NOW & NEXT

Cooperatives & Condominiums Alert

MAY 2, 2023

New York AG cracks down on unit rentals prior to condo conversion

By Erica F. Buckley, Richard Shore, and Julienne Hoffman[1]

Sponsors must be aware that engaging in short-term rentals during an offering plan review may violate a myriad of New York laws.

What's the Impact?

- The NYAG will investigate illegal short-term rentals and violations of rent stabilization laws, as well as Martin Act violations during the conversion of vacant buildings to condominium status.
- Seeking short-term gains could cost you—consult with counsel before providing unit rentals while an offering plan is under review.

Last month, the New York Attorney General's Office (NYAG) announced the settlement of an investigation involving the illegal renting of residential apartments and single rooms to non-purchasing occupants in an alleged vacant building undergoing condominium conversion in New York City. Principals of the condominium sponsor engaged in illegal short-term rentals—the

[1] Julienne Hoffman (Law Clerk—Cooperatives & Condominiums practice) assisted with the preparation of this alert.

tenants paid rent in cash, often rented for less than 30 days, and were not provided written leases—all while representing to the NYAG that the building undergoing condominium conversion was vacant of all residential occupants.

According to the NYAG investigation, principals of the condominium sponsor made several misrepresentations to the NYAG regarding the occupancy status of the building, including the submission of false affidavits stating that the building was unoccupied during the offering plan review process. In addition, the condominium sponsor misrepresented that the building was vacant in their application for 421-a tax benefits to the New York City Department of Housing Preservation and Development (HPD) and failed to comply with the rent stabilization requirements of Real Property Tax Law § 421-a once they began renting apartments prior to consummation of the condominium offering plan.

What was the result?

The condominium sponsor paid a steep price for its conduct, agreeing to pay $420,000 in penalties and disgorgement while also agreeing to provide all current building occupants with rent-stabilized leases.

What's the takeaway?

This is not the first time we had seen NYAG investigate both (a) short-term rentals in vacant condominium conversions (rentals that are 30-days or less are prohibited in New York City under the Multiple Dwelling Law) and (b) false affidavits associated with vacant Part 20 condominium conversions, specifically related to the occupancy status of buildings after the offering plan was submitted to the NYAG, but before the offering plan was accepted for filing.

Sponsors must be on notice that the NYAG will use its broad powers under the Executive Law to investigate illegal short-term rentals and violations of rent stabilization laws and its broad powers under the Martin Act relating to the offer and sale of real estate securities, such as condominiums. While the review of an offering plan is a lengthy process that can take many months, and many sponsors are stuck with carrying costs during that time, renting the apartments is strictly prohibited (with the only exception being the rental of a unit in contract to a prospective purchaser). In a tight housing market where costs are high, sponsors understandably look to find ways to monetize the building in the short term, but if sponsors engage in rentals of units during the time the offering plan is being reviewed by the NYAG, before acceptance, they run the risk of being subject to Martin Act and Executive Law violations.

Developers would be wise to consult with their offering plan counsel—and consider engaging special counsel to advise as well, particularly if the NYAG begins an inquiry or investigation. Nixon Peabody's full-service Cooperatives and Condominium and State Attorneys General teams stand ready to assist clients on these matters to help avoid scrutiny and to get the best results possible once an investigation is commenced.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

Erica F. Buckley
212.940.3733
ebuckley@nixonpeabody.com

Richard J. Shore
212.950.3050
rshore@nixonpeabody.com