

THE ADMINISTRATION OF RENTS UNDER RENT STABILIZATION: THE ROLE OF THE DIVISION OF HOUSING AND COMMUNITY RENEWAL

As discussed in the section dealing with the history of rent stabilization, the State Division of Housing and Community Renewal (“DHCR”), through its Office of Rent Administration (“ORA”), is responsible for administering rent stabilization (along with rent control). The DHCR has three major roles within the rent stabilization system: It has the quasi-legislative role of promulgating the Rent Stabilization Code. It has the executive role of administering the various filing, registration and special rent adjustment provisions of the Code, and in prosecuting those who violate any part of it. And finally, it has the quasi-judicial role of judging the merits of claims brought pursuant to the Code between tenants and owners in accordance with the standards applicable to administrative tribunals. If appealed, such determinations are subject to review by the state courts. What follows is a brief discussion of those areas where the decisions of the DHCR may affect rent levels.

Major Capital Improvements and Individual Apartment Improvements

The introductory paragraphs of a June 1989 report entitled Review of the Major Capital Improvement Program prepared for the DHCR by Ernst & Whinney and Speedwell, Inc., outline the issues and objectives related to this program:

In an attempt to maintain and improve the condition of rent regulated housing in New York, owners who undertake building-wide major capital improvements (MCI's) have historically been allowed increases in base rents over and above annual rent guidelines and MBR rent increases to compensate them for such investments. These increases are allowed without the consent of tenants if the improvements are for “the operation, preservation and maintenance of the structure” and are approved by the Division of Housing and Community Renewal (DHCR). In addition, one-fortieth of the cost of improvements made to individual apartments can be added to the monthly base rent with the tenant's consent or if the apartment is vacant.

The concept of rewarding owners by increasing their internal rate of return has always been controversial, since the increase is basically financed by the tenants who occupy the building and do not have a significant role in approving the improvements. Representatives of tenant interests argue that the potential for MCI increases encourages owners to delay maintenance activity, for which no incentive is provided, in order to qualify for the MCI program and its investment incentives. In addition, increases to base rents

impact tenant affordability. Representatives of owner interests argue that a rent regulated system removes their ability to recapture replacement costs without special consideration, and that the current incentive levels are not sufficient to attract needed improvements (p.1).

Basically, the major capital improvement program allows owners to increase monthly rents by a formula that allocates 1/84th of the cost of the improvements among the units in the building. Rents may not be increased by more than 6% per year (15% for rent controlled units), however, and owners must often wait two or three years before the full 1/84th allocation is fully incorporated into the building's rent structure. Thus, if 1/84th of the cost of a given improvement would ultimately permit a 10% increase in monthly rent, the tenant will receive a 6% MCI rent increase in year one and a second increase equaling 4% of the original rent in year two.¹²⁴ These increases are added separately and apart from increases granted by the Rent Guidelines Board. Once the rents have been increased they remain part of the base rent even after the expiration of the 84-month "amortization" period.¹²⁵ Major capital improvements may also qualify for J-51 tax benefits but a portion of the rent increases must be forgone if these benefits are granted. MCI increases must be approved by the DHCR before they may be collected. Tenants are notified of the MCI application and given an opportunity to object.

Where new appliances or improvements to individual apartments are concerned, 1/40th of the cost is added to the apartment's base rent. The owner is required to obtain permission from the tenant who occupies the unit to qualify for this type of rent increase. If the apartment is vacant, the rent of the subsequent tenant is simply adjusted and no approval is necessary. There is no cap on the annual increase in rent that may be collected as a result of the improvement and the prior approval of DHCR is not required.

Rent increases resulting from major capital improvements and individual apartment improvements received a great deal of attention at the hearings of the Rent Guidelines Board in the late 1980's. Tenants often asserted that guideline adjustments should take into account the returns being realized by owners through these programs. Owners argued that, taken as a whole, they are still under-compensated for their investments. According to the above quoted study, "the estimated rate of return for the sample [of 1003 MCI applications studied], excluding a few J-51 ineligible buildings, was 18.2%"(p.3). This figure is somewhat overstated, however, since the

¹²⁴ The practice of adding an additional increase of 6% (for a total of 12%) to make up for delays in processing MCI applications was stricken by the N.Y. Court of Appeals in *Bryant Ave. Tenant's Association v. Koch* 71, N.Y. 2d 856 (1998).

¹²⁵ This aspect of the MCI program has been upheld by the New York State Court of Appeals (*Ansonia Residents Assn. v. DHCR*, 75 N.Y. 2d 206 (1989)).

“amortization period” was five years or sixty months when the study was conducted. Legislation in 1990 [perhaps in response to the study's findings] extended the amortization time to the current seven-year or 84-month period, thus reducing the allowable rent increase.

Based upon an “analysis of the provisions of the [individual apartment] program” the “annual after tax rate of return ... was estimated to be 33.9% if the improvements were not financed and 68.5% if 60% of the improvements were financed.”(p.3). Despite a DHCR initiative to raise the amortization period (and thus reduce the rate of return) the forty month period for this program remains in effect and was codified in statute with the adoption of the Rent Regulation Reform Act of 1993. Since no prior approval is needed for the individual apartment improvements, no delay in obtaining these increases is incurred.

Hardship Rent Increases

A rent regulation system that required owners to maintain artificially reduced rents in the face of chronic operating losses would be viewed as confiscatory. Nearly every rent regulation system allows for some type of rent adjustment to remedy such situations.

Under rent stabilization in New York City there are two formulas for determining whether a rent increase is appropriate in hardship cases: the **comparative** method and the **alternative** method. Under the comparative method a rent increase may be granted if the owner has not maintained the same average net income in the current three year period as was maintained for the years 1968-70 (marking the beginning of rent stabilization). If records are unavailable, a more recent three-year period may be substituted, under certain conditions.

The hardship application will not be approved unless the owner can demonstrate that:

- the present rate of return on the owner’s equity (fair market value minus the unpaid principal amount of the mortgage indebtedness) is less than 8.5%;
- s/he has owned the building for at least three years;
- no previous hardship application has been granted in the past three years;
- real estate taxes and water and sewer charges have been paid or have been lawfully challenged; and
- all services are being maintained and immediately hazardous violations have been corrected or restoration and correction has been made a condition of granting the increase.

In calculating the rate of return the Code establishes six times the rent roll as the fair market value. Operating expenses, an allowance for management services and “actual annual mortgage debt service” are subtracted from gross rents to determine if the remaining balance falls short of 8.5% of the owners equity in the building. If it does, and all other conditions are satisfied, the owner may obtain rent increases equal to the difference between the average annual net income for the three-year base period and the average annual net income for the current period. Rents may be raised no more than 6% in any one-year period, however, and tenants may cancel their leases if they wish to leave and avoid the increases.¹²⁶

Under the **Alternative Hardship** formula established by the Omnibus Housing Act of 1983, owners are permitted to receive a rent increase when the building’s annual operating expenses (including mortgage interest) are greater than 95% of the gross rent. To qualify for a hardship increase the owner must:

- have owned the property for at least three years;
- have at least a 5% equity position;
- not have received a hardship increase within the previous three years;
- have paid or have lawfully challenged real estate taxes and water and sewer charges; and
- have maintained all services and corrected all immediately hazardous violations or restoration and correction has been made a condition of granting the increase.

Like comparative hardship, rents may be increased no more than 6% per year until the hardship has been remedied and the tenant may avoid the increase by canceling the lease.¹²⁷

According to a 1989 report on hardship increases prepared by the Policy and Research Bureau of DHCR, “from 1984-1988 inclusive, 128 alternative hardship applications were reviewed. Of these, 92 were denied, 1 was approved, 33 were pending and 2 were withdrawn.” Eleven comparative hardship applications were reviewed. Ten were reported as “denied for being incomplete” and one was pending. The report went on to suggest some of the most likely reasons for the limited number of applications and the extremely low approval rate:

- “Owners are not losing money”.
- Because of tenant affordability problems “owners...are not interested in a complicated filing for a rent increase they cannot collect”.

¹²⁶ See RSC §2522.4(b) and RSL 26-511(c)(6).

¹²⁷ See RSC §2522.4(c) and RSL 26-511(c)(6-a).

- “The hardship application suffers from ‘bad press’”.
- Many small owners cannot afford the services of an accountant, may not keep good records and may “face language barriers and other handicaps in dealing with the rent regulation structure”.
- “The hardship application process is too complex”.
- Economic conditions including length of ownership, mortgage costs and purchase price have operated to help limit the prevalence of true hardship cases. Yet, “the current low level of applications received, may change radically with the slowdown of New York City’s economic expansion.”

The approval rate of hardship applications has increased little and the number of applications received annually remains very low. In recent years about two dozen such applications have been filed each year. This is an area of consistent concern to the RGB and the focus of possible legislative reform by DHCR. The return guaranteed by the hardship program was the subject of an unsuccessful constitutional challenge in the U.S. 2d Circuit Court of Appeals.¹²⁸

Fair Market Rent Appeals: (Apartments moving from Rent Control to Rent Stabilization)

As noted in the section concerning the history of rent regulation, most apartments under rent control will become rent stabilized upon vacancy. Over 700,000 formerly rent controlled units have fallen under rent stabilization this way, although only a small fraction of newly stabilized tenants will challenge their rents. Because the relationship of rents in rent controlled units to prevailing market rents varies dramatically from unit to unit, a standard increase upon becoming rent stabilized would result in stabilized rents which themselves are erratic and inconsistent in their relationship to market rents. To avoid this the authors of the ETPA wanted to provide a large degree of flexibility in the setting of rents when rent controlled units become stabilized. They did not, however, want to deprive tenants in newly stabilized units of an opportunity to protest rents that bear no reasonable relationship to a “fair” market amount. Consequently, a system was adopted which allows tenants to challenge newly stabilized rents in formerly rent controlled units through what is known as a “Fair Market Rent Appeal”.

This process begins with the vacancy of a rent controlled tenant. Recall that rent controlled units may be found in any building constructed prior to February 1, 1947, with three or more legal units and occupied by the same tenant since June 30, 1971 or occupied by the tenant’s lawful successor (a spouse, adult lifetime partner or other family member). Rent controlled units that are in 3, 4 or 5 unit buildings do not

¹²⁸ See case #16, supra at 43-44.

become stabilized upon vacancy and, consequently, no process for appealing rent levels is available. If the vacated apartment is in a building with 6 or more units, although stabilized, the owner is initially free to advertise the apartment for any amount. The owner must, however, notify any new tenant of his/her right to challenge the rent within 90 days by providing the tenant with an “Initial Legal Regulated Rent Notice”. If the tenant decides to challenge the rent, the tenant “need only allege that [the Initial Legal Regulated Rent] is in excess of the fair market rent and ... present such facts which, to the best of his or her information and belief, support such allegation”.¹²⁹

Once the appeal is filed, two methods are employed in attempting to determine if the new rent is legally “fair”. The DHCR will look to a special guideline promulgated by the Rent Guidelines Board [more will be said about how this guideline is established on pages 87-89]. Until 1988 this special guideline took the form of a percentage increase above the pre-existing Maximum Base Rent for the unit. From 1988 through 1990 the Board experimented with alternative formulas above the Maximum Collectible Rent or “MCR” [See page 28 for the distinction between MCR & MBR]. Returning to the original approach, in 1991 and 1992 the special guideline consisted of a fixed rate of 15% above the MBR. In an attempt to close the gap between rents in pre-47 stabilized units and rents in recently decontrolled units, in 1993 the Board moved to a straight 40% increase above the MCR.

In later years the Board added a minimum increase above both the MBR and the MCR. Thus, in 1995 the special guideline consisted of the greater of 35% above the MBR or 45% above the MCR. In 1996 and 1997 the numbers were 40% and 50% respectively. In 1998 the Board increased the special guideline to the greater of 80% above the MBR or a minimum of \$650. In 1999, 2000, and 2001 the Board adopted a complex special guideline consisting of the greater of 150% above the MBR plus the fuel cost adjustment, or the Fair Market Rent for existing housing established by the U.S. Department of Housing and Urban Development. Beginning in 2002, this was lowered to 50% above the MBR or the HUD Fair Market Rent, and the fuel cost adjustment was eliminated.

The DHCR will also consider “rents generally prevailing in the same area for substantially similar housing accommodations”. This is known as the “comparability” standard. The owner may submit evidence of rents for comparable units rented to tenants up to four years prior to or one year subsequent to the commencement of the complaining tenant’s initial lease. Leases ending more than one year prior to the commencement of the complaining tenant’s lease are updated by guideline amounts. Alternatively, “[a]t the

¹²⁹ See RSL §26-513(b), included in Appendix O.

owner's option, market rents in effect for other comparable housing accommodations on the date the tenant filing the appeal took occupancy" may be considered.¹³⁰

The Office of Rent Administration will average the rent adjusted pursuant to the Special Guideline with any qualified comparable rents in reaching a final rent determination in a Fair Market Rent Appeal. Thus, the comparability standard does not operate in a manner that is wholly independent of the Special Guideline. Notably, unlike other rent overcharges, rents paid in excess of the Fair Market Rent determined by the DHCR are not subject to treble damages.

It is critical to note that if the newly established legal rent exceeds \$2,000 upon vacancy the apartment can become deregulated in accordance with the Rent Law of 2003. However, the owner is not required to charge the new tenant a rent that exceeds \$2000.

Overcharge Proceedings

The Rent Stabilization Code clearly prohibits charging rent in excess of the legal regulated rent and this includes a prohibition against demanding "key money" or any other special charge not specifically authorized by the Code.¹³¹ The amount of the security deposit and the distribution of interest from such deposits is also regulated by the Code.¹³² Willful rent overcharges may result in a penalty to be paid to the tenant equal to three times the overcharge. Treble damages for willful overcharge claims may be collected for only two years of the overcharge. An overcharge which the owner demonstrates not to have been willful will result in a straight repayment of the overcharge to the tenant plus interest. Damages for non-willful overcharge claims may be had for up to four years prior to filing the overcharge claim.¹³³ Both the Rent Stabilization Code and Section 213-a of the State's Civil Practice Law and Rules prohibit consideration of evidence of a rent overcharge occurring more than four years prior to the filing of the complaint. It is important to note that certain courts (most notably the Housing part of the Civil Court of the City of New York) have concurrent jurisdiction with the DHCR over rent overcharge claims.

¹³⁰ RSC 2522.3(e)(2).

¹³¹ See RSC §2525.1 et seq.

¹³² See RSC §2525.4; see also General Obligations Law, Article 7 - The security deposit laws are enforced by the State Attorney General's Office.

¹³³ See generally RSC §2526.1.

Other Adjustments in Rent: air conditioners, failure to maintain services, failure to register

Air Conditioners

In buildings where the owner provides electricity to individual tenants as part of the services covered by the base rent [approximately 10% of stabilized units], the owner may add a special separate charge for air conditioner usage when a new air conditioner is installed. If the air conditioner is installed by the tenant the owner may charge the monthly amount permitted by the DHCR in accordance with its most recent operational bulletin update on air conditioner rates. (See DHCR's twenty-fifth annual update of section B of supplement No. 1 to operational bulletin 84-4. For the period from 10/1/10 through 9/30/11 - permitting a \$26.83 per month charge per air conditioner if electricity costs are included in the rent). If installed by the owner with the tenant's permission, the same amount may be collected and, in addition, the owner may collect 1/40th of the cost of the air conditioner as permitted by §2522.4(a)(1) of the Code.

Failure to Maintain Services

As noted in the discussion concerning habitability (*supra*, at pages 64-66), failure to maintain the services required under §2520.6(r) of the Rent Stabilization Code could result in a rent reduction equal to the last guideline increase. The DHCR is responsible for reviewing these applications.¹³⁴ Most of the services covered are protected by the warranty of habitability, however, and it is often the case that tenants will resolve service complaints in a housing court proceeding - most typically in response to an owner's action for non-payment of rent. Notably, new amendments to the Rent Stabilization Code have classified a number of service reductions as "de minimus" and therefore not substantial enough to result in a DHCR ordered rent reduction (RSC 2523.4(e)).

Appliance Surcharges (Dishwasher, Washing Machine, Dryer)

Effective with Operational Bulletin 2005-1, in March of 2005, the DHCR began allowing landlords to charge a surcharge to tenants with tenant-installed dishwashers, washing machines, and dryers. While landlords are not required to allow tenants to install their own dishwashers, washing machines, or dryers, where the landlord does consent the surcharge compensates the landlord for the extra water and electricity used by such appliances. Rates differ based on whether electricity is or is not included in the rent of the apartment. For washing machines, in electrical exclusion buildings the monthly surcharge is \$16.82 per month, and is \$18.60 for electrical inclusion buildings.

¹³⁴ See RSC §2523.4

For dryers, the rates are \$0.00 per month for exclusion buildings and \$15.00 for inclusion buildings (\$8.68 for gas powered dryers in electrical inclusion buildings). For dishwashers the rates are \$4.74 and \$7.12 respectively. The surcharge is not part of the permanent rent and can be reviewed annually by DHCR.

Failure to Register

The Rent Stabilization Code requires owners to register all rent stabilized units.¹³⁵ Failure to register will bar an owner from collecting any rent increase for the period during which the apartment was required to be registered but was not. Once a late registration is properly filed the owner may collect these increases on a prospective basis only. Thus, the tenant is not obligated to pay any rent increase until the unit is properly registered and the owner may not recoup his/her losses by registering late. The Rent Regulation Reform Act of 1993 added that if rents collected on unregistered units “were lawful except for the failure to file a timely registration, the owner, upon the service and filing of a late registration, shall not be found to have collected an overcharge at any time prior to the filing of a late registration. If such late registration is filed subsequent to the filing of an overcharge complaint, the owner shall be assessed a late filing surcharge for each late registration in an amount equal to fifty percent of the timely rent registration fee.”¹³⁶

High Rent Vacancy Deregulation

Apartments where the legal rent is \$2,000 per month or more *after the tenant vacates the unit* may no longer subject to rent regulation. Vacancy deregulation of high rent units has been in effect since July 7, 1993 under the provisions of the 1993 Rent Regulation Reform Act. Notably, a stabilized rent can exceed \$2,000 per month and remain stabilized if the same primary tenant remains in the apartment and renews his or her lease, and they are not otherwise subject to high income deregulation.

High Income Deregulation

If the legal regulated rent for an apartment exceeds \$2,000 per month and the total household income for two consecutive years exceeds \$175,000 per year, the apartment is subject to statutory decontrol. Confirmation of income is a process that involves the filing of an income statement with the DHCR if the owner makes a proper demand. If the tenant fails to respond in a timely fashion, the unit is subject to destabilization by default. If an income certification is received, the DHCR will check it against the records of the State Department of Taxation and Finance. If such a check confirms an income greater than \$175,000 a destabilization order will issue.

¹³⁵ See RSC §2528.

¹³⁶ Rent Stabilization Law §26-517(e).