Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Making The Most Of New York City Preferential Rent Laws

Law360, New York (February 23, 2016, 12:00 PM ET) --

Nicholas Kamillatos

Are the "preferential rent" rules for rent stabilized apartments settled? The enforceability of discontinuing preferential rents and restoring the legal rent for rent stabilized apartments becomes more important should rent levels temporarily become flat, or even drop in certain neighborhood locations. How do the parties ensure that they both get the benefit of the bargain they make in preferential rent arrangements?

What Happens When Less Than the Maximum Legal Rent is Collected for Rent Stabilized Apartments?

Since first enacted in 1969, the New York City Rent Stabilization Law (RSL) and Code (RSC) have provided for limits on rent increases which can be charged and collected for renewal or vacancy leases. Inasmuch as the rent stabilization system imposes uniform citywide rent increases regardless of local neighborhood market conditions, there has always been the possibility that owners may not be able charge and collect the maximum legal regulated rent for a particular rent stabilized apartment. This could be due to prevailing market conditions or the need to provide concessions in order to convince a tenant to sign a vacancy lease or renew their lease. In those instances where the owner did not charge the maximum legal rent upon a lease renewal or vacancy lease, the New York State Division of Housing and Community Renewal (DHCR)[1] and the courts held that the owner had permanently "waived" the maximum legal rent increase, such that the maximum legal rent was reduced to the amount *actually* charged and collected, rather than the maximum legal rent which *could* have been charged. That reduced legal rent then became binding on future lease renewals. In short, the temporary rent reduction or concession became permanent. Collingwood Estates v. Gribitz, NYLJ. April 24, 1975 at 17, col. 6 (S. Ct. N.Y. Co.) (Fine, J.). This waiver process became known as the "Collingwood Rule."

The effect of the Collingwood Rule could be draconian. The owner could reduce the rent increase as a one-time temporary concession and then, after the concession had burned off and market rents increased, the Collingwood Rule prevented the owner from restoring the higher legal rent which was deemed permanently waived.

Preferential Rents, the Evolution

The Collingwood Rule remained in effect unchanged for over 12 years. During that time owners who collected less than the full legal regulated rent permanently waived the right to collect the legal rent

after granting a one-time and/or "temporary" preference. This draconian result was partly addressed in the 1987 Amendment to the Rent Stabilization Code. The 1987 RSC amendments included newly enacted Code Section 2521.2(b) which stated in pertinent part:

Where the legal regulated rent is established and a rent lower than the legal regulated rent is charged and paid by the tenant *upon vacancy of such tenant*, the legal regulated rent previously established plus the most recent applicable guidelines increase plus such other rent increases as authorized pursuant to Section 2522.4 of this title may be charged a new tenant (emphasis added).

In short, the 1987 RSC amendment modified the Collingwood Rule, such that *on a vacancy lease*, the previously waived higher legal rent could be restored for the next rent stabilized apartment tenant.

RSC Section 2521.2(b) only remedied property owners' Collingwood Rule problem for future tenants after a vacancy. It did not address lease provisions granting a temporary preference to a rent stabilized apartment tenant who remains in possession after the preference expires. That issue was addressed by the courts in Missionary Sisters of the Sacred Heart lll v. DHCR, 283 A.D. 2nd 284 (1st Dept. 2001). In that case, the property owner entered into a lease agreement with a tenant granting a temporary preference which expired on a specific date. The rider executed by the property owner and tenant provided that the preference was the result of market conditions at the time the lease was executed.

In a complaint filed with the DHCR, the tenant contended that the preferential rent was a lease term which was a condition of the tenancy, and therefore, that preference had to be carried forward into all future lease renewals, (as generally required by the RSL and RSC). The property owner contended that the preferential rent applied only to the term of that one lease, and that it was not a term or condition of the tenancy which had to be renewed. DHCR granted the tenant's complaint, and the Supreme Court, New York County, affirmed DHCR's determination. The Appellate Division reversed the Supreme Court, and annulled the DHCR's order. The Appellate Division ruled that RSC §2521.2(b) was not controlling in the case, instead the issue was the enforceability of the temporary preferential rent rider between the owner and tenant. The controlling authority which answered that issue was Century Operating Corp. v. Popolizio, 60 N.Y.2d 483 (1983), where the court considered the context of a preferential rent rider and its effect on future lease renewals.

In Century Operating, the Court of Appeals held that the terms of a lease rider between owner and tenant would control the issue of whether a preference or concession is carried forward into future rent stabilized lease renewals. The court concluded in Century Operating that the two month rent concession given to an initial tenant was not intended by the parties to carry forward into lease renewals, and therefore renewal leases would be based on the full legal regulated rent, not the reduced level of the one-time concession. The Court of Appeals interpreted the language of the concession rider under the circumstances of the tenant moving into a building which was basically still under construction.

Applying the rationale of Century Operating to the preferential rider in Missionary Sisters, the Appellate Division concluded that the parties agreed to a temporary preference which would not apply to future lease renewals, because the future market conditions would determine whether the preference would continue. The Appellate Division concluded that the factual basis for the original preference was no longer in effect, and therefore the preference expired by its own terms and would not be carried forward into lease renewals.

In June, 2003, the state Legislature effectively codified the Missionary Sisters decision by enacting Chapter 82 laws of 2003,[2] which amended the RSL Statute as follows:

Where the amount of rent charged to and paid by the tenant is less than the legal regulated rent for the housing accommodation, the amount of rent for such housing accommodation which may be charged upon renewal or upon vacancy thereof may *at the option of the owner, be based on such previously established legal regulated rent*, as adjusted by the most recent applicable guidelines increases and any other increases authorized by law (emphasis added).

By this statutory codification, the Legislature recognized that property owners can discontinue a temporary preference in a future lease renewal at the owner's sole option. The statutory law was now clear and unambiguous; preferential rents could be discontinued at the owner's option at the end of the lease to which the preference applied. That ought to have ended all litigation over this issue, but did it?

The Current State of the Law and Preferential Rent Rules

The 2003 amendment to the RSL explicitly provides that preferential rent agreements can be temporary and the owner can discontinue the preferential rent at the end of the lease for which the preference was agreed to so long as there was a written lease provision to that effect. Coupled with the RSC then in effect, registering the preferential rent as well as the higher reserved legal rent seemed to end all debate as to the enforceability of temporary preferential rents and the ability to reset the rent to the higher reserved legal rent at the end of the preference. The courts, however, disagreed. In various opinions, the courts ruled that the preference would continue throughout the tenancy if the language of the preferential rent riders was not explicit as to the expiration of the preference. In 448 West 54th Street Corp. v. Doig-Marx, 5 Misc.3d 405, 784 N.Y.S.2d 292 (N.Y.C. Civ. Ct., N.Y. Co. 2004), Colonnade Management LLC v. Warner, 11 Misc.3d 52, 812 N.Y.S.2d 209 (App. T. 1st Dep't 2006), Matter of Pastreich v. New York State Division of Housing and Community Renewal, N.Y.L.J., April 14, 2008, at 33, col. 4 (App. Div., 1st Dep't), Von Rosenvinge v. Wellington Fee LLC, N.Y.L.J., April 21, 2008, at 19, col. 1 (Sup. Ct. N.Y. Co.). Failure to specify that the preference was only in effect during the term of the vacancy or renewal lease to which it applied, exposed property owners to the risk that the preference would continue as a term and condition of a rent stabilized apartment tenancy.

The January 2014 amendment to the RSC then further complicated matters. RSC §2521.2(b) was again amended by DHCR to provide as follows:

b) Such legal regulated rent as well as preferential rent shall be rent set forth in the vacancy lease or renewal lease pursuant to which the preferential rent is charged.

c) Where the amount of the legal regulated rent is set forth either in a vacancy lease or renewal lease where a preferential rent is charged, the owner shall be required to maintain, and submit where required to by DHCR, the rent history of the housing accommodation immediately preceding such preferential rent to the present which may be prior to the four-year period preceding the filing of the complaint.

Prior to this amendment, setting forth the preferential rent and legal rent in a written lease provision and reserving the higher legal rent coupled with the annual registration of that information on DHCR's database, was deemed to conclusively reserve the legal rent, and the owner's right to terminate the preference at the end of the affected lease term. The January 2014 amendment instead mandates that property owners maintain rent histories of the preferential rent information dating back to the term of the lease *prior to* the preference being first granted, regardless of the standard "four year" look back rule. DHCR claims that requiring owners to maintain and produce such apartment rental histories dating back more than four years, is required by judicial determinations. While the statutory law remains

arguably settled, the practical application of preferential rents is now as complicated as ever, if not more so.

As required by the RSC §2521.2(c), rent stabilized apartment property owners now must maintain all preferential rent information no matter how long the preference is provided, in order to withdraw the preference and restore the rent to the reserved higher legal regulated rent. However, DHCR has no authority to overrule the Appellate Division decision in Missionary Sisters or the Court of Appeals ruling in Century Operating, so does that mean that the preferential rent lease rider requirements of those decisions still apply as requirements beyond the current explicit terms of the RSL/RSC? If so, does that mean complying with the explicit requirements of the RSL and RSC §2521.2(c) alone is not a safe harbor to insure the ability to impose the higher legal rent when a preference expires? In order to safely reserve the higher legal regulated rent and utilize that higher rent for future lease renewals or vacancy leases, current best practice mandates that property owners should:

- Specify the reason for the preference in a form of written lease rider and specifically provide in that rider that the preference is temporary and shall only apply to the term of that vacancy or renewal lease;

- In accordance with DHCR instructions, annually register the preference and the higher reserved legal regulated rent on the DHCR rent registration database;

- Retain indefinitely all lease records relating to the preference and the lease in effect prior to the preference.

Current market conditions also make property owner lease drafting and documentation more important than ever. Market trends indicate in many neighborhood rents could be flat or declining for a period of time. Concessions for vacancy leases are already increasing. (See, the following report from Miller Samuel Inc.). During this period of flat rents and/or increased concessions, property owners will be providing temporary preferences to maintain occupancy levels. Failing to properly draft and document preferential rent agreements could result in a permanent reduction of legal rents based on recent court decisions and the January 2014 amendment to the RSC. Prudent property owners will take steps to insure that their preferential rent riders are properly drafted and their rent records are sufficiently maintained to prevail in nonpayment cases in which they seek rent, and defend against tenant claims of rent overcharge.

—By Nicholas Kamillatos, Rosenberg & Estis PC

Nicholas Kamillatos is a member of New York real estate law firm Rosenberg & Estis.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] Its predecessor agency was known as the Conciliation and Appeals Board.

[2] The preferential rent rules, both codified and case law discussed in this article do not apply to situations such as the initial lease for a 421-a apartment or the initial lease for a newly created apartment in a rent stabilized building.