The Aztec Recognition Form

Almost everyone who has ever purchased a co-op has heard about the "recognition agreement." It is required by lenders, it is talked about by boards and their agents, and it is delivered at closings. However, most co-op owners do not really know why it exists, what it is, what it does, and what precautions are necessary on behalf of co-ops in connection with executing it. Here are some answers.

WHY IT EXISTS

Some proprietary leases specifically provide that a shareholder may borrow money and pledge his shares and lease as security for a loan. Some leases prohibit loans for the purpose of purchasing the shares and lease without first securing the consent of the corporation. Many proprietary leases are completely silent as to a shareholder's ability to borrow money and pledge his shares and lease as security for a loan.

Prior to the advent of the formal recognition agreement as we know it today, lenders sought to negotiate directly with developers/converters to provide corporate documents that facilitated the loans ultimately necessary to sell the units. Accordingly, many of the buildings converted in the late sixties and early seventies have proprietary leases that contemplate share and lease loans. However, as conversions in the metropolitan area became more prevalent, converters, as well as boards of directors, sought to develop a document which would satisfy a lender's fear concerning the enforceability of their security. At the same time, they tried to protect the co-op in its desire to review the transfer of the shares and the occupancy of the apartment should the lender foreclose after a default by a tenant-shareholder.

The form developed is the recognition agreement, and it was first put forward by Aztec Document Systems. Subsequently dubbed the Aztec form, it represents a balancing act between the rights and desires of the lender and those of the co-op.

Except for those few buildings fronting Fifth Avenue, Park Avenue, and other exclusive locations where purchasers pay for their apartments completely in cash, every board must realize that the value of their apartments partially rests upon the ability of prospective purchasers to obtain financing.

To this end, a board must provide accommodations to a lender to protect its security and realize upon default, the value of its loan, through foreclosure or otherwise, and to assure the lender that the mere fact of extending the loan will not constitute a default under the borrower's proprietary lease. Moreover, the agreement creates an early warning system of a borrower's financial difficulty, through notification of the lender concerning the tenant-shareholder's default.

Lenders, on the other hand, recognize the need to protect the board's ability to pass upon who shall reside in the building (including purchasers at a foreclosure). Accordingly, lenders have agreed to specifically recognize the co-op's right to judge any transfers they may make upon foreclosure.

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WHAT IS IT?

- A recognition agreement is a three-party contract. Primarily, it is between a tenant-shareholder's lender and the co-op, which is then signed and approved by the shareholder. The highlights of this contract can be summarized as follows:

- It certifies to the lender that the tenant-shareholder is the owner of the apartment (shares and lease).

- It acknowledges that the corporation has consented to the lender making a loan to the shareholder, in exchange for which the lender has taken back a lien on the borrower's shares and lease.

- It prohibits the co-op from giving its consent to any further encumbrances (pledge), subletting, termination, or surrender of the lease without the lender's approval.

- It requires the co-op's intention to terminate the lease; setting out these conditions:

If the tenant-shareholder's default can be cured by the payment of money, the lender must be promptly notified of defaults involving any amount equal to, or exceeding, three months maintenance. The co-op agrees to take no action to terminate the lease or cancel the shares if the default is cured by the lender within 15 days.
If the tenant-shareholder's default cannot be cured by the payment of money, the co-op agrees to take no action until such time as the lender had had a reasonable opportunity to induce the tenant-shareholder to cure (but no less time then is provided in the proprietary lease to make such a cure).
If the co-op terminates the lease and cancels the shares for a default not curable by the payment of money, then, provided the lender pays any monies due under the proprietary lease when due, the co-op agrees not to sell or sublet the apartment without lender's approval, unless the net proceeds of such sale or subletting shall equal or exceed the amount owing to the lender.
The agreement exculpates the cooperative from liability should the co-op fail to notify the lender of the tenant-shareholder's default before terminating the lease. That only occurs, though, if the lender is promptly advised when the co-op discovers its failure and, if the co-op has already sold or contracted to sell the apartment, that the lender is paid the net proceeds of such sale (to the extent of the loan balance) after the co-op is reimbursed for all suns owed it.

- It provides that the co-op must accept payment from the lender on behalf of the tenant-shareholder, without limiting the lender's rights against the tenant-shareholder.

- The co-op recognizes the lender's lien against the shares and lease, and if the lease be terminated, or the shares canceled, against the net proceeds of any sale or subletting, after the co-op receives reimbursement for all sums due to it.

- It gives the co-op the right to demand and receive a copy of the financial and credit information provided by the tenant/shareholder to the lender.

- The lender acknowledges that it has no right or power to transfer the shares and proprietary lease to anyone without the co-op's approval, as required by the proprietary lease.

- The lender indemnifies the co-op against any liability incurred in connection with any claim the tenant-shareholder or his successor may make which arises pursuant to the co-op's actions under the recognition agreement.

- It provides that notices under the agreement that are required to be sent to the co-op will be sent by registered or certified mail care of the managing agent and provides a space to insert an address to which notices are to be sent to the lender.

THE HIDDEN MEANING

The specific provisions, as stated above, are clear and speak for themselves. However, there are subliminal benefits to the co-op not readily apparent when perusing the specific terms of the agreement. Specifically, the notification provisions designed to permit the lender to monitor its borrower, coupled with the provision facilitating the ability of the lender to make payment directly to the co-op for the tenant-shareholder's default, effectively creates a situation wherein the lender becomes the shareholder's guarantor of performance and payment.

Many co-ops have already found that sending a defaulting shareholder's lender a copy of a notice to cure increases the chance of a positive response form the tenant-shareholder, who is usually more concerned with the bank calling his loan then with his obligation to pay his maintenance regularly. In those situations where the share holder does not cure, the coop will receive funds directly from the lender seeking to avoid foreclosure by the co-op, who maintains a first and superior lien (under the proprietary lease and/or bylaws) to that of the lender.

Moreover, the symbiotic relationship created by the agreement affords prospective buyers a source of funds with which to purchase apartments in the building. By doing so, demand for apartments is kept high, which in turn keeps market prices high, thereby benefiting all of the tenant-shareholders.

The bylaws of every cooperative corporation grant to the co-op a first lien upon the cooperative shares to secure any sums which may be due and owing from the tenant-shareholders to the corporation. This provision which creates a lien on the shares, should be (and is generally) noted on each share certificate, thus limiting, by statute, the bank's ability to obtain a superior lien. Accordingly, a board of directors need not generally fear that a prospective lender who forecloses its lien will adversely affect the co-op's ability to collect any money which may be due it. In fact, on foreclosure, the lien of the co-op must be paid before that of the lender.

However, the co-op must carefully review any proposed recognition agreement submitted by a lender other than the Aztec form or one very similar to it. Many banks have attempted to modify the agreement, by using their own form, to divest the co-op of rights that it may otherwise have. Some lenders have even tried to eliminate the exculpatory language which frees the co-op from liability should it, in error, fail to notify the lender of a default. These modifications should not be permitted, so as to keep the delicate balance between the co-op and the lender created by the Aztec form.

With the full understanding to the historical background which gave rise to the agreement in use today, coupled with the knowledge of the form's various and principal terms and conditions, a co-op and its managing agent can maintain the delicate balance which will protect the rights of the lender, while continuing to facilitate the co-op's need to control the occupancy of the building and its economic and social homogeneity.

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