The Treasure Trove on the Ground Floor

Rebecca McAlpin for The New York Times

Alan B. Mitchell, a resident and former board president of 47 East 88th Street, says replacing the previous storefronts with higher-paying retail tenants like Armani Junior has helped to keep down maintenance costs for residents.

By JULIE SATOW
Published: April 12, 2013

New York is rife with urban legends, like the one about the nine-foot crocodile that lives in the sewers, or the one about the treasure buried on Liberty Island.

Then there is the one about the zero-maintenance apartment. But it turns out this one is true.

Apartments that come with low or no monthly charges — and in some cases actually pay their owners a yearly dividend — do exist, but can be as elusive as the perfect slice of pizza. A recent change in a federal tax law, however, could make them more common.

Until 2007, a federal tax regulation known as the "80-20 rule" required that residential co-ops receive at least 80 percent of their gross income from their tenant-shareholders, and no more than 20 percent from other sources, like ground-floor rent for retail space. If they didn't comply, buildings lost their legal status as co-ops and the tax benefits that come with it. As a result, buildings charged below-market rent for their commercial spaces or otherwise performed legal gymnastics to retain their status as co-ops.

Chang W. Lee/The New York Times

At 464 Broome Street in SoHo, co-op shareholders pay no maintenance and receive $20,000 a year in income from the ground-floor retail rents. A two-bedroom loft there is now in contract for 10 percent above the asking price.

When Congress relaxed the law, co-ops became free to charge more for their ground-floor stores. But it hasn't been until recently that most buildings could take advantage of the rule change, because many of them had signed 10- or even 20-year leases that are only now expiring.

In neighborhoods like SoHo and along Madison Avenue, where retail rents are high, it has meant a windfall for some co-ops. "Most buildings didn't expect the law to change so quickly, so were locked into long-term leases," said Richard Siegler, a lawyer at Stroock & Stroock & Lavan.

Stuart M. Saft, a partner at the law firm Holland & Knight, said that "over the next few years, you are going to see those co-ops that are lucky enough to have commercial spaces see a tremendous amount of revenue."

A lucrative ground-floor lease can add 10 percent or more to the value of an apartment, residential brokers say. A sprawling two-bedroom loft at 464 Broome Street in SoHo, for example, is in contract for $3.22 million, nearly 10 percent over its asking price, in large part because the listing not only offers no maintenance but provides its shareholders with $20,000 a year in income.

"The building has just eight apartments," said Henry Hershkowitz, a broker at Douglas Elliman who represented the seller, "so the revenues from the two stores on the ground floor cover the real estate taxes, the building's upkeep, even a full-time super, and then there is money left over for an annual dividend."

An apartment of this size in SoHo would typically come with a monthly maintenance of $2,400, said **Robert Dankner**, the prest of Prime Manhattan Residential, which represented the buyer. When $20,000 a year in dividends is added to the nearly $30,000 saved in maintenance, there is a net savings of close to $50,000 a year, he noted.

As Mr. Dankner put it: "Depending on how you model it, it would take $750,000 earning a 6.5 percent interest to get that kind of return. Or, if they live there for 10 years, they save themselves half a million dollars. If you think of it from this perspective, even with the bidding war and it selling for over ask, the apartment was undervalued."

On Madison Avenue, a large prewar co-op building had been forced for years to charge below-market rents for its six storefronts so it would not fall off the so-called 80-20 cliff. The leases expired in 2011, and the 16-story building, at 47 East 88th Street, "totally changed the dynamic of the retail," said Alan B. Mitchell, a resident and a former board president.

The co-op spent roughly $300,000 on renovations, including replacing the storefronts' dilapidated security gates and awnings, and reproducing the ornate copper crown moldings that once adorned the facade. Some of the new tenants also contributed to the storefront renovations, and were responsible for upgrades like central air-conditioning. Robert Marc Optical, for instance, "spent a substantial amount putting marble tiling throughout the store and installing lighting," Mr. Mitchell said. (Anticipating the increased income from higher retail rents, the co-op also commissioned other work, renovating the basement, doubling the size of the gym and installing a family recreation room.)

A version of this article appeared in print on April 14, 2013, on page RE1 of the New York edition with the headline: The Treasure Trove on the Ground Floor.

The New York Times

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The co-op, which has 58 apartments, replaced several commercial tenants with brand-name designers like Malia Mills, Armani Junior and Robert Marc Optical. The rent jumped as high as $325 a square foot, from a maximum $50 a square foot before 2011. Annual rent for each of the six stores is now $250,000 to $325,000, according to Faith Hope Consolo, the chairwoman of the retail group at Douglas Elliman, which represented the building on the leases. A four-bedroom apartment sold last year for nearly $5.2 million, a record price for the building, according to Elly Pateras, the property manager and a vice president of Douglas Elliman.

Mr. Mitchell said that "while the cash balance will diminish this year because of all of the renovations, it will grow substantially over time." This will in turn keep the maintenance from going up as much as it might have otherwise. The new retail leases also include an annual 3 percent rent bump, "so that in and of itself will help cover any increases in the cost of living," he added. "We run a conservative balance sheet with minimal debt."

But while a co-op's ability to charge more for commercial space can be a financial bonanza for its shareholders, not every building is able to take advantage of it. Back when the 80-20 rule was more restrictive, many co-ops opted to cash out and sold their ground-floor retail spaces to avoid the headache of being landlords.

Others that decided not to sell their retail circumvented the 80-20 rule by creating a long-term master lease of the ground-floor space, in which the owners of the master lease would be all building residents and some outside investors, who then would sublease the space to a retail tenant at market rates. This became problematic when sellers moved out of the building but kept their ownership stake in the master lease, preventing new owners from benefiting from it.

"Now that the 80-20 rules have been relaxed," said Margaret D. Baisley, a real estate lawyer with her own practice in SoHo, "those entities who formed these master leases want to take them back, but other investors have come to own them and they don't want to change the scheme, to the detriment of the building."

And even for those buildings that own their retail spaces outright, the effect on their bottom line may be somewhat muted. "Our storefront income is great, but it is not as romantic as you may think," said Karel De Boer, an agent at Douglas Elliman and the property manager for 17 East 89th Street. "While our rent has increased, so have real estate taxes, payroll taxes and utilities."

As their old leases expire, the co-op, which has four storefronts, is installing higher-paying tenants, including the children's clothing store Caramel Baby & Child and the Italian sportswear brand Le Civette. Last year it evicted one of its tenants, the gallery Art of the Past, after its owner, Subhash Kapoor, was arrested in India for allegedly stealing priceless artifacts. "There are a lot of legal fees associated with evicting a tenant," Mr. De Boer said, "and during the process we couldn't collect any rent." In addition, as is typical for landlords, the co-op must pay a brokerage fee and provide its new retail tenants with three months of free rent, further cutting into its income.

Yet while the rent increases may not be a panacea, the additional income from the new retail tenants has allowed the full-service co-op to keep maintenance low — it is just $3,100 a month for a 2,600-square-foot three-bedroom, for example — and the assessments to a minimum.

"There is an inverse relationship between maintenance and real estate values," Mr. Siegler said, "so co-ops that are lucky enough to generate income from commercial leases and can keep their monthly costs low are going to benefit." He represents a co-op on Madison Avenue with storefront leases poised to expire over the next several years. "When the time comes," he added, "they will be able to reduce their maintenance, pay off their mortgage and do capital improvements — over all, a wonderful thing."

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