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Nonprofit Tenant Tax Exemptions: The Lease May Not Permit Them

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A nonprofit tenant paying full real estate taxes under a net lease with at least 30 years remaining may be paying taxes it does not owe. The applicable transaction structure has been available since 2009: convert the leasehold into a condominium unit, and the tenant becomes an owner for purposes of Real Property Tax Law (RPTL) Section 420-a. The structure is well documented, and the Department of Finance has approved such structures repeatedly.

Unless specifically negotiated, long-term leases in New York City typically do not grant the tenant the right to record a leasehold condominium declaration, and a landlord's consent is not implied from silence. The tenant typically discovers this years into the lease term with nothing but a request as leverage. This article is about closing that gap at signing, and the provisions fee owners should demand in exchange.

The Ownership Requirement and the Answer to It

New York has a longstanding public policy of exempting real property owned by certain not-for-profit entities to encourage and foster legislatively favored, publicly beneficial services and operations. (See *Brookdale Physicians' Dialysis Associates, Inc. v. Department of Finance of City of New York*, 41 N.Y.3d 608 (2024)).

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RPTL Section 420-a(1)(a) exempts real property owned by qualifying religious, charitable, hospital, educational, and similar organizations, used exclusively for those purposes. Ownership is the operative word. A nonprofit occupying space as a tenant gets nothing, even under a net lease obligating it to pay every dollar of tax on the space. It bears the burden of ownership without the benefit.

The Department of Finance resolved this through a line of rulings holding that a leasehold interest, once subdivided into a condominium unit under Article 9-B, is real property owned by the unit owner, notwithstanding that the interest beneath the unit is a lease rather than a fee. (See See *Dime Sav. Bank of New York, F.S.B. v. Pesce*, 93 N.Y.2d 939 (1999); *Frisch v. Bellmarc Management, Inc.*, 190 A.D.2d 383; *Jerdonek v. 41 West 72 LLC*, 143 A.D.3d 43 (2016); *Eastbrooke Condominium v. Ainsworth*, 33 N.Y.3d 139 (2019); *Voron v. Board of Managers of Newswalk Condominium*, 186 A.D.3d 833 (2020)). A condominium unit is a separate tax lot, separately assessed, whether a fee or a leasehold sits under it does not change that. The conversion turns a tenant into an owner of record without altering the economics of the tenancy.

Three conditions govern eligibility:

• The unit must be devoted exclusively to non-residential use.

• The leasehold must have at least thirty (30) years remaining when the condominium declaration is recorded.

• The unit owner must be directly liable for the taxes on its own unit.

The doctrine has expanded rather than contracted. Later rulings reached foreign-government and UN-affiliated tenants (See *Republic of Argentina v. City of New York*, 25 N.Y.2d 252 (1969)), and the Department of Finance has since confirmed that a nonprofit-operated homeless shelter satisfies the non-residential requirement (See *Association For Neighborhood Rehabilitation, Inc. v. Board of Assessors of City of Ogdensburg*, 81 A.D.3d 1214 (2011)), a meaningful clarification given how much city-supported social-service space is configured to function like housing.

When You Need a Second Layer, and When You Don't

Practitioners overstate the need for a "condominium within a condominium." The structure is required far less often than the literature suggests, and the variable that determines it is not tax lot count.

Where the tenant holds a lease of an entire building, or an entire undivided parcel, that has never been divided into a fee condominium, the leasehold condominium is declared directly on the leasehold estate with no nesting (i.e. forming a leasehold condominium unit inside a unit of an already-existing fee condominium, rather than directly on a whole-building lease).

The net lease itself, whether a ground lease of land or a net lease of a standing building, supplies the property against which the declaration is recorded, and the fee owner never creates a fee condominium at all. This covers new construction on a long-term ground lease and a nonprofit taking a whole-building net lease of an existing structure alike.

The nested structure is necessary only where a fee condominium already exists and the nonprofit's space sits inside one of its units. There, no one holds the building as a whole: the relevant fee owner holds a single unit alongside other unit owners under a board of managers, and a declaration cannot be recorded against a building that owner does not own.

The workaround is a lease with a term of at least 30 years of that unit, or part of it, subdivided into a leasehold condominium nested within the existing unit boundaries. The second layer is a consequence of the preexisting regime.

The diligence question is not how many units the building has. It is whether the building is already condominiumized and whether the space sits inside one existing unit. A whole building under a single net lease supports direct condominium formation even with multiple commercial subtenants alongside the nonprofit, provided the declarant holds the leasehold interest over the entire building.

The Drafting Gap

The direct formation case (i.e. when the tenant holds a lease of an entire building), the common one, is also the one most exposed to the issues that arise. A whole building net lease is precisely the instrument a fee owner signed years before anyone contemplated a condominium conversion, and precisely the instrument whose silence the tenant must overcome.

Silence does not favor the tenant. A landlord's consent is not implied because a lease fails to address a particular restructuring of the tenancy. A tenant cannot record a declaration encumbering the landlord's fee and creating a new, separately transferable real property interest the landlord never agreed to. The strategy cannot be executed unilaterally after the fact, it requires the fee owner's affirmative cooperation, and a silent lease gives the tenant no basis to compel it.

The answer is to negotiate the structure into the lease at or prior to signing. Tenants get a defined path. Fee owners get conditions they would never obtain if asked to cooperate years later, under time pressure, with the tenant's tax exemption application pending. The following provisions belong in any long-term lease where the tenant is, or may become, or may assign to, a qualifying nonprofit.

Conversion Right, Conditioned:

Landlord shall, at Tenant's sole cost and expense, cooperate in good faith with Tenant's submission and recording of a declaration establishing a leasehold condominium with respect to the Premises pursuant to Article 9-B of the Real Property Law, provided that (i) the unexpired term of this Lease is not less than thirty (30) years as of the date of recording, (ii) the Premises are and will remain devoted exclusively to non-residential use, (iii) Landlord shall have approved the form of declaration, by-laws, and unit boundaries, such approval not to be unreasonably withheld, and (iv) no Event of Default is then continuing. Landlord's cooperation shall not be construed as a subordination of Landlord's fee estate.

Cost Allocation:

Tenant shall pay all costs and expenses incurred in connection with the formation, recording, and maintenance of the leasehold condominium, including without limitation survey and unit-boundary work, preparation of the declaration and by-laws, filing and recording fees, title charges, Landlord's reasonable out-of-pocket attorneys' fees, and the costs of any application to the Department of Finance or the Attorney General.

Mortgagee Coordination:

Tenant's right to form the leasehold condominium is expressly conditioned upon receipt of the prior written consent of each holder of a mortgage encumbering Landlord's fee estate, and upon execution and delivery of such subordination, non-disturbance, recognition, or amendatory instruments as any such holder may reasonably require.

Reversionary Protection:

Upon the expiration or earlier termination of this Lease for any reason, the leasehold condominium and all units created thereunder shall automatically terminate and be of no further force or effect, and Tenant shall, at its sole cost, promptly execute, acknowledge, and record all instruments necessary to remove the declaration and all related instruments of record. Tenant's obligations under this Section shall survive the expiration or earlier termination of this Lease. Tenant hereby irrevocably appoints Landlord as its attorney-in-fact, coupled with an interest, to execute and record such instruments in Tenant's name if Tenant fails to do so within thirty (30) days of written demand.

It is standard ground lease practice, consent standards, mortgagee recognition, surrender obligations, applied to a structure most forms do not contemplate. The omission is rarely deliberate because the strategy simply was not on the table when the lease was originally signed. Counsel on either side of a long-term lease to a nonprofit, hospital, or educational institution should raise it at the term sheet, not improvise it a decade later.

The reversionary provision deserves particular attention. A recorded declaration outlives the lease unless something removes it. A fee owner that cooperates without securing an automatic termination mechanism and a self-help remedy may find, on a tenant default, that it holds a fee encumbered by a condominium regime it cannot unwind without difficulties.

Financing and Title

If the fee is mortgaged, the fee mortgagee's consent is required, and timing is critical.

Lenders will want recognition and SNDA terms settled before recording, not after, the declaration carves a separately transferable, separately encumberable interest out of collateral the lender already holds. Engage title counsel early, particularly on nested structures (i.e. condominium within a condominium), where the interaction between the fee condominium's governing documents and the leasehold declaration raises priority questions a conventional condominium closing never presents. Formation must precede or run parallel with the exemption application, the Department evaluates an existing unit, not a proposed one.

Risks

Letter rulings bind no one but their requester. They are persuasive, fact-specific, and not regulations. Where the building, lease terms, or use differ materially from the ruling being relied upon, request a new letter ruling, the cost of a ruling request is trivial against the cost of a denied exemption after the structure is built.

The exclusive non-residential use requirement demands precision in mixed-use buildings. Unit boundaries must separate residential from nonresidential space cleanly on the declaration. Inaccurate boundary work is a common way an otherwise sound structure fails.

Finally, note the anti-abuse provision in the pied-à-terre surcharge enacted this year under Tax Law Article 30-C, which penalizes bad-faith subdivision of residential condominium units to avoid the surcharge. (Also see McKinney's Tax Law Sections 1351 and 1354(e)(2)(b)). It targets a different transaction, but it signals the direction of regulatory attention toward unit subdivisions generally. Nonprofit leasehold formations are non-residential and serve a documented statutory purpose, document that purpose contemporaneously (board resolutions, the ruling request, formation correspondence) rather than reconstructing it later under scrutiny.

Practice Pointers

- Raise the leasehold condominium structure at the term sheet on any long-term lease to a nonprofit, hospital, or educational institution. Fee owners get conditions at signing that they will never get later.
- For fee owners: never cooperate without an automatic-termination provision and a power of attorney coupled with an interest to clear the declaration of record.
- For tenants: diligence whether the building is already condominiumized and whether the space sits within a single existing unit. That determines direct formation versus nesting, and the cost difference is material.
- Confirm the facts underlying any letter ruling you intend to rely on. Where they diverge, request your own.
- In mixed-use buildings, invest in unit-boundary drafting on the front end. There is no cure after recording.

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