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Common Areas:

Value at the End of the Hall

By Jonathan J. Miller

As operating costs continue to rise, co-op and condo boards are considering other sources of income to operate their buildings and keep maintenance increases and assessments to a minimum. The sale of common areas to in-house residents has become more commonplace in recent years and provides an opportunity for additional income for the cooperation.

At the same time, apartment owners have had fewer purchase options as a result of the limited housing inventory in the Manhattan real estate market over the past five years. It may be easier for a shareholder to fulfill an immediate housing need by purchasing common space to enhance his or her apartment. Examples of common space sales include the end of a hallway between two apartments, basement storage room, a small closet adjacent to an apartment, double-height ceiling space over a basement garage, unimproved roof area, former elevator shafts, and an unused rooftop water tank.

A typical scenario might go like this: a couple is expecting their first child and currently occupy a one-bedroom co-op apartment. They search for a two-bedroom apartment but cannot find any suitable choices in their price range with the level of amenities they currently enjoy. With the time constraints and the inconvenience of moving, they approach the owner of the studio apartment across the hall. Since both apartments are situated at the end of the hallway and the layout would be enhanced if the hallway were incorporated into the layout, the co-op board is contacted.

In this case, the sale of the unused space can benefit the seller, the co-op corporation (or condo board) and the buyer. The co-op corporation would benefit from the capital infusion from the sale and the increased revenue from the shareholder's higher maintenance charges. The buyer, of course, would gain additional space.

However, before any decisions are made, both parties should seek out legal advice for matters such as the potential modification to the certificate of occupancy, zoning considerations, architectural integrity of the project, and approvals needed. Purchasers should note that they are usually required to pay associated costs.

Since common areas are anything but common in their characteristics, how can the market value of so many types of space be estimated? Market value is defined by the Appraisal Institute as, "The most probable price in cash, terms equivalent to cash, or in other precisely revealed terms, for which the appraised property will sell in a competitive market under all conditions requisite to fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress."

The sale of common area is not based on its market value, since it is not exposed to the open market and the buyer and seller are captives of its location. It usually has no practical use to any parties but the owner of adjacent apartments and the corporation. The space would not be sold to purchasers that do not own an apartment in the building or to an owner on another floor. Therein lies the problem, since there is no "market" for the property. The value of the space is therefore termed "value in use," which is defined by the Appraisal Institute as "the value a specific property has for a specific use." It is essentially

the establishment of a reasonable relationship between the price and size of the space between the two parties.

The challenge to the board is to be fair to the purchaser yet responsible to the shareholders. The challenge to the apartment owner is to establish whether the finished result will provide additional value to the apartment, both in a financial and functional sense.

As is often the case, there are usually no recent sales of common area within the building to use as a basis for comparison. Because it is not representative of market transactions in a given building, information on common area transactions is often not released, although the release of such data would not affect the property's market values. In addition, these transfers are often combined with the purchase of an adjacent apartment.

One method of valuing common area is to look at the relationship between actual common area sales and apartment sales within that same building. Although such transactions do not indicate market value on their own, they establish a relationship with market sales in their respective buildings. This relationship can be expressed as a percentage and can then be applied to a representative price per square foot indicator in the subject building. For example, if a representative price per square foot is currently \$600 and the common area percentage is 80 percent of market levels, the common area value could be \$480 per square foot.

The estimate of the common area value should not be subject to the actual condition of the adjacent shareholder apartment, but rather the typical condition of an apartment in the building. In other words, a shareholder should not pay more or be allocated more shares for adjacent common area based on the condition of his/her apartment. This is an important point and is consistent with allocation methods at the time of the conversion of the building.

Unlike the estimate of "value in use," the share allocation should be made as if the space were incorporated into the adjacent apartment. The shareholder benefits from the additional space in perpetuity. Shares per square foot are the determinant factor because the space is usually incorporated into the existing apartment indefinitely, and the shareholder enjoys an ongoing benefit.

The original share allocation at conversion varies by many factors, including floor level, number of bedrooms, square footage, outdoor space and view. The share per square foot ratio of other similar-sized apartments on the same or similar floors should be analyzed and compared to the subject space.

The sale of common area greatly benefits both the co-op corporation and the individual shareholder. Who says there isn't value at the end of the hall?

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