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New Landlord-Tenant Law Hammers Co-op Boards, Shareholders and Condo Investors

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New York's Housing Stability and Tenant Protection Act of 2019, which was enacted and became effective on June 14, 2019, profoundly impacts the residential real estate sector throughout our state. Inasmuch as the new law refers to "all rentals," its provisions govern the conduct of co-op boards, shareholders who sublease their apartments, and condo owners who rent their units, among other types of landlords. The new law does not affect condo boards.

Compliance with this new law will uproot well-established norms of co-op operations, particularly in the realms of admissions policy, administrative practices, collection of arrears, and prosecution of eviction proceedings. Although lobbying efforts are underway to either exclude co-ops from the application of the law or modify its provisions as to co-op operations, until such time as the law is changed either by legislative action or judicial construction, compliance with the new law will be complicated and expensive.

Below we highlight the key changes and suggest ways for boards and property managers to adapt to the new landscape.

Background Checks

Co-op boards and other landlords are still permitted to conduct background, credit and litigation checks, which may be charged back to the prospective tenants. However, the aggregate cost to the prospect is now the actual cost or $20, whichever is less, and even this fee must be waived if the prospective tenant presents the landlord with a report issued within 30 days of the application.

Moreover, co-op boards and other landlords are now prohibited from refusing to rent apartments "on the basis that the potential tenant was involved in a past or pending landlord-tenant action or summary proceeding." Furthermore, when a potential tenant who was involved in a landlord-tenant dispute is declined a lease, and the landlord has consulted with a tenant screening bureau or otherwise reviewed the tenant's court records, there now exists a rebuttable presumption that the rejection was based on such involvement.

We have always strongly advised our co-op board clients to perform background, credit and litigation checks on prospective purchasers. This is so boards have information about prospective residents beyond their financials, and about the nature of a potential neighbor being allowed into their community. A proclivity to litigate or an anti-social background portend future trouble for the community, and therefore could easily militate in favor of rejection of their application. For these reasons, we continue to recommend background, credit and litigation checks on prospective purchasers and subtenants, even if it means absorbing the lion's share of the cost. That marginal cost is borne by the entire tenancy so its impact on any one shareholder is limited, and it could potentially avert an extremely costly error in admissions. In addition, while a previous landlord-tenant history of litigation should not be the sole basis for rejecting an applicant, if there are other types of litigation an applicant has engaged in, that information is still pertinent.

A board can also use other independent information to rebut the presumption created by this statute with respect to previous landlord-tenant cases, such as

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financial issues or compatibility issues, both of which are still valid bases for rejection.

With respect to the cost of these searches, boards are of course free to shift the full cost of background, credit and litigation checks to the selling shareholder. The seller would then be in a position to negotiate an adjustment for this cost with the purchaser.

Application Processing and Move-In Fees

Other than the $20 background check fee, boards are now prohibited from levying any charges on purchasers and subtenants "before or at the beginning of the tenancy." So application, processing and move-in fees are now prohibited. However, as noted above with respect to background, credit and litigation checks, the board may require that these fees be paid by the selling shareholder.

Move-out fees and charges for the use of services and amenities during the course of a tenancy are apparently permissible, as these are not at the "beginning" of the tenancy.

Obviously, applications need to be processed, and unless individual board members are willing to perform these tasks, the co-op will need to absorb the cost of hiring someone, such as a managing agent, to process applications.

Late Charges

Many boards have been aggressively enforcing late fee policies as a means of incentivizing timely payment of maintenance. However, the new law limits late fees to $50 or 5% of the monthly maintenance charge, whichever is less. It is unclear from the statutory language whether this is intended to be a one-time only fee or if it can be levied monthly, although it's likely that a monthly late fee that doesn't exceed the statutory limit would be permissible.

Obviously, this limitation does not facilitate timely payment of maintenance. However, boards should continue to assess late fees as permitted by law and we recommend (pending legislative or judicial clarification to the contrary) assessing them monthly. Boards should also more carefully scrutinize purchasers' financials at the time of admission, more aggressively push banks to pick up shareholders' arrears pursuant to the terms of the recognition agreement, and move faster to commence nonpayment proceedings in housing court, which is now the mandatory forum for seeking payment of rent arrears.

Security Deposits

Collection of security deposits, including maintenance escrows, is still permitted. However, the new legislation prohibits collection of "deposits or advances in excess of one month's rent." Thus, the size of any such security deposit is severely limited.

We have strongly endorsed the practice of boards' approving the applications of financially marginal purchasers on condition that they pay at closing a sum of money equal to at least one full year's maintenance into escrow (commonly referred to as a "maintenance escrow") to secure performance of their financial obligations under the proprietary lease. This money was returnable to the purchasing shareholder after a specified period of time during which they demonstrated their ability to meet their financial obligations. However, such an arrangement, to the extent it entails more than one month's rent, appears to constitute a prohibited "deposit" under the statute.

This restriction is particularly regrettable. The maintenance escrow arrangement enabled boards to accommodate countless sellers and purchasers whose applications otherwise would likely have been rejected. Boards will now have no recourse but to either reject applications from financially marginal purchasers or rely on the far more cumbersome and riskier security device of a maintenance guaranty from a third party. Boards may request that a prospective cooperator obtain a line of credit to be drawn down on in the event of a maintenance default, but this would of course be largely dependent on a bank's willingness to extend the line of credit.

We believe (pending legislative or judicial clarification to the contrary) that refundable "damage escrows," separate and distinct from move-in fees, are still permissible. Damage escrows are security for the shareholder's obligation to complete both the move-in and move-out in a damage-free manner, not "deposits or advances" related to the lease. As such, we believe (pending legislative or judicial clarification to the contrary) boards may and should continue to collect refundable damage escrows for move-ins and move-outs.

In the past we have advised co-op boards to provide in their alteration agreements that security deposits and other financial payments collected from the shareholder be deemed "additional rent" under the proprietary lease. However, this characterization arguably makes them prohibited "deposits and advances" within the meaning of the new law. We

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therefore suggest dropping all references to "additional rent" from your alteration agreements.

Landlord-Tenant Procedural Changes

The new law will increase costs and time associated with evicting residential tenants who fail to pay their rent or maintenance, or otherwise breach the terms of the proprietary lease. It places limits on what monies can be collected by a landlord in summary proceedings in landlord-tenant court, and it increases the length and complexity of notice requirements.

Going forward, a judgment of possession may only be obtained for base maintenance (including assessments) in a summary nonpayment proceeding (i.e., expedited court proceeding typically without discovery in landlord-tenant court). Other charges commonly levied by co-op boards, such as late fees, utility charges, cable, repair costs, fees for use of amenities and fees due under an alteration agreement, and attorney's fees, are recoverable only in a separate plenary action (i.e., a full-fledged court proceeding with discovery in either Supreme or civil courts). This is so even if such charges are styled as "additional rent." These changes will make recovery of such incidental charges, which typically entail relatively small amounts of money, far more protracted and expensive. Many boards will be making business decisions to simply write these charges off.

One solution would be to seek non-rent charges in a plenary action. Another solution would be to pursue non-judicial foreclosure actions to collect arrearages where the shareholder does not reside in the apartment. (Such a proceeding is not available against a shareholder residing in the apartment as that would impermissibly preclude any warranty of habitability defense). A third option would be to wait until the shareholder is ready to sell or refinance their apartment and then refuse to issue a "current maintenance letter," thereby forcing the issue and recouping the outstanding incidental charges at closing.

Even when summary proceedings are pursued: a predicate letter is required before a rent demand is issued, the notice periods are longer (for rent demands), the time to answer is longer, and it is much more difficult to compel the payment of maintenance while the case is pending (use and occupancy).

Under the new law, attorney's fees are not recoverable upon a default judgment in a summary proceeding. And, when a tenant does appear in the summary proceeding (prior to the judge's determination) and tenders the full amount of base rent (maintenance) due, the landlord is *required* to accept the payment, discontinue the proceeding, and forfeit its claim to attorney's fees in that proceeding.

Under the new law, when a tenant files a complaint with the landlord there is a rebuttable presumption that any eviction proceeding filed within one year of the complaint is retaliatory in nature (previously, it was 180 days). Since retaliatory motive is a viable defense in any objectionable conduct, or "Pullman," proceeding initiated by a board, this reform could easily complicate Pullman proceedings against legitimately undesirable tenants. Boards and their managing agents must therefore respond to and carefully document responses for each and every tenant complaint to be able to rebut the presumption of retaliatory motive.

Nonpayment proceedings are still permitted against estates, but no warrant of eviction will be issued against individuals who remain in occupancy and claim possessory rights to the apartment at issue. Such a result is extremely problematic since the sale of the unit at auction would not be practical so long as there are remaining occupants.

Finally, unlawful evictions are now deemed criminal, classified as a Class A misdemeanor punishable by imprisonment and a minimum fine of $1,000 per incident.

Conversions

The new law severely crimps conversions to co-op or condo ownership. It eliminates "eviction offering plans," requires that a sponsor have contracts to sell 51% of the units at issue to bona fide tenants before a plan can be declared effective, and mandates — in addition to the tenants' 90-day exclusive right to purchase their apartments after the plan has been declared effective — that tenants be given a six-month right of first refusal if a sponsor is going to sell any occupied apartment in the future. Finally, tenants who elect not to purchase and who qualify as senior citizens or handicapped persons within the meaning of the statute receive preferential rent for as long as they reside in the building.

Please do not hesitate to contact us if you have any questions regarding the sweeping changes this law imposes.

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