

## COUNSEL'S CORNER

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WHITE PLAINS—Every board member of a cooperative or condominium is faced with a difficult problem when a neighbor falls into arrears.

Unfortunately, in this economy, this problem is becoming more and more prevalent. Many boards believe that they cannot hurt their neighbors and take action to collect the outstanding maintenance and/or common charges. However, this may well be a violation of the fiduciary duty that every board member owes the organization and board that he or she is a board member of.

To take a simplistic example, if you have a 100-unit cooperative or condo with a budget of \$1,000,000, when one unit owner/shareholder does not pay, it means that the other 99 have to make up and subsidize the \$10,000 per year that is not being paid by the defaulting person. Thus, it costs each person an additional \$101+ each year to subsidize the delinquent party.

And with a condominium, this money may be lost forever if a bank comes in and forecloses. Moreover, the more the arrears builds up the harder it is for the delinquent party to make up the arrears and bring themselves back into good standing.

### A Course of Action for Boards

Therefore, what is a board to do? We recommend to our clients that the board has no choice but to take some type

of legal action. As a first step, when a unit owner/shareholder falls into arrears, even for one month, the managing agent should first call and/or send a friendly "note" to find out if there is a problem or see if the check was lost.

If the unit owner/shareholder recognizes that there is a problem, a simple pay-out might be worked out with the board. We recommend that this be incorporated in a formal "stipulation" or agreement. If there is an inadequate, or no response, and it is past the 10th of the following month (the second month of arrears), we recommend that at that point the arrears be given to legal counsel for the cooperative or condo. This is the point where the steps to be taken go different paths.

### The Steps for a Cooperative

This article will deal with the collection by a cooperative and leave to a future article the condominium's collection procedures.

With a cooperative, the first step is a three-day notice. This is a predicate to an eviction proceeding and has to be "served" with the same formality as legal papers would be served. The contents of the notice are specific, and while a three-day notice can also be oral, we heartily recommend against that option, as, invariably there is a "he says this/she says that" dispute.

A written three-day notice is specific and the terms are standard. Concomitant with this or alternatively, the cooperative could notify the lender (if any) and seek payment from the lender. However, this may well cause the shareholder's mortgage to go into default.

Therefore, many boards are hesitant to do this and would rather follow the so-called "eviction" route, wherein the shareholder may well bring himself/herself back into financial compliance without causing a default under the mortgage.

However, in time, if the shareholder does not pay and the eviction proceeding continues, legal notification to the lender is required under the recognition agreement. The bank may or may not pay the arrears (and all incurred late charges and legal fees) depending on the value of the unit, as well as the amount of the mortgage.

In any case, most times a delinquent shareholder will bring himself/herself back into good standing before a formal (non-judicial) foreclosure either by the bank, or the cooperative, takes place.

From the cooperative's perspective, it will always be protected because it will almost always recoup all of its outstanding maintenance, as well as the attendant fees and late charges and if the lender wants to protect its interest it will have no choice but to pay the cooperative the arrears. The coop-

## Reviewing Collections for Co-ops & Condos

erative will, if it has to proceed with a foreclosure against the shareholder, have priority before a bank, and therefore the bank will either pay the balance of the monies owed the cooperative to prevent being wiped out or, alternatively, may

work with the board to quickly and efficiently deal with arrears in a manner that is fair to all concerned.

### The Condo Scenario

Regarding condominium arrears, it must be recognized

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walk away from the unit if the unit is not worth enough or the mortgage is small enough and the outstanding maintenance and legal fees are significant.

Nevertheless, expeditious action is necessitated both from the point of view of the shareholder (so that the shareholder does not find himself/herself in too much of a hole) and the other shareholders, who basically are subsidizing the delinquent shareholder as well as the cooperative, as an entity, in protecting its financial position.

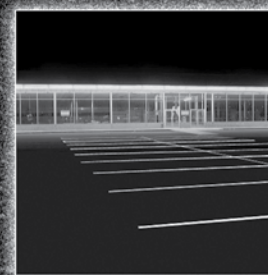
Every board should adopt a consistent policy which not only considers the financial circumstances of a shareholder who comes to it for financial relief or consideration, but also the needs of the cooperative relative to securing payment in as expeditious a manner as possible. Legal counsel can assist in both drafting and implementing such a policy and

that collection of these arrears is quite different than with a cooperative. A future article will deal with proper methodology and the judicial process that is required, but one difference between a cooperative and condominium collection process must be recognized, i.e., that with a condominium, the bank has a superior lien and if the bank forecloses, it will extinguish any common charge lien that the condominium has built up — therefore, there is even more reason to, for reasons to be explained later, move quickly against the delinquent unit owner. Again, there will be more to come!

**Editor's Note: The authors are with Finger and Finger, A Professional Corporation. The firm, based in White Plains, is Chief Counsel to the Building and Realty Institute of Westchester and the Mid-Hudson Region (BRI).**

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