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Fair-Market Tenants and Condominium Conversions

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A recent newspaper article reports that between 2009 and 2012, a total of 117 rental buildings in Manhattan and Brooklyn were converted to cooperative or condominium ownership.[1] Many of the units contained therein were deregulated. This article explores what rights tenants of these units have vis-à-vis rent-regulated tenants when a building is being converted, if and how fair-market tenants can obtain benefits similar to those enjoyed by rent-regulated tenants upon a conversion, and the effect of leasing units at fair-market rents both before and after a conversion.

The Statutory Scheme

The Martin Act[2] governs the conversion of rental buildings to cooperative or condominium ownership. Substantively, the statute allows for an "eviction plan" to be declared effective if 51 percent of the tenants enter into agreements to purchase their units.[3] However, the much more common practice now is for sponsors to offer a non-eviction plan which may be declared after sponsors enter into contracts for at least 15% of the units in the building with either bona fide tenants in occupancy or purchasers who represent that either they or members of their immediate family will occupy the apartment when it becomes vacant.[4] Once the plan is declared effective, the sponsor can file a declaration and the condominium is officially created. The sponsor will then close on sales of the units to individual purchasers.

Under the Martin Act, rent-stabilized and rent-controlled tenants who chose not to purchase their units are entitled to the status of "non-purchasing tenants" and essentially go on as before except, if the apartment is purchased by an investor, with a different landlord. As the statute provides, "[n]o eviction [can] be commenced at any time against non-purchasing tenant for failure to purchase or any other reason applicable to the expiration of the tenancy…"[5] Moreover, rentals for such non-purchasing tenants "shall not be subject to unconscionable increases beyond ordinary rentals for comparable apartments during the period of their occupancy."[6] Stated somewhat differently, the regulated tenants may elect to retain their protected rent-stabilized and rent-controlled status under GBL §352-eeee(2)(c)(iii). However, fair-market tenants, who enter into lease agreements with the landlord/sponsor suffer a different fate.

'MH Residential 1'

The Martin Act defines a non-purchasing tenant as "[a] person who has not purchased under the plan and who is a tenant entitled to possession at the time the plan is declared effective or a person to whom a dwelling unit is rented subsequent to the effect date."[7]

The question arises: Since fair-market tenants lack the right to automatic renewals of their leases, can they ever be considered to be non-purchasing tenants subject to the same rights and protections as their regulated brethren? In the First Department, covering Manhattan and the Bronx, the answer likely appears to be "no."

In *MH Residential 1 v. Barrett,*[8] the First Department found that where the lease of a fair-market tenant expires prior to the time the attorney general accepts the sponsor's offering plan for filing, the tenant cannot be considered a non-purchasing tenant and therefore is not entitled to remain in the apartment.

The Appellate Division ruling culminated the first phase of a long and drawn out litigation where the sponsor had brought holdover proceedings against more than 20 fair-market tenants whose leases expired before the sponsor's offering plan was accepted for filing. The tenants claimed that because they were "tenants in occupancy," they were protected under the Martin Act. The Civil Court initially found in the tenants' favor. However, the Appellate Term, First Department reversed and granted the possessory judgments to the sponsor."[9]

Although the Martin Act does not define the term "tenant in occupancy," the Appellate Term, relying on *De Kovessey v. Coronet Props,*[10] found that the fair-market tenants were not "tenants in occupancy" because they lacked a "landlord-tenant relationship" with the sponsor due to fact that their leases expired prior to the time the offering plan was accepted for filing by the attorney general.[11]

On appeal to the Appellate Division, the tenants argued that a landlord-tenant relationship with the sponsor did indeed exist because, under the Real Property Actions and Proceedings Law,[12] a tenancy does not formally terminate until a warrant of eviction is issued by the court. Thus, the tenants claimed, because warrants had not been issued, they remained as tenants in occupancy on the date the plan was accepted for filing, and were therefore entitled to receive renewal leases at not unconscionable rents.

Justice David Saxe, writing for the Appellate Division, affirmed the ruling of the Appellate Term "although for reasons somewhat different" from that court.[13] According to Saxe, the inquiry should not have been whether a "landlord-tenant" relationship existed when the offering plan was accepted for filing, but rather whether the fair-market tenants satisfied the definition of a "non-purchasing tenant," namely, one who is entitled to possession at the time the plan is declared effective.[14]

Saxe found that the unregulated tenants' rights were extinguished when their leases expired. Therefore, he continued, "absent some special circumstance, the tenant retains only the minimal protections applicable to the common law tenant at sufferance."[15] However, because the issue of statutory coverage was before the court, it did not have the opportunity to determine whether any fair-market tenant exhibited a special circumstance. The court concluded that the Martin Act "does not bestow, by mere implication, tenancy rights on individuals whose rights have expired with the terms of their leases."[16]

Nonetheless, the Appellate Division found that the fair-market tenants retained the right to prosecute their affirmative defense of retaliatory eviction.[17] Hence, the judgments of possession were vacated and the matters were returned to the Civil Court for trials. This led to several more years of litigation. By the time the matters finally settled, the fair-market tenants had remained in their homes for more than eight years.[18]

At the Housing Court level, it came to light that one tenant was suffering from stage four cancer and another was over 90 years of age and had lived in his

apartment for more than 50 years. Yet, the Housing Court did not find these conditions to constitute the type of "special circumstance" that the Appellate Division previously mentioned.

The Appellate Division in *MH Residential* was not called upon to address the fact situation of whether a unregulated tenant whose lease was in effect at the time the plan was accepted for filing by the attorney general, but then expired prior to the plan being declared effective, could be considered a "non-purchasing tenant." However, applying the reasoning from that case, the answer appears to be "no" since under the literal language of the statute, such fair-market tenant is not "entitled to possession at the time the plan is declared effective."

The Appellate Division Second Department, which covers Brooklyn and Queens together with several other counties, has not been presented with a fact pattern similar to *MH Residential*, rendering it difficult to determine whether that court would adopt the First Department's interpretation of coverage under the Martin Act. However, given the split of opinion between the two departments regarding another aspect of Martin Act coverage, uniformity may well be absent here as well.

An odd feature of the Martin Act is that while the unregulated tenants cannot obtain statutory protection during the conversion process, they may, depending on the jurisdiction where the building is converted, obtain protection post conversion.

Post-Conversion Rentals

A non-purchasing tenant may also be a person "to whom a dwelling unit is rented subsequent to the effective date." But do these words really mean what they say? The First Department says "no."

First Department View. In *Park West Village Assoc. v. Chiyoko Nishoika*,[19] a sponsor entered into a fair-market lease with a tenant five years after the building had been converted to condominium ownership. Upon expiration of the lease, the sponsor brought a holdover proceeding against the tenant seeking to recover possession of the unit. The tenant defended the sponsor's proceeding on the basis that she qualified as a non-purchasing tenant entitled to a renewal lease because she was a "person to whom a dwelling unit [was] rented subsequent to the effective date."

As the Appellate Term explained, "[t]enant argues, in effect, that the definitional language is broad enough to extend statutory eviction protection in perpetuity to all tenants who lease apartments in converted condominium buildings, even those tenants whose possessory interest is created years after completion of the conversion process."[20]

The court rejected that view, writing:

> Considering the harm sought to be avoided by the Legislature—the imminent eviction of tenants in possession during the conversion process—the statutory language conferring non-purchasing tenant status on person to whom a dwelling unit is rented subsequent to the effective date. (General Business Law §352-eeee (1)(c)) reasonably can be read to include only persons who lease a converted unit between the effective date of the offering plan and the closing date of the ownership conversion.[21]

The Appellate Term did not explain what it considered to be the "closing date of the ownership conversion" and this appears to be an error in language because a condominium is created when the sponsor has filed the declaration. Nonetheless, it appears that the court believed that a fair-market tenant could obtain protected status of automatic renewals at not unconscionable rents only by leasing the unit between the date the plan was declared effective and before the declaration creating the condominium was filed. This is consistent with the court's conclusion in the case that: "[i]t is difficult to understand why GBL §352-eeee, a statute designed to regulate conversions, should be twisted to afford post conversion tenants, strangers to the conversion transaction, a windfall at the expense of the seller and purchaser principals."[22]

Second Department View. The Appellate Term, Second Department has taken the opposite approach to post-conversion sponsor rentals. In *Geiser v. Maran*,[23] a case involving a cooperative rather than condominium conversion, the court held that the "process of conversion" does not end when title to the building is transferred to the cooperative corporation but rather when all the unsold shares held by the sponsor are sold to bona fide purchasers. *Geiser* followed the principle, first laid down by that court in *Paikoff v. Harris,* [24] that tenants who entered leases with sponsors after the effective date of the plan would be free from eviction and entitled to continued leases at comparable rents.

In *Paikoff*, the sponsor leased an apartment to fair-market tenants subsequent to conversion of a building. Upon the expiration of the lease, a renewal was offered at a much higher rent. When the tenants rejected the offer, the sponsor brought a holdover proceeding to recover possession. Tenants claimed protection by the Martin Act as non-purchasing tenants because they rented after the effective date of the plan. The Appellate Term agreed with the tenants. The court's rationale placed its focus on the initial economic choice the sponsor made rather than when the lease was entered into. Ruling that "there can be no valid distinction between tenants in possession at the time of conversion and those who rent from sponsors after the conversion,"[25] the court explained:

> If a sponsor chooses to rent an apartment after the conversion rather than to sell it, this will ordinarily be because market conditions favor a rental over a sale. When these conditions change, the sponsor will again find it advantageous to discontinue renting. If it was the Legislature's intent to protect tenants from dislocation caused by the shift in the owner's economic interest, it could only address the problem thoroughly by protecting tenants that rent from sponsors after the conversion as well as those in possession at the time of the conversion.

Paikoff remains good law in the Second Department.[26] However, there are now opposing views from different panel members of that court. In *Arkansas Leasing v. Gabriel*,[27] a justice who sat on the Paikoff panel, issued a dissent whereby she would now adopt the First Department reasoning set forth in *Parkwest Village* opining that "the Legislature never intended to protect tenants entering into post conversion leases."[28] Most recently, in *MMB Apts v. Guerra*,[29] an appeal decided in 2014, another Appellate Term justice, relying on the dissent in *Arkansas Leasing*, opined that a re-examination of *Paikoff* was warranted.[30]

Non-Purchasing Tenant

What rights does a fair-market tenant that hits the sweet spot and obtains non-purchasing tenant status possess? Foremost, such a tenant has the right to renew the lease since a sponsor who converts pursuant to a non-eviction plan is permanently barred from evicting the tenant based upon the expiration of the tenancy. The term would be negotiated between the parties.

The tenant is also protected from being forced to enter into a lease that offers an "unconscionable rent increase." Whether a rent is unconscionable is not measured by the size of the increase from one lease to another, but whether the proposed rent comports with what is being charged for comparable apartments. As the Appellate Term stated, "[t]he purpose of the statute was not to institute a system of rent regulation for "non-purchasing tenants but to prevent sponsors from charging these tenants above market rents as a means of forcing them out.

Conclusion

Although the protections thereof for fair-market tenants during and after the conversion of a rental building to condominium ownership is not the most settled area of the law, some rules emerge from the cases:

- Fair-market tenants whose leases expire before a condominium conversion plan is declared effective, are not protected from eviction and cannot claim the right to a renewal lease at a non-unconscionable rent.

- In order for the plan to be declared effective, there must be executed contracts for at least 15% of the units in the building from either bona fide tenants in occupancy or purchasers who represent that either they or members of their immediate family will occupy the apartment when it becomes vacant.

- For tenants who enter into fair-market leases after the plan is declared effective, far greater

protection exists, at least for the present time, in the Second Department when the tenant will be safe from eviction and entitled to a renewal lease at a price comparable to similar apartments. In the First Department, there is still an ill-defined window of protection.

Of course, these rules are also subject to change by statute or, more likely, by case law. At present, the Second Department appears to be a more fertile ground for effecting a change in the rights, or lack thereof, accorded to fair-market tenants during and after the conversion process.

ENDNOTES:

1. E.B. Solomont, "Conversions See New Urgency in Hot Sales Market," The Real Deal, (November 2014), http://therealdeal.com/blog/2014/11/11/conversions-see-new-urgency-in-hot-sales-market/.
2. N.Y. Gen. Bus. Law, Art. 23-A, §§352-359-h (McKinney).
3. N.Y. Gen. Bus. Law, Art. 23-A, §352-eeee (1)(c) (McKinney).
4. N.Y. Gen. Bus. Law, Art. 23-A, §352-eeee (1)(b) (McKinney).
5. N.Y. Gen. Bus. Law, Art. 23-A, §352-eeee (2)(c)(ii) (McKinneys).
6. N.Y. Gen. Bus. Law, Art. 23-A, §352-eeee (2)(c)(iv) (McKinneys).
7. N.Y. Gen. Bus. Law, Art. 23-A, §352-eeee (1)(e) (McKinneys).
8. MH Residential 1 v. Barrett, 78 A.D.3d 99 (1st Dept. 2010).
9. MH Residential 1 v. Barrett, 22 Misc.3d 25 (1st Dept. 2008).
10. De Kovessey v. Coronet Props, 69 N.Y.2d 448 (1987).
11. MH Residential 1, 22 Misc.3d at 27.
12. N.Y. Real Prop. Act. & Proc. L. § 749(3) (McKinney 2009).
13. MH Residential 1, 78 A.D.3d at 100.
14. MH Residential 1, LLC, 78 A.D.3d at 102.
15. MH Residential 1, LLC, 78 A.D.3d at 104.
16. Id.
17. Id.
18. Full Disclosure: Adam Leitman Bailey, P.C represented one of the parties through much of the appeal process and during the trials upon remand.
19. Park West Village Assoc. v. Nishoika, 187 Misc.2d 243 (1st Dept. 2000).
20. Park West Village Assoc., 187 Misc.2d at 244.
21. Park West Village Assoc., 187 Misc.2d at 245.
22. Id.
23. Geiser v. Maran, 189 Misc.2d 442 (2d Dept. 2001).
24. Paikoff v. Harris, 185 Misc.2d 372 (2d Dept. 1999).
25. Paikoff v. Harris, 185 Misc.2d at 377.
26. Paikoff v. Harris, 185 Misc.2d at 378.
27. Arkansas Leasing Co. v. Gabriel, 3 Misc.3d 46 (2d Dept. 2004).
28. Arkansas Leasing, 3 Misc.3d at 51.
29. MMB Apts. v. Guerra, 45 Misc.3d 132(A) (2d, 11th, & 13th Jud. Dists. 2014).