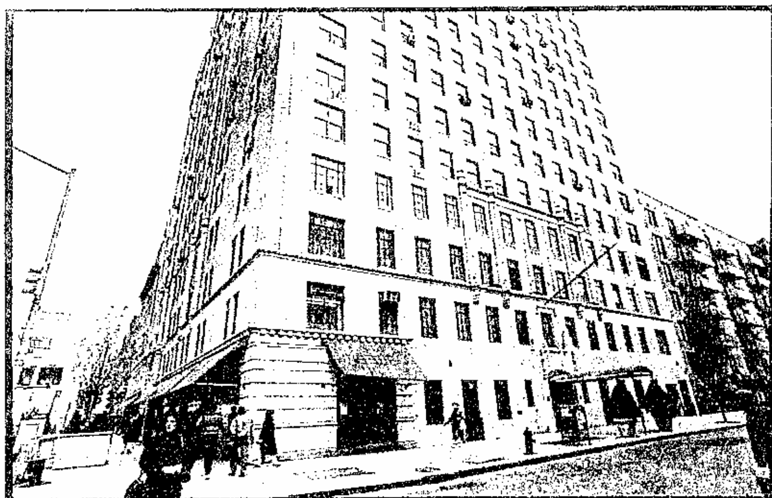
REAL ESTATE SCOREBOARD

COND-OPS



DAVID TOMONO

The home of Barneys New York, 161 W. 16th St., couldn't go co-op and couldn't go condo. So it did both: it went cond-op.

Cond-op, the newest word in the ever-increasing jargon of real estate-ese, is also now the hottest type of conversion among New York developers. Though the process of cond-opping is both costly and complicated, the up side is that it provides a solution to a much-feared IRS rule that threatens the status of co-ops with ground-floor shops.

The cond-op is, as its name suggests, a hybrid of the two most popular forms of apartment ownership in New York: the

PAGE 43

CONTINUED FROM PAGE 41
condominium and the cooperative. In a co-op, the owners hold shares of a cooperative and pay maintenance fees on the residential space; in a condo, the tenants actually own the space occupied and pay mortgages. While condominiums are preferable to many who can afford the down payment, New York "traditionally has been a co-op market," says Benjamin Barshay, a sales agent with Treger Realty.

Generally, co-ops tend to be somewhat less expensive than condos. Many buyers also prefer the security of the co-op; because the co-op is owned by the shareholders, the board can control membership and restrict subletting. In addition, the property tax is not paid individually by the shareholders but as one deed by the co-op. While the tenants pay maintenance fees toward that deed, the overall taxes paid may be lower than the taxes paid by a condominium owner, says Gil Neary, president of Coleman Neary Realty.

With benefits, however, go restrictions. The 80/20 rule, part of IRS Code 216, states that a co-op may not earn more than 20 percent of its income from nonresidential sources. When the proportion of profits that come from commercial tenants exceeds 20 percent, the entire co-op loses its preferential status for the year.

Enter the cond-op. Essentially, the cond-op skirts the IRS' 80/20 rule by splitting the residential cooperative into a legal entity distinct from the condominium as a whole. Generally, the first floor (or floors) of the cond-op is made up of typical condominium space that can be sold to retailers or leased as commercial space by the sponsor. The second part, consisting of residential apartments, is set up to be owned jointly by a co-op with shares sold accordingly. While the actual co-op is enclosed within the larger condominium, the co-op is its own entity; it has its own board meetings and enjoys all the tax advantages of a typical co-op.

Over the past few years, "one-third of all conversions of residential buildings with retail space were to cond-op," estimates Timothy Fine, managing director of Charles H. Greenthal Real Estate Management. Says Barshay, "Without a doubt, this is the way of the future."

Much of the reason for the cond-op's current success is historical. In the '70s and '80s, when many co-op dwellers sought the convenience of Laundromats, newsstands, gourmet bakeries, and video stores, the leasing of ground-floor space for commercial use became widespread. It was a fine arrangement for apartment owners and retailers alike, but when commercial real estate prices rose, the proportion of income derived from retailers jumped, and the co-ops risked their special tax status.

Since violation of the 80/20 rule results in the loss of a co-op's status for that entire year, co-ops began issuing "sweetheart leases" that offered retailers their commercial space at considerably lower than going rates. "Store owners could pay $10 a square foot in a co-op building on a block where any other space would go for $40 per square foot," says Barshay. But these arrangements ran into trouble in 1980, when the attorney general's office determined these "sweetheart leases" were illegal and began cracking down on them. That set the stage for a new legal tactic for outwitting the IRS—the cond-op. Cond-ops, says Fine, let a sponsor "have his cake and eat it too." The sponsor gets the revenue of the sale of the building's apartments to the cooperative and "for icing, he gets to keep the leases on the commercial space."

The actual legal process of going cond-op is complicated—and lengthy. The conversion of 161 W. 16th St., where Barneys New York is located, has been in the works since August 1988 and is not expected to finish until this coming January, says Benjamin Barshay of Treger Realty.

Treger has owned the building since 1962, when Barneys occupied only one floor. As the retailer grew more popular, tenants on the second and third floors of the building moved to higher floors until Barneys occupied the first four floors (and the basement) of the building. As owner of the building, Treger collected commercial and residential rent. But with the rising cost of maintenance and property taxes, Treger saw the opportunity to make a profit in conversion. Because of a large outstanding mortgage, converting and selling the entire building would have been too costly, and because of the retail value of Barneys, a co-op was out of the question. So the decision was made: the building would go cond-op.

Since January of '89, 30 percent of the 155 1BR, 2BR, and studio apartments have been sold. To outsiders, a 500-square-foot, renovated studio with marble bath, whirlpool, and glass-brick sleeping alcoves is $120,000. Insiders who already have leases in the building are being offered shares for 30 to 40 percent less.

Ironically, though the cond-op revolution continues, only the keen-eyed apartment hunter is likely to know it has occurred at all. Sponsors of buildings profit from the increased rent of their retail space made possible by a cond-op arrangement, but for the average cond-op tenant says Gil Neary, the distinction between co-op and cond-op is largely one of semantics: "Tenants see the building is brick, the windows are glass."

Pamela Stoc