\) See supra text accompanying notes 60-62.
board would exceed a certain determinable amount, which was equal to $5,000 multiplied by the number of units. The bill’s drafters believed (and presumably the Legislature shared that belief) that the committing of the unit owners to repay over time such relatively small amounts—less than $5,000 for the owner of a unit with a smaller-than-average common interest—would not justify the trouble and expense of obtaining consents, particularly in large developments that were home to persons of modest means. The Governor’s veto memorandum suggested his concern that committing unit owners to repay even such sums, notwithstanding that they could be the subject of a direct up-front lump-sum assessment, would be unfair to unit owners who were not in-

78 Governor’s Veto Memorandum #15 (N.Y. A. 6658-A, 220th Sess.), N.Y. LEGIS. ANN. 485 (1997), the body of which is as follows:

This bill would amend the Real Property Law to allow the board of managers of a condominium to borrow funds on behalf of unit owners. A board of managers would be authorized to borrow up to $5,000 per unit for capital purposes, subject to any limitations set forth in the declaration or the by-laws. Borrowing in excess of $5,000 per unit would be allowed on the consent of a majority of unit owners. Additional borrowing would be authorized to the extent permitted by the declaration and by-laws. The loans authorized by this bill would be secured by the board’s right to receive future common charges, and lenders could require a condominium’s common charges to be increased to levels sufficient to repay such loans.

I am disapproving this legislation because it fails to include adequate safeguards to protect condominiums owners. As written, the bill would allow a condominium’s board of managers to incur $5,000 of indebtedness on behalf of each unit owner without the owner’s consent. Indeed, the bill does not even require notice to the affected owners. While the vast majority of condominium boards would use the borrowing authority provided by this legislation in a prudent manner, an improvident board could borrow substantial sums on behalf of unit owners for an ill-advised improvement project, thereby saddling the owners with exorbitant common charges for years to come. Moreover, the bill’s $5,000 threshold is excessive. In many parts of the State, $5,000 can represent a considerable percentage of the value of a condominium unit and an even greater percentage of the owner’s equity in his or her home.

While the bill’s so-called “safe harbor” provisions—which allow the declaration and by-laws to be amended to limit the board’s borrowing authority—give owners an opportunity to regulate borrowing, I am concerned that condominium owners may be unaware of the new authority conferred on their board of managers until the borrowing occurs. At that point, it would be too late for the owners to act. Further, if owner consent is not required, the bill should contain some form of oversight by the Attorney General or other responsible governmental entity.

The bill is disapproved.

Id.
involved in a vote over the subject. As noted above, the revised bill accommodated the Governor's view. It is hoped that potential borrowers will not be discouraged from entering into these smaller loan transactions (and thus be forced to fall back on lump-sum exactions) because of the disproportionate burdens and expenses of administration that will pertain to borrowing smaller amounts.

E. Subdivision 2—Introduction

This subdivision of section 339-jj allows a board of managers to provide a lender with meaningful assurances that a loan properly incurred by the board will be repaid. It applies to all such debt, there being no difference for this purpose whether the debt is being incurred pursuant to document-based power or statute-based power.

Prior to separate discussions of the four different kinds of repayment assurances that are authorized—some undoubtedly stronger than others (and, therefore, of different utilities to lenders in different circumstances)—it should be noted that the use of the word "may" makes clear that each of the four is permissive and, in theory at least, loan documents could include none or any number of those assurances. Additionally, the listing was not meant to be exclusive; so long as no prohibition is violated, a lender is free to insist on other safeguards as well.

F. Subdivision 2—Assignment of Income

A board now has power to assign to a lender any or all of its rights "in and to receive future income and common charges." Presumably, such an assignment would not be absolute; rather, it would be in the nature of an assignment of rents, to become operative only in the event of a default.

The phrase "future income" was intended to be broadly construed so as to include all receipts of any kind, so long as they are within the control of the board. The word "income" was not intended to have a technical tax meaning; rather, it was meant to cover all items that would be shown as money

79 It follows, of course, that there is no basis for reading any of the now-available forms of assurance into documents, whenever signed, that did not or in the future do not specifically provide therefor.
80 N.Y. REAL PROP. LAW § 339-jj(2) (McKinney Supp. 1999).
coming into the condominium in a typical budget or financial statement. Examples might include rents from commercial tenants, fees from concessionaires, and, in some cases, litigation awards.

The specific mention of common charges was to forestall any contention that “income” might not include them. It is the statutorily defined term that was intended to be referenced, and all common charges of any type were meant to be covered, including special assessments as well as regular periodic charges.

The subdivision’s last sentence allows a board to confer upon a lender the right, in the event of a default under the loan documents, to step into the board’s shoes in order to secure and enforce a lien for unpaid common charges.81 In such a case, the lender will be able to file the same lien that the board would otherwise have been able to file, except that the lien will be in the name of the lender, which will then be in a position to foreclose on the unit in the same manner as the board would have been able to foreclose in accordance with the provisions of section 339-aa. Of course, a unit owner’s common charges are limited to his applicable portion of common expenses. Under normal circumstances, that would mean that the total liened amount would reflect only his percentage of common interest multiplied by the amount of the debt service (or, on maturity, of the loan) due. Thus, under this mechanism a single unit owner would not have to pay an amount greater than would be based on his share of the loan, except that, like any other condominium expenses, if some unit owners did not pay their shares, the deficiency would then become an expense of all the other unit owners.82

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81 A present assignment of any liening rights that may arise in the future would seem to be sufficient without any necessity of a separate assignment after the occurrence of a deficiency. If it should turn out to be otherwise, it is expected that assignments in blank and powers of attorney will become part of every set of condominium board loan documents.

82 It is recognized that the enforcement of liens by a lender against recalcitrant unit owners for the non-payment of common charges will be an unusual situation. Certainly, lenders are not going to view numerous separate foreclosures as their primary remedy. In addition, lenders will recognize that they are enforcing a payment of common charges, which is subordinate to a first mortgage of record on the unit. See N.Y. REAL PROP. LAW § 339-z (McKinney Supp. 1999); Bankers Trust Co. v. Board of Managers, 616 N.E.2d 848, 850 (N.Y. 1993) (finding legislative intent to subordinate common charges to such a mortgage). Although it would be unusual for
G. Subdivision 2—Granting of Liens

A board now has power to grant a lender a lien on any or all of the "funds or other real or personal property that it holds." The word "holds" was intended to make clear that the power extends to any property in which the board has a right or that the board controls. Indeed, the drafters understood the "hold" concept to have such a broad reach that they deemed it advisable for the statute to state that the power is not to be construed as extending to any property that is part of the common elements (the liening of which still requires the unanimous consent of the unit owners). Subject to that limitation, a board can now grant liens on such property as bank accounts, certificates of deposit, financial instruments, reserve funds, building equipment, snow blowers, uniforms, light bulbs, etc., as well as any units that the board may have acquired.

Although it is to be expected that lenders will not fail to acquire liens on all possible property, a board will rarely be able to borrow a sizable amount on the basis of this kind of assurance alone.

H. Subdivision 2—Creation of Trust Fund

A board now has power to commit common charges to the payment of a debt by agreeing that, subject to certain limitations, the funds are to be held in trust for that purpose and that board members risk civil action and even criminal sanctions if they use such funds for any other purpose while there are amounts due and unpaid under the loan documents. This mechanism parallels the protection given to contractors under section 339-jj(2), where the treatment of common charges as trust funds is provided as security for such creditors in the special framework of a condominium because the normal real property rights of a mechanic's lien

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83 N.Y. REAL PROP. LAW § 339-jj(2) (McKinney Supp. 1999).
84 See supra text accompanying notes 53-55.
85 Among other possibilities, such an acquisition might be by a foreclosure under section 339-aa, by a conveyance from a unit owner who abandoned his unit under section 339-x, or as a result of exercising a right of first refusal provided for in the condominium documents.
Similarly, where a board would want to borrow money (but a real estate mortgage cannot be granted because of the special nature of condominium ownership), lenders can now be given important security, which they would need in order to consider these loans as secured loans so as to encourage them to make funds available to qualified condominiums.

The new provision tracks precisely the language that has existed, and has survived unchallenged, for thirty-five years in section 339-l(2). It is to be assumed that the two trust fund provisions will be interpreted similarly.

Like its model, the provision's language is broad and inclusive, covering not only common charges already "received" but also "common charges . . . to be received . . . and the right to receive such funds." However, the new section also makes clear that any section 339-jj(2) trust fund rights are subordinate to the section 339-l(2) trust fund rights of labor or materials providers.

It is important to note that the new provision speaks only of amounts already due under the terms of the loan documents, which was meant to exclude all amounts that, while owing, are not yet payable. It was not contemplated, and it would be inappropriate to argue, that the entire debt is due at any given time before maturity. Thus, it will not be necessary to retain all common charges in trust until the debt is fully repaid, so long as currently required payments are being made. On the other hand, maturity can occur by acceleration, so that counsel will need to be especially attentive to such matters.

Although use of the section 339-jj(2) trust fund device does not directly mandate the payment of amounts due under the loan documents, such use is expected normally to have that effect, inasmuch as a board of managers will rarely be in a position simply to decline to make any payments whatever to others. Almost always, payments will have to be

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88 See supra text accompanying note 56.
90 Although one or two of the practitioners involved in some of the original "brainstorming" sessions expressed concern that the requirement of payment of the amount "due" might be interpreted to mean, at any time, the full balance of the amount that had been borrowed, the prevailing view was that it was virtually impossible that such an unreasonable interpretation would be adopted by the courts.
made so that essential services will be maintained. In drafting sessions there was some discussion about including in the law a provision making clear that unit owners could not do an end run around the provision by setting up an ad hoc body to collect and remit sums intended to maintain such services; however, the majority view was that it was unnecessary to do so, both because the courts could be relied upon to apply the statute in such a way as to prevent such shenanigans and also because it was believed to be unlikely that anyone would risk criminal prosecution by participating in such a scheme.

The drafters of the new law considered the inclusion of the trust fund device to be essential if mainstream lenders were to be induced to make loans on normal commercial terms. Indeed, the drafters were so certain that lenders would normally insist on this form of assurance that early drafts provided that, as in the case of labor and materials providers under section 339-l(2), the commitment was automatic (subject, of course, to the ability of a lender to waive the benefit of the provision). At the urging of some of the legislators, though, the provision was modified to allow a board either to agree in the loan documents to receive common charges as trust funds for the repayment of borrowed amounts or (in theory, at least) to decline to make such an agreement.

All along the road from initial thought to embodiment in the state's law, reservations were expressed as to the wisdom of allowing a board to undertake such exposure in order to effectuate a borrowing on behalf of unit owners. To put it in stark terms: Should it be made possible for a board of managers to agree to put a lender in a position to threaten board members with incarceration or amercement if they chose to use limited funds on hand to keep the premises habitable rather than to meet current obligations on the loan? After reflection, the answer was always affirmative—for a number of reasons, including the following:

(1) As noted above, the same power had long ago been placed in the hands of providers of labor or materials for the common elements, and no major difficulties had ensued.

(2) If a board should run into a legitimate and unanticipated problem, it is to be expected that a mainstream lend-
ing institution would grant forbearance on reasonable terms. And, if there should be a genuine issue—such as a nonfrivolous dispute as to how much is payable at a particular point in time—a court of equity could be relied upon to fashion appropriate relief, whether injunctive or otherwise.

(3) All homeowners, including owners of cooperative apartments, risk even more devastating losses if required mortgage payments are not made.

(4) Under the statute as enacted, a board of managers can fully protect itself by simply declining to confer this particular form of assurance on a lender. Alternatively, a board can negotiate for extended grace periods and/or other ameliorations. But borrowers must understand that lenders in all likelihood will, and not improperly, insist on trust fund provisions as the heart of their protection. Whether or not a board grants to a lender the trust fund form of assurance will doubtless be determined by the circumstances of the marketplace, including the relative bargaining powers of the parties and the amount of competition.

In the end, the lawmakers were convinced—and, in the authors' opinion, correctly so—that none of the other forms of assurance would regularly instill in lenders a sufficient degree of confidence that they could enforce repayment of any loans that they might make to boards of managers, so that there would have been little point in enacting the condominium borrowing law without the trust fund provision.

I. Subdivision 2—Right to Cause Increase in Common Charges

It is apparent that some of the other assurances could be rendered nugatory by a failing on the part of a recalcitrant and aggressive board to assess common charges at a high enough level. For example, a lien to enforce the payment of common charges would be of little use if the unit owner simply had no payment obligation in the first instance. Accordingly, the new statute allows a board to agree in loan documents that, if the lender so requires, the board will increase common charges to the extent necessary to pay any amounts

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65 It is interesting to note that a board has less control as to debts to contractors; under section 339-1(2) a manager or a managing agent can, without any participation by the board, expose the board members to liability in that context. See supra text accompanying note 56.
due under the provisions of the loan, which, as noted above, would usually be only periodic payments, special payments, late charges, and the like (but which would include the full remaining principal amount on maturity, whether by reason of acceleration or upon arrival at the end of the original term). For example, if monthly payments were not being made because the board had insufficient funds and was unwilling to adopt an increase in regular common charges, a lender could step in and require the board to assess the unit owners their proportionate shares of the deficiency. Alternatively, in order to ensure that the board would have sufficient funds to make regular payments, a lender might require an increase in common charges to be established at the inception of the loan. In addition, if a loan were to mature, whether by mere expiration of time or as the result of an acceleration, an unpaid lender could require the board to assess the unit owners their applicable portions of the debt at that time. Presumably, a mandatory injunction would be obtainable if a board were to disregard an obligation to increase common charges.

It bears emphasis that the statute authorizes a board to grant only a very limited power to a lender in this regard. An uncircumscribed power to bring about increases would be inappropriate and almost certainly unenforceable.

J. Subdivision 2—Priorities

After some consideration, the drafters decided—not unanimously—that on the whole it would be better to defer to another day consideration of the entire subject of priorities as between lenders making loans to condominiums. Consequent-
quently, with only the above-noted exception of the preservation of the trust fund priority of providers of labor or materials for the common elements, section 339-jj contains nothing specific on the point.

As to three of the four kinds of repayment assurances, that would not appear to be a major omission. To the extent that rents are involved, the usual rent assignment rules can be applied to income stream assignments; well-known rec-

resolutions to be included in the condominium's records, both to prevent excessive borrowing from a financial protection point of view and, possibly, to provide actual notice to a subsequent lender that reviews such records as part of its due diligence. A subsequent lender proceeding in the face of such actual notice might be in a poor position to enlist the aid of a court of equity.

It should be noted that the recordability of a section 339-jj assignment is or would be a mixed blessing. A lender who is satisfied that he is the first one on the scene might well prefer non-recordability. If his assignment is recordable and he fails to record it, he will come in behind a subsequent lender without notice who does record his assignment. Also, indexing two documents (i.e., the assignment and the instrument terminating it) against every unit can be quite expensive in some counties. On the other hand, the holder of a senior non-recordable assignment runs no priority-loss risk by failing to offer it for recording.

An assignment of rents, as opposed to an assignment of common charges, would plainly be recordable under New York Real Property Law section 294-a (which provides for the recording, and effect of non-recording, of an assignment of rents), and it is to be expected that an assignment of rents to be received from any units or other realty held by the board will normally be recorded. However, because of the inordinate expense that may be involved, the situation is likely to be much more problematic as to an assignment of rents to be received from the common elements. Common charges clearly are not rents. See Frisch v. Bellmarc Management, Inc., 597 N.Y.S.2d 962, 965 (App. Div. 1993). It follows that section 294-a would not apply to an assignment of common charges.

Although the point is perhaps arguable, New York Real Property Law section 291 (which provides for the recording, and effect of non-recording, of a “conveyance”) would likewise appear to be inapplicable to an assignment of common charges, inasmuch as, insofar as possibly relevant here, New York Real Property Law section 290 defines a “conveyance” as a “written instrument, by which any estate or interest in real property is created, transferred, mortgaged, or assigned, or by which the title to any real property may be affected.”

The Condominium Act has since its inception provided that “every instrument affecting the property or any unit included within the meaning of ‘conveyance’ as used in article nine of this chapter [which includes sections 290, 291 and 294-al], shall be entitled to be indexed and recorded pursuant to and with the same effect as provided in said article nine.” N.Y. REAL PROPERTY LAW § 339-s (McKinney 1989) (emphasis added). This provision would appear to be redundant; section 291 would apply ex proprio vigore to “every instrument . . . within the [section 290] meaning of ‘conveyance,’” whether or not it affected any condominium property.

The legislative proposal in the form advanced by the New York State Bar Association included an attempt to make every section 339-jj assignment recordable. However, it did so by suggesting a revision of section 339-s that would have included a reference to such an assignment as an “instrument affecting the property or any
ordination and perfection rules are plainly applicable to liens granted on property held by the board of managers, and there would seem to be no difficulty in having more than one lender able to require an increase in common charges.

It may be, though, that troublesome priority questions will arise in connection with the trust fund provision. Where more than one lender has been granted this safeguard, how is it to be determined which has first call on the funds? Or must they be paid pro rata?

If one lender is to take precedence over another, it is likely that the rule will normally be first-in-time, first-in-right. In that event, it will be necessary for a potential lender to assure itself that it is first in line, and reliance on title insurance will not be an option. It would seem that comfort similar to that enjoyed by a mortgagee that has recorded its mortgage is not obtainable as the law stands at present. However, still available are protective provisions in loan documents, affidavits from board members and opinions of counsel.

If, on the other hand, all lenders that have received the trust fund form of assurance will be entitled to pro rata payment regardless of timing—which would seem to be the more natural reading of the statute—even a first-in-time lender will have something to worry about. In that case, no matter what kinds of covenants a lender has obtained in its loan unit included within the [section 290] meaning of “'conveyance.'” Some of those involved in preliminary discussions felt that this approach was unsatisfactory. More precisely, the proposal called for amending the first sentence of section 339-s to read as follows (new matter italicized):

The declaration, any amendment or amendments thereof, an assignment made in accordance with §339-ji, and every other instrument affecting the property or any unit included within the meaning of 'conveyance' as used in article nine of this chapter, shall be entitled to be indexed and recorded pursuant to and with the same effect as provided in said article nine.

However, this portion of the Bar Association proposal was omitted from the bills that were actually introduced. The proponents of the new law were never made aware of why that happened, but the practical exigencies of the situation did not admit of pressing the point.

There may be some uncertainty as to how UCC-1 financing statements should be filed. Accordingly, prudent lenders may attempt to file under several permutations of the name of the grantor of a security interest. For example, filing might be attempted under all of the following: “The Board of Managers of the XYZ Condominium,” “Board of Managers of the XYZ Condominium,” “The XYZ Condominium,” and “XYZ Condominium.”
documents, other perfectly legitimate (and also victimized) subsequent lenders may appear and properly claim a right to share in any trust fund.

It remains to be seen whether the statute's silence on such matters will prove to be a significant deterrent to lenders or whether the pressures of competition will cause such concerns to be brushed aside.

K. Subdivision 3

The purpose of this provision is to preserve, to the extent that doing so may be necessary, any agreements that were properly authorized in condominium documents and at law prior to the enactment of the new section. In addition, the provision allows for the possibility that boards of managers might be authorized, presumably by the declaration and/or by-laws, to have powers beyond those specified in section 339-jj.

There were differences of opinion as to whether a provision of this kind was necessary or would be desirable. Although a majority of the participants in preliminary drafting sessions felt that it was unnecessary, the pleonasm was included in the proposal in order to confirm explicitly what was believed to be the rule and thereby preempt any mischievous arguments that might otherwise be made to the contrary.

V. CONCLUSION

By adopting section 339-jj, New York has taken a giant step to bolster the viability of the state's condominiums. To achieve its aims, the statute incorporates some creative devices, but there is no apparent reason that it should not operate smoothly as it is put into effect by willing lenders and motivated borrowers.