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Divorcing Yourself From Your Cooperative Apartment

DIVORCING yourself from your cooperative apartment may prove to be more difficult than divorcing yourself from your spouse. In this slumping market for cooperative sales, many divorcing couples are opting to transfer title between themselves rather than sell their apartment for a loss. However, divorcing spouses should be advised that merely agreeing to a transfer of all right, title and interest to a cooperative apartment within the confines of a separation agreement is insufficient to complete the conveyance which cannot be finalized without involvement of the cooperative board and the lending institution, if there is a loan.

The cooperative board, which must approve the transfer, is the first obstacle in transferring a cooperative apartment between spouses. If the non-monied spouse retains the apartment, the cooperative board may refuse to



release the monied spouse from liability for maintenance payments and assessments. In certain cooperative apartment buildings, the cooperative board will request financial documentation such as tax returns and net worth statements of the spouse retaining the apartment prior to approving the transfer.

The lending institution which retains the stock certificate and proprietary lease as collateral, if there is a loan, must be involved with the transfer. A transfer cannot be completed without the institution, which must relinquish the original stock certificate and proprietary lease.

Prior to Oct. 1, 1988, security interests in instruments other than negotiable documents could be perfected by the secured party taking possession of the actual documents.¹ Thus security interests in individual units

of a real cooperative were perfected upon taking physical possession of the stock certificate and proprietary lease.²

Inasmuch as perfection of security interests in individual units of a real estate cooperative on or after Oct. 1, 1988 are governed by UCC §9-304(7) which requires that perfection of a security interest is made by filing in accordance with UCC §9-401, lending institutions can no longer consent to the issuance of a new stock and lease without having the ancillary documentation revised as well.

As a result of the change in the law, if the names on the stock certificate and proprietary lease are different from the names on the UCC-1 that was filed, the lender will forfeit its perfected interest in the collateral.

Thus, in order to release one party from liability by altering the parties on the stock certificate and the proprietary lease, a new promissory note, security agreement and UCC-1 statement must be executed. Moreover, as lenders are no longer apt to blindly release anyone from liability and many banks sell their loans thereby making it impossible to simply release one party from liability, in all likelihood the lender will require a refinancing in order to complete a transfer of ownership.

In today's real estate market though, a refinancing is not always feasible. Many apartments are no longer as valuable as they were when they were purchased. If the appraised value of the apartment is less than the outstanding balance of the loan, the difference of the values must be paid to refinance the loan. Next, the refinancing party must be able to qualify for the loan as a single person. If the original loan was approved based upon two separate incomes and two separate net worth statements, the divorced spouse may not qualify for the loan alone.

If the cooperative board refuses to approve the transfer, or the parties do not refinance the loan, in all likelihood both spouses will remain on the original stock certificate and proprietary lease until the apartment is sold. It is quite common for spouses to transfer all right, title and interest to their cooperative apartment, among themselves without actually completing the transfer. The consequences of remaining on the stock and lease while giving up all right, title and interest to the apartment are substantive.

In a typical marital settlement, one spouse transfers his right, title and interest to the cooperative apartment, to the other spouse. The parties agree that the acquirer shall be responsible for paying the monthly payments under the loan, including the maintenance and all assessments.

The acquirer indemnifies the transferor for any failure to make such payments, and the transferor relinquishes his interest in the apartment in return for a monetary distribution which is payable in installments. In this scenario, a new stock certificate and proprietary lease are not issued and the transfer is not completed.

The most significant situations that must be anticipated in the foregoing example are the following: (a) refinancing the cooperative loan in the future; (b) the future sale of the apartment; (c) bankruptcy for the spouse liable for payments on the loan, (d) the impact of the incomplete conveyance on the transferor's credit rating, and (e) the death of the spouse who retains ownership in the apartment.

There are several precautionary measures to take.

A. Refinancing

To facilitate a transfer which results from a future refinancing, upon execution of the Separation Agreement, the divorcing spouses should execute: (a) an assignment of proprietary lease, (b) acceptance of assignment, and (c) stock power. This documentation should be held in escrow by the attorneys, pending approval of the transfer by the cooperative board and action by the lending institution to release the transferor from liability with respect to the underlying loan.

B. Tracking Down an Ex-Spouse

As it is probable that the sale of the cooperative apartment will occur prior to either a refinancing, or death of either spouse, it benefits the acquirer, if the transferor signs a limited, irrevocable power of attorney giving the acquirer power to sign documents assigning the transferor's right, title and interest to the apartment.

If a limited power of attorney is not executed, the acquirer may be relegated to searching for the transferor to execute documents, when it is time to sell the apartment.

C. Bankruptcy

Divorcing spouses should be protected in the event that one spouse files for bankruptcy. In the foregoing example, the transferor may be financially damaged if the acquirer files for bankruptcy. If the acquirer is liable for payments to the transferor and the Bankruptcy Court determines that the payments are part of the property settlement and not support, maintenance or alimony payments, then the payments may be discharged. Simply labeling the payments support or maintenance, when in fact they are part of the equitable distribution, will not prevent the payments from being discharged as it is a well-established

principle in bankruptcy law that dischargeability must be determined by the substance of the liability rather than its form.³

An indemnification will not protect the acquirer either because liability pursuant to the indemnification may also be discharged in bankruptcy. The transferor's entitlement to the payments may be protected if pursuant to the terms of the Separation Agreement, the transferor is given a secured interest in other property owned by the acquirer. In a situation where it seems likely that one spouse may file for bankruptcy — and in this economic climate it appears that virtually anyone might file for bankruptcy — it is not advisable to remain joint title holders to a cooperative apartment.

D. Credit History

Inasmuch as an agreement between spouses with respect to liability for a cooperative loan is not operative with respect to third parties, the transferor's credit will be affected provided that he remains a title holder to the cooperative shares and proprietary lease. For example, a lending institution may be unwilling to loan additional funds to the transferor for as long as he remains liable under the original cooperative loan. An indemnification from the acquirer to the transferor may be insufficient to satisfy the lending institution, a guarantee from a third party may be satisfactory. Additionally, if the acquirer defaults on the cooperative loan and a default judgment accrues, the transferor may be looked to for payment.

E. Death of One Spouse

Title to a cooperative apartment held by tenants by the entirety, will transfer by operation of law to sole ownership by the surviving spouse upon the death of one of the spouses, provided that the parties were not divorced prior to the death. Once the parties are divorced title transfers to tenants in common.

The separation agreement should provide that, as long as record title to the cooperative shares and proprietary lease continue to be held in the names of both spouses, the transferor shall hold said interests in and to the cooperative shares and the proprietary lease as nominee for the acquirer and for his/her exclusive benefit.

The separation agreement should also provide that, if the acquirer dies prior to the transfer of title between spouses, the transferor will, upon the request of the acquirer's personal representative and without delay, join with such personal representative in transferring his/her right, title and in-

interest in and to the cooperative shares and the proprietary lease to the transferor's personal representative or to any purchaser to whom the representative wishes to sell the apartment.

If the transfer is completed, state and city transfer taxes must be paid. By statute, it is the person who is

transferring the interest in the cooperative apartment who is obligated to pay the transfer tax. In a marital settlement, the issue of who is responsible for paying the tax should be part of the settlement negotiations from the outset.

Recently, parties to marital settlement agreements who have indicated that the consideration for the transfer between spouses is zero have been audited and charged penalties and interest as a result.

In New York City, the consideration for a transfer pursuant to a separation agreement or divorce decree includes the value of any marital rights exchanged for the property plus any consideration paid by the grantee for the transfer. The consideration is presumed to equal the fair market value of the property transferred in proportion to the interest transferred.

Computations for this tax in New York City are as follows: (a) if the fair market value for the apartment is less than \$500,000, the tax is 1 percent of the value of the interest transferred; or (b) if the fair market value for the apartment is greater than \$500,000, the tax is 1.425 percent of the value of the interest transferred.⁴

New York State allows an underlying loan to be subtracted from the consideration for the apartment. The transfer tax for New York State is \$4 dollars per thousand dollars based upon the consideration for the apartment.⁵ In New York State there is also a mansion tax which is chargeable for all transfers above \$1 million. This tax is 1 percent of the consideration for the apartment.

The Proprietary Lease will indicate whether a flip tax will be charged as a result of the transfer between spouses. In most instances the managing agent for the cooperative apartment building charges a fee for completing the paper work involved with the transfer.

Prior to signing a separation agreement, divorcing couples are often more concerned with getting the deal done than with the minutiae. However, as the cooperative apartment is often the most valuable marital asset, the issues involved in transferring title between spouses should be dealt with from the outset. During settlement negotiations, divorcing spouses should balance the benefits and expenses incurred in connection with completing the transfer of cooperative ownership with the future liabilities that may accrue if the transfer is not completed.

-●●●..... 67
- (1) UCC §9-304(1).
 - (2) *Brief v. 120 Owners Corp.*, 157 AD2d 515, 549 NYS2d 706 (1st Dep't 1990).
 - (3) *Biggs v. Biggs*, 907 F2d 503 (5th Cir. 1990).
 - (4) Title II, Chapter 27, NYC Administrative Code.
 - (5) Articles II, 31 and 31-B of the New York State Tax Law.

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