

ASK THE FORMER REGULATOR

Expert Analysis

# Benefits of Leasehold Condominiums For Operators of Homeless Shelters

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**Q**uestion: I run a large nonprofit in New York City that operates homeless shelters. I am advised that a leasehold condominium may be a beneficial structure for us instead of a long-term lease. Can you give an overview of leasehold condominiums and how they are created, as well as confirm whether operating a shelter qualifies for any special benefits?

**Answer:** You are correct that a leasehold condominium structure may, in fact, be more beneficial for a nonprofit versus a long-term lease. That is, so long as the anticipated long-term lease was for 30 years or more, which is the minimum length of time needed to create a leasehold condominium compliant with Article 9-B of the Real Property Law (known as the Condominium Act). The benefit to a nonprofit that owns a leasehold condominium unit or units is the potential eligibility for a valuable tax exemption under N.Y. Real Prop. Law §420-a (the “420-a Exemption”). And yes, the New York City Department of Finance (DOF) confirmed in 2022 that a nonprofit that operates a homeless shelter can apply for the 420-a Exemption.

## Overview of Leasehold Condominiums

Generally, leasehold condominiums involve an owner of land maintaining a leasehold interest in such land at the

time of submitting the overall property comprised of the land and improvements under the Condominium Act. In the case of a nonprofit acquiring one or more condominium units in a building being converted to condominium ownership, the nonprofit would purchase the units that represent the improvements, along with a leasehold interest in the land.

To comply with the Condominium Act, the leasehold condominium must be devoted exclusively to non-residential purposes under a lease with an unexpired term of at least 30 years from the date the condominium declaration is recorded. See N.Y. Real Prop. Law §339-e(11). Since condominiums subdivide multiple dwellings, a leasehold condominium must have more than one condominium unit to be formed.

In cases where a fee condominium already exists, it is also possible to create a leasehold condominium within an existing fee condominium, which would allow a nonprofit to own only part of the condominium’s property. This “condominium in a condominium” is accomplished by leasing the fee condominium units to an affiliate of the fee owner, who creates the internal condominium, and then selling the leasehold units of the internal condominium to the nonprofit. To create a “condominium within a condominium,” there must be at least three tax



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lots at the time of formation, with at least two condominium units remaining after the “condominium in a condominium” is formed.

### **Eligibility for 420-a Exemption**

The 420-a Exemption provides a full exemption from real property taxes to nonprofit organizations (organized for the religious, charitable, hospital, educational or for the mental and moral support of men, women, and children) that own property in New York. Typically, the 420-a Exemption is not available to nonprofits that lease their properties as tenants since they do not “own” the real property and merely are lessees. For example, if a nonprofit is a lessee of an entire property under a net lease or ground lease, it would still have to pay all the property’s real estate taxes since it does not own the fee interest.

Luckily, in 2009, the DOF issued a private letter ruling confirming that a nonprofit holding title to a leasehold condominium unit where the leasehold interest is at least 30 years qualifies for the 420-a Exemption. See FLR-08-4886, Feb. 13, 2009.

### **What Is Necessary To Form a Leasehold Condominium?**

Like fee condominiums, leasehold condominiums require governing documents. These include a declaration, by-laws and documents representing the leasehold interest in the land, such as a ground lease and memorandum of lease. Like fee condominiums, the creation of a leasehold condominium is treated as a real estate security under New York’s Blue-Sky Law, known as the Martin Act, and, therefore, a no-action letter is generally required before the fee owner can submit the property under the Condominium Act. Also, technical filings must be made to the DOF to create tax lots and record the declaration and by-laws, along with tax lot drawings for each of the proposed condominium units.

Overall, it is a more complex structure and legal process than a lease, but the benefits of the 420-a Exemption often outweigh the additional time and costs. The only other important thing to note is time. It is not unusual to

allocate close to 12 months to create a leasehold condominium from start to finish.

Once the condominium is formed, the nonprofit can apply for the 420-a Exemption by completing an online application available on the DOF’s website (which is subject to change from time to time). As a word of caution, if you are required to hold title to the property in a housing development fund company, there are additional requirements imposed by the New York City Department of Housing and Development (HPD) that you should be aware of. An overview of these requirements is available on HPD’s website (and are also subject to change from time to time).

### **Homeless Shelters and 420-a Exemption:**

Given that the 420-a Exemption is not available to nonprofits that lease their property and, for leasehold condominiums, the property must be devoted exclusively to non-residential purposes, it makes sense that one would be cautious as to whether operating a homeless shelter in a leasehold condominium works for purposes of the 420-a Exemption.

Luckily, in 2022, the DOF issued another private letter ruling confirming that the use of property as a homeless shelter would constitute an eligible “non-residential purpose” under the Condominium Act. See 1 FLR-22-5024, Nov. 4, 2022. The DOF looked to the legislative intent of the phrase “devoted exclusively to non-residential purposes” and noted that this language was added to the Condominium Act in 1974 to allow developers increased flexibility in utilizing space for commercial purposes.

Accordingly, the DOF ultimately confirmed that shelter use is not residential use and that a nonprofit shelter operator could, therefore, form a leasehold condominium and be eligible for the 420-a Exemption.

In conclusion, it would make sense for a nonprofit in New York City to understand the benefits of leasehold condominiums as well as the value of the 420-a Exemption. This is especially true if your nonprofit operates a homeless shelter, which, per the DOF, is a non-residential purpose entitling your organization to robust tax relief.