THE THEFT OF AFFORDABLE HOUSING:

HOW RENT-STABILIZED APARTMENTS ARE DISAPPEARING FROM FRAUDULENT INDIVIDUAL APARTMENT IMPROVEMENTS AND WHAT CAN BE DONE TO SAVE THEM

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I.
INTRODUCTION

Long before modern rent laws were enacted in New York City the rental market was "governed by the law of short supply and great demand."[1] The consequences of this market failure led to great human suffering and social unrest. In response, the government attempted to ameliorate the harsh consequences of an overheated rental market with evolving forms of rent regulation. Rent stabilization is currently the main form of rent regulation allowing the middle- and working-class the ability to afford to live in New York City by prohibiting unjustified evictions and ensuring limits on rent hikes. These tenants have protection against substantial rent increases and security in knowing they cannot be evicted for arbitrary reasons. As of 2013, forty-six percent of New York City renters, or 961,000 households, lived in rent-stabilized housing.[2] While this number may seem large, it is a significant decrease from the nearly sixty-three percent of rental units that were subject to rent regulation in 1981.[3] This loss in affordable housing threatens to further increase homelessness and eliminate the diversity that makes New York City a vibrant place to live and work.

One of the greatest challenges facing the future of rent stabilization is the illegal theft of affordable housing through fraudulent individual apartment improvements ("IAI"). IAI are an exception to the limits on rent increases imposed by rent stabilization. IAI were originally meant to promote building renovations by allowing landlords to recoup investments made to improve properties. However, due to a lack of government supervision, IAI are frequently exploited by property owners. In a recent audit, City Comptroller Scott Stringer found that "fraudulent activity may have expedited the loss of an untold number of rent-stabilized units from the City's regulatory system."[4] The loss of this untold number of units has far-reaching effects on the City's tenants who are increasingly marginalized by unaffordable rents and an unavailing legislature. The goal of this article is to explain how the present system of rent stabilization occurred in the context of struggle between millions of middle and working class

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1. Stephen Dobkin, *Confiscating Reality: The Illusion of Controls in the Big Apple*, 54 BROOK. L. REV. 1249, 1260 (1989).

2. MOON WHA LEE, N.Y.C. DEP'T OF HOUS. PRES. & DEV., HOUSING NEW YORK CITY 2011 at 3 (Nov. 2013), http://www1.nyc.gov/assets/hpd/downloads/pdf/hvs/HVS-report-2011.pdf.

3. FURMAN CTR. FOR REAL EST. & URB. POL'Y, RENT STABILIZATION IN NEW YORK CITY 2 (Apr. 2012), http://furmancenter.org/files/publications/HVS_Rent_Stabilization_fact_sheet_FINAL_4.pdf.

4. SCOTT M. STRINGER, OFFICE OF THE COMPTROLLER OF N.Y.C., THE GROWING GAP: NEW YORK CITY'S HOUSING AFFORDABILITY CHALLENGE 27 (Apr. 2014), http://comptroller.nyc.gov/wp-content/uploads/documents/Growing_Gap.pdf.

tenants and the wealthy real estate lobby, how that struggle has led to an affordable housing crisis, and what can be done to create a more equitable city. Part II provides historical background, describing the evolution of New York City rent regulation from 1920 through today and explaining how these laws became so unnecessarily complex. Part III examines how courts have reconciled conflicting messages from the legislature in their handling of rent overcharges, focusing on cases of unsupervised IAI fraud. Finally, Part IV recommends several legal and policy changes that would increase transparency for all parties, provide greater clarity in the law, and prevent the theft of affordable housing.

II.
A BRIEF HISTORY OF RENT REGULATION IN NEW YORK CITY

A. Rent Control

The patchwork of rent laws in New York City "has created an impenetrable thicket, confusing not only to laymen but to lawyers."[5] Rent control in its most basic form limits the rent an owner may charge for an apartment and restricts the right of any owner to evict tenants.[6] Beginning in 1920, New York City briefly implemented rent control. In 1929, however, rent control ended due to a building boom.[7] In 1942, President Franklin Delano Roosevelt implemented rent control under the Emergency Price Control Act through the federal Office of Price Administration.[8] After the Office of Price Administration was disbanded, rent control continued under the federal Housing and Rent Act, which regulated housing completed or converted to residential use on or before February 1, 1947.[9] The purpose of this Act was to combat a severe post-World War II housing shortage caused by the return of soldiers and wartime rationing of building materials that had limited construction during the war.[10]

After the war, the federal government withdrew from rent regulation. The State of New York, however, continued to suffer from a housing shortage. The New York legislature enacted the Emergency Housing Rent Control Law, administering rent control beginning in 1947.[11] The state rent control program began with approximately 2,500,000 rental units. As the housing shortage

5. 89 Christopher Inc. v. Joy, 318 N.E.2d 776, 780 (N.Y. 1974).

6. N.Y. STATE DIV. OF HOUS. & CMTY. RENEWAL, FACT SHEET #1: RENT STABILIZATION AND RENT CONTROL (May 2008), http://www.nyshcr.org/Rent/FactSheets/orafac1.pdf.

7. JOSEPH A. SPENCER, NEW YORK CITY TENANT ORGANIZATIONS AND THE POST-WORLD WAR I HOUSING CRISIS, *in* THE TENANT MOVEMENT IN NEW YORK CITY, 1904–84, 89 (Ronald Lawson ed., 1986), http://www.tenant.net/Community/history/hist-toc.html.

8. 50 U.S.C. §§ 901–05 (Supp. II 1942).

9. 50 U.S.C. § 1892(c)(3) (Supp. I 1948).

10. Woods v. Cloyd W. Miller Co., 333 U.S. 138, 142–43 n.6 (1948) (quoting H.R. REP. NO. 80-317, at 1, 2, 3, 10–11 (1947)).

11. City of New York v. Div. of Hous. and Cmty. Renewal, 765 N.E.2d 829, 830 (N.Y. 2001).

became less severe, the state passed limited decontrol measures that reduced the number of regulated units to 1,800,000 by 1961.[12]

B. Rent Stabilization

Implementing decontrol measures was the government's attempt to be governed "by supply and demand . . . [b]ut by 1968 there was a rapid and radical change in the situation which created a serious housing crisis which the city felt obligated to meet."[13] The expectation that supply and demand would work "proved to be unfounded."[14] The vacancy rate had plummeted to 1.23% and median rents for unregulated apartments increased by 26.5%.[15] Through the Local Emergency Housing Rent Control Act, the state legislature empowered large cities "to prevent exactions of unjust, unreasonable and oppressive rents" by allowing cities with a population of one million or more to administer rent regulation by an agency of the city itself.[16]

New York City acted by passing the Rent Stabilization Law ("RSL") of 1969,[17] which was a milder second-generation form of rent control. Under the RSL, landlords would self-regulate through the Rent Stabilization Association ("RSA").[18] Rent stabilization was considered a "compromised solution"[19] which was "a less onerous form of regulation than rent control."[20] The city's implementation of the law united tenants and landlords alike in dislike although for very different reasons.[21] Landlords were still contesting any form of regulation of their property rights.[22] Jane Benedict, the principal founder of the tenant advocacy group Metropolitan Council on Housing, declared on behalf of tenants that the "concept of a self-policing law is a farce" but "it is better than

12. ART SHULMAN, N.Y. STATE DIV. OF HOUS. & CMTY. RENEWAL, RENT REGULATION AFTER 50 YEARS: AN OVERVIEW OF NEW YORK STATE'S RENT REGULATED HOUSING 1993, http://www.tenant.net/Oversight/50yrRentReg/history.html.

13. 8200 Realty Corp. v. Lindsay, 261 N.E.2d 647, 653 (N.Y. 1970).

14. La Guardia v. Cavanaugh, 423 N.E.2d 9, 11 (N.Y. 1981).

15. David K. Shipler, *Many Families Find They Must Leave City for Housing*, N.Y. TIMES, Feb. 23, 1969, at 1.

16. N.Y. UNCONSOL. LAW § 8602 (McKinney 2014).

17. Rent Stabilization Law of 1969, Local L. No. 16, 1969 N.Y. Local Laws 176 [hereinafter RSL].

18. *Id.* § YY51-6.0; *see also* Manocherian v. Lenox Hill Hosp., 643 N.E.2d 479, 480 (N.Y. 1994).

19. 8200 Realty Corp. v. Lindsay, 261 N.E.2d 647, 654 (N.Y. 1970).

20. Sullivan v. Brevard Assocs., 488 N.E.2d 1208, 1211 (N.Y. 1985).

21. David K. Shipler, *Both Sides Upset by New Rent Law*, N.Y. TIMES, Sept. 7, 1969, at 40.

22. *See, e.g.*, 8200 Realty Corp. v. Lindsay, 261 N.E.2d 647 (N.Y. 1970); Somerset-Wilshire Apts., Inc. v. Lindsay, 304 F.Supp 273 (S.D.N.Y. 1969); Lincoln Plaza Assocs. v. Barbarisi, 60 Misc. 2d 905 (N.Y. Civ. Ct. 1969). Property owners are still making many of these arguments today. *See* Harmon v. Markus, 412 F. App'x 420 (2d Cir. 2011), *cert. denied* 132 S. Ct. 1991 (2012); Adam Leitman Bailey & Dov Treiman, *Rent Stabilization Constitutional? Not Now* 40 N.Y. ST. B. REAL PROP. L. J. 31 (2012).

decontrol."[23] The main difference between rent control and rent stabilization is that rent control enacted a rent ceiling that froze rents on well-maintained buildings and reduced rents for buildings with violations, while rent stabilization allowed property owners many ways to increase rent for work done to improve the apartment and permitted adjustments to rent based on economic conditions with every new lease.[24]

The RSL regulated all residential buildings with six or more units constructed between February 1, 1947 and March 10, 1969.[25] All regulated owners had to join the RSA, which had primary responsibility in administering the law.[26] The RSA was given the power to promulgate a rent stabilization code ("RSC"), subject to city approval.[27] Any disputes between rent-stabilized tenants and owners were to be reviewed by the RSA-funded, but supposedly neutral, Conciliation and Appeals Board ("CAB").[28] The RSL also established the Rent Guidelines Board. The role of the Rent Guidelines Board was to annually determine rent adjustments based on the economic conditions in the city.[29] The building owners would receive rent adjustments of either a dollar amount or percentage of previous rent at the beginning of each new lease. The landlord would then have the choice, which most took, to increase the legal regulated rent by the maximum amount permitted by the Rent Guidelines Board.[30] Besides limited rent increases, rent-stabilized tenants received the right to not have their services decrease[31] and the right to renew their leases for perpetuity except for limited exceptions.[32] If rent overcharges took place, tenants could pursue the matter at CAB. The RSL was silent as to how overcharges should be decided so the landlord-controlled RSA designed the enforcement rules within the rent stabilization code.[33] If a tenant succeeded in an overcharge claim, CAB would order the landlord to refund the tenant the overcharge.[34] There was no additional interest or penalty to serve as a disincentive to overcharges. Finally, the city provided oversight of and assistance to the RSA through the government's Housing and Development Administration.[35]

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23. David M. Grant, *After Four Years, Rent Stabilization Finds the Critics Have Mellowed*, N.Y. TIMES, Mar. 18, 1973, at 402.

24. Diane Ungar, *Emergency Tenant Protection in New York: Ten Years of Rent Stabilization*, 7 FORDHAM URB. L.J. 305, 305 (1979).

25. RSL § YY51-6.0.

26. *Id.* § YY51-6.0(b).

27. *Id.*

28. *Id.* § YY51-6.0(b)(3).

29. *Id.* § YY51-5.0.

30. *Id.* § YY51-6.0(c)(2).

31. *Id.* § YY51-6.0(c)(8).

32. *Id.* § YY51-6.0(c)(9).

33. William Weisner, *Rent Stabilization: New C.A.B. Rent Overcharge Procedures*, 11 FORDHAM URB. L.J. 693, 705 (1983).

34. RSL § YY51-6.0(c)(3).

35. *Id.* § YY51-6.0.

Rent regulations suffered a setback when Governor Nelson Rockefeller enacted vacancy decontrol measures that removed rent stabilization and rent control status from any apartment becoming vacant on or after July 1, 1971.[36] The state also enacted the Urstadt Law, which prohibited New York City from extending or imposing stricter rent controls than those created in Albany.[37] By December of 1973, 300,000 rent-controlled units and approximately 88,000 rent-stabilized units lost their protections through deregulation.[38] In June of 1974, faced with spiraling rent and a severe housing shortage, New York passed the Emergency Tenant Protection Act ("ETPA"),[39] which took effect in New York City upon its unanimous adoption by the City Council.[40] The ETPA was an enabling act that empowered the City to extend rent stabilization as long as the City Council declared the existence of an emergency in the supply or condition of the housing market.[41] An emergency may exist as long as the vacancy rate does not exceed five percent.[42] For context, the national rental housing vacancy rate in the third quarter of 2014 was 7.4 percent.[43]

The ETPA repealed vacancy decontrol and re-regulated as rent-stabilized the decontrolled apartments in suburban localities of Westchester, Nassau, and Rockland counties in addition to New York City.[44] It also expanded rent stabilization to buildings with six or more dwelling units built before 1974.[45] In addition, the state government created the Division of Housing and Community Renewal ("DHCR") to administer rent regulation for the localities outside New York City.[46]

In 1983, the legislature passed the Omnibus Housing Act that amended several sections of rent stabilization infrastructure that persist today.[47] DHCR became the administrative agency responsible for rent stabilization in New York City and the suburban counties.[48] Administration of rent regulation would no

36. Act of June 1, 1971, ch. 372, 1971 N.Y. Laws 1163–64.

37. Act of July 7, 1971, ch. 1012, 1971 N.Y. Laws 2488–89; *see also* Kenny Schaeffer, Metro. Council on Housing, *Breaking the Chains: New York Needs Home Rule* (Dec. 2012), http://metcouncilonhousing.org/news_and_issues/tenant_newspaper/2012/December/breaking_the_chains_new_york_needs_home_rule.

38. SHULMAN, *supra* note 12. "Deregulation" or "decontrol" of rent control and "destabilization" of rent stabilization refer to the removal of rent-regulated status from an apartment unit.

39. Ungar, *supra* note 24, at 313.

40. *Rent-Stabilization Law Passes Council, 42 to 0*, N.Y. TIMES, June 21, 1974, at 41.

41. La Guardia v. Cavanaugh, 423 N.E.2d 9, 12 (N.Y. 1981).

42. N.Y. UNCONSOL. LAW § 8623 (McKinney 2013).

43. Robert R. Callis & Melissa Kresin, *Residential Vacancies and Homeownership in the Third Quarter 2014*, U.S. CENSUS BUREAU NEWS (Oct. 28, 2014 10:00 AM), http://www.census.gov/housing/hvs/files/qtr314/q314press.pdf.

44. Act of May 29, 1974, ch. 576, sec. 4, § 14, 1974 N.Y. Laws 1510, 1523.

45. *Id.* § 4, 1974 N.Y. Laws at 1516.

46. *Id.* § 8, 1974 N.Y. Laws at 1519.

47. Act of June 30, 1983, ch. 403, 1983 N.Y. Laws 1777.

48. *Id.* at sec. 3, § 8, 1983 N.Y. Laws at 1778.

longer be performed by property owners through the RSA. Starting on July 1, 1983, landlords would have to register rents and services annually with DHCR.[49] Lastly, beginning in April 1, 1984, landlords faced a treble damages penalty for willfully overcharging tenants.[50] However, rent overcharges became subject to a four-year statute of limitations.[51]

For a time the rent laws were extended rather routinely.[52] However, in 1993, Senate Republicans launched the "most determined attack in nearly two decades" on rent stabilization.[53] The landlord lobby changed the law allowing the deregulation of vacant rent-stabilized apartments where the rent exceeded $2000 (vacancy deregulation) or occupied apartments where the tenant's income exceeded $250,000 and the rent exceeded $2000 (luxury deregulation).[54] This meant that apartments where the rent was over $2000 would lose all protections once the tenant left. At the time, only apartments in Manhattan had high enough rents to be affected. However, the new law harmed tenants by removing apartments from the system[55] and set the precedent that protections should be tied to income. This was a politically charged decision as it set out to alter the existing concept of rent stabilization as a right to affordable housing for all, turning it into a program arguably focused solely on helping tenants beneath an arbitrary income level.[56]

Emboldened by the 1993 victory and the election of Republican Governor Pataki, the landlord lobby advocated for drastic changes in the 1997 renewal. Senate Majority Leader Joseph L. Bruno compared the damage rent regulation supposedly caused to the real estate market to the damage caused by an atomic bomb.[57] As rent stabilization's expiration date drew close, a city hotline received "as many as 100 calls an hour from tenants wondering what would happen to their homes if the rent laws lapsed" with no agreement between the Senate Republicans and Assembly Democrats.[58] The stalemate was ultimately broken

49. *Id.* at sec. 5, § 12-a, 1983 N.Y. Laws at 1781.

50. *Id.* at sec. 4, § 12(a)(1), 1983 N.Y. Laws at 1779.

51. *Id.* at sec. 4, § 12(a)(1)(b), 1983 N.Y. Laws at 1781.

52. Timothy L. Collins, *"Fair Rents" or "Forced Subsidies" Under Rent Regulation: Finding a Regulatory Taking Where Legal Fictions Collide*, 59 ALB. L. REV. 1293, 1316–17 (1996).

53. Kevin Sack, *A Test of Wills; In Albany Rent Stabilization Battle, G.O.P. is Standing Firm on Changes*, N.Y. TIMES, June 17, 1993, at B1.

54. Act of July 7, 1993, ch. 253, sec. 1, § 2(m), 1993 N.Y. Laws 2667, 2667.

55. Janet Babin, *How New York City Tenants Lost Their Political* Clout, WNYC (Aug. 12, 2015), http://www.wnyc.org/story/nyc-political-clout-tenants.

56. *See, e.g.*, Gabrielle DeNaro, *Welcome to the Jungle, Where the Rent is Too Damn High: Using Rent Regulation in New York City to Maintain an Affordable Housing Stock*, 16 CARDOZO J. CONFLICT RESOL. 939, 960 (2015) (proposing that arbitration hearings should take place for rent-stabilized tenants to determine if they are deserving of regulated status based on income).

57. James Dao, *Softening His Stance, Bruno Says He Will Support Rent Protections for Poor Tenants*, N.Y. TIMES, Dec. 31, 1996, at B5.

58. Clifford J. Levy, *The Tenants: City Workers Flooded with Phone Calls*, N.Y. TIMES, June 15, 1997, at 29.

by an agreement to extend the rent laws with significant changes named the Rent Regulation Reform Act of 1997 ("RRRA of 1997").[59]

The RRRA of 1997 gave landlords a twenty percent increase in rent when a tenant vacated and an additional bonus increase if the tenants had lived in the apartment for eight or more years.[60] The luxury deregulation was lowered from $250,000 to $175,000.[61] The Act also explicitly stated that high rent vacancy deregulation applied to apartments where the legal regulated rent hit $2000, regardless of what was actually being paid.[62] This change meant communities where market rents were far below $2000 could still have protections taken away as long as the landlord could legally charge above the $2000 threshold. The Public Housing Law was amended to provide for contracts in which, if a developer would commit to build a residential building, the State would agree not to impose rent regulation on the new construction for fifty years, thereby making any expansion of rent regulation more difficult.[63]

Lastly, the RRRA of 1997 attempted to create a stricter four-year statute of limitations on overcharge claims.[64] The Court of Appeals discerned that the purpose of the statute of limitations was to "alleviate the burden on owners to retain paperwork indefinitely."[65] However, the way the act was planned to operate was that if "the fraud is not discovered for four years, the illegal rent is ratified, and the landlord, at the next vacancy, would easily be able to remove the unit from regulation altogether under" high rent vacancy deregulation.[66] The 2003 Act was essentially an eight-year extension of the RRRA of 1997.[67]

The next round of debate involved the extension of rent stabilization with the Rent Act of 2011.[68] Many of the changes were reforms to alleviate the severity of the RRRA of 1997. High-income rent deregulation was increased from $175,000 to $200,000 and high rent vacancy deregulation was increased from $2000 to $2500.[69] This was deemed important as rents across the city had drastically increased in the fourteen years since the vacancy deregulation was introduced. The law also decreased the renovation costs passed on to tenants in the IAI formula for buildings with thirty-six or more apartments. The new

59. Rent Regulation Reform Act of 1997, ch. 116, 1997 N.Y. Law 1814.

60. *Id.* at sec. 19, 1997 N.Y. Laws at 1823.

61. *Id.* at sec. 7-b, 1997 N.Y. Laws at 1816.

62. *Id.* at sec. 15, 1997 N.Y. Laws at 1820–21.

63. *Id.* at sec. 27, N.Y. Laws at 1827.

64. *Id.* at sec. 31, N.Y. Laws at 1829–30.

65. Gilman v. N.Y. Div. of Hous. & Cmty. Renewal, 782 N.E.2d 1137, 1139 (N.Y. 2002).

66. Craig Gurian, *Let Them Rent Cake: George Pataki, Market Ideology, and the Attempt to Dismantle Rent Regulation in New York*, 31 FORDHAM URB. L.J. 339, 398 (2004).

67. *Id*. at 341.

68. Act of June 24, 2011, ch. 97, 2011 N.Y. Laws 752.

69. *Id.* at pt. B, sec. 34, §§ 26-403.1, 26-504.1, 2011 N.Y. Laws at 779–80.

formula passed one-sixtieth of renovation cost on to tenants' monthly rents instead of one-fortieth.[70]

The latest changes in the rent laws occurred in 2015. Albany was in a state of flux after leaders of both the Assembly and the Senate were arrested on corruption charges relating to kickbacks from real estate developers.[71] The Assembly pushed for eliminating vacancy deregulation and making rent increases tied to building improvements temporary. Meanwhile, the Senate pushed for automatic income verification so apartments would lose rent stabilization protection through luxury deregulation.[72] Governor Cuomo was widely seen to be acting passively in response to these demands, despite his public statements in support of pro-tenant changes to rent regulation.[73] The compromised Rent Act of 2015[74] was described by Michael McKee, of the Tenant's Political Action Committee, as an "absolutely lousy deal."[75] The latest changes included lengthening the amortization rate of major capital improvements to eight years for buildings with thirty-five or fewer units or nine years for building with thirty-six or more units.[76] There were more limits placed on vacancy increases for apartments with legal regulated rent greater than actual market rent.[77] The limit for high rent deregulation increased from $2500 to $2700.[78] This limit will increase annually by whatever amount the Rent Guidelines Board raises rents for one-year leases starting in 2016.[79] The biggest change is that vacancy deregulation only occurs when the prior tenant rent exceeds $2700.[80] The past understanding had allowed landlords to increase the rent with IAI during the vacancy period to exceed the high rent threshold. No changes were made to IAI.

Rent regulation has been the subject of fierce battles in Albany. Reform is usually centered around the deadline for the expiration of rent stabilization. The

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70. *Id*. at pt. B, secs. 15, 18, 25, 2011 N.Y. Laws at 772–74.

71. Susanne Craig, Jesse McKinley & Thomas Kaplan, *When Will It End? Much Work Is Left as Albany Session Winds Down*, N.Y. TIMES, June 18, 2015, at A23; William K. Rashbaum, *Realty Firm's Power Laid Bare*, N.Y. TIMES, Dec. 19, 2015, at A1.

72. Mireya Navarro, *Uncertainty Mounting as Little Progress Is Seen in Albany on Rent Regulations*, N.Y. TIMES, June 20, 2015, at A16.

73. *Id*.

74. Rent Act of 2015, ch. 20, 2015 N.Y. Sess. Laws (McKinney).

75. Thomas Kaplan & Jess McKinley, *Tentative Deal in Albany Would Extend Rent Laws; Key Issues Are Unresolved*, N.Y. TIMES, June 24, 2015, at A19.

76. N.Y. UNCONSOL. LAW § 8584(4)(a)(7) (McKinney Supp. 2015).

77. N.Y. UNCONSOL. LAW § 8630-a.

78. N.Y. UNCONSOL. LAW § 8625(a)(13).

79. N.Y. UNCONSOL. LAW § 8625(a)(13).

80. *Id*. However the First Department indicated that the prior rent law regime should have also followed this method. *See* Altman v. 285 W. Fourth, LLC, 127 A.D.3d 654, 655 (N.Y. App. Div. 1st 2015) ("[T]he increase could not effectuate a deregulation of the apartment since the rent at the time of the tenant's vacatur did not exceed $2,000." (citing N.Y.C., N.Y., ADMIN. CODE §§ 26-504.2, 26-511(c) (2005); Roberts v. Tishman Speyer Props., 62 A.D.3d 71, 77 (N.Y. App. Div. 2009), *aff'd*, 13 N.Y.3d 270, 280 (2009))).

present system is set to expire on June 15, 2019[81] but the rent laws affecting millions could be changed at any time.

III.
THE THEFT OF AFFORDABLE HOUSING THROUGH FRAUD

A. Individual Apartment Improvements

One of the greatest challenges to rent regulation has been ensuring that rents do not exceed their legal regulated amounts. Under rent stabilization, landlords are primarily limited to rent increases through vacancy increases, renewal increases, major capital improvements ("MCI"), and individual apartment improvements. Vacancy increases are rent increases that occur after a tenant moves out of an apartment and are determined by a formula.[82] Increases for each renewal lease for an existing tenant are calculated by the Rent Guidelines Board annually by looking at the economic conditions and then universally permits landlords to increase rent by an amount or percentage to each renewal lease for that year.[83] MCI permanently increases rent when the landlord makes building-wide improvements or replaces a major building system.[84] The landlord must apply for the MCI at DHCR.[85] Tenants have the opportunity to contest the application.[86] There are also limits on how much an MCI can increase an individual's rent.[87]

Each of the preceding increases are either standardized and universally applied based on a simple formula or approved after some review by DHCR. IAI are the exception. Legislators did not want rent stabilization to create slums so IAI were put in place to incentivize landlords to improve apartments. Landlords can only receive an IAI for work that was "more than normal maintenance"[88] and not "merely repairs or decorating."[89] Repair work such as painting, plastering, replacing window glass, and refinishing floors are not considered improvements.[90] Expenses spent on new appliances[91] and gut renovations[92] done in "connection with an overall renovation of an apartment" qualify for an IAI.[93]

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81. N.Y. UNCONSOL. LAW § 8581(2) (McKinney 2014).

82. N.Y. COMP. CODES R. & REGS. tit. 9, § 2522.8.

83. *Id.* § 2503.5.

84. *Id.* §§ 2522.4(a)(2)–(3).

85. *Id.* § 2522.4(a)(2)(e)(1).

86. *Id.* § 2522.4(a)(15).

87. *Id.* § 2522.4(a)(8).

88. Linden v. Div. of Hous. and Cmty. Renewal, 217 A.D.2d 407, 407 (N.Y. App. Div. 1st 1995).

89. Charles Birdoff & Co. v. Div. of Hous. and Cmty. Renewal, 204 A.D.2d 630, 631 (N.Y. App. Div. 2d 1994).

90. *See, e.g.*, Graham Court Owners Corp. v. Div. of Hous. and Cmty. Renewal, 71 A.D.3d 515, 515 (N.Y. App. Div. 1st 2010); 425 3rd Ave. Realty Co. v. Div. of Hous. and Cmty. Renewal, 29 A.D.3d 332, 333 (N.Y. App. Div. 1st 2006); Yorkroad Assocs. v. Div. of Hous. and Cmty. Renewal, 19 A.D.3d 217, 217–18 (N.Y. App. Div. 1st 2005); Mayfair York Co. v. Div. of Hous.

Unlike with an MCI, a landlord does not have to seek prior approval for IAI.[94] The reason behind the difference is the fear that landlords would not invest in improvements due to the backlog of MCI cases at DHCR.[95] Landlords of buildings with more than thirty-five apartments may collect a permanent monthly rent increase equal to one-sixtieth of the cost of the improvement to the apartment.[96] For buildings with thirty-five apartments or fewer, the owner can collect an increase equal to one-fortieth of the total improvement cost.[97] If the apartment has a tenant then the landlord must get written consent for the rent increase from the tenant.[98] No consent is required for IAI performed in vacant apartments.[99] There is also no requirement for a landlord to prove the cost was reasonable, only that the money was actually spent.[100]

This uncapped, unsupervised system is an enormous economic incentive for fraud "because, while most increases under rent stabilization allow only a moderate rise in rent, a one-fortieth increase can allow huge increases, limited only by how much a landlord can invest to improve a given apartment."[101] For example if a landlord of a thirty-three unit building spends $10,000 to renovate the kitchen and bathroom, that cost would be passed to the tenant in the form of an extra $250 of rent each month, every month going forward, forever. The landlord is then guaranteed a thirty-percent return on investment for as long as the apartment is rent-stabilized with a tenant willing to pay the legal regulated rent.

The burden is on the tenant to request either the courts or DHCR to review the validity of an IAI through an overcharge complaint.[102] Only after a complaint is made does the landlord need to submit any evidence. Permissible evidence may include cancelled checks contemporaneous with the completion of work, an invoice receipt marked paid in full contemporaneous with completion of the

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and Cmty. Renewal, 240 A.D.2d 158, 158 (N.Y. App. Div. 1st 1997).

91. Clearwater Realty Co. v. Yonac, 8 Misc. 3d 115, 115 (N.Y. App. Term 2d 2005).

92. 206 W. 104th St. LLC v. Cohen, 41 Misc. 3d 134(A) (N.Y. App. Term 1st 2013).

93. 212 W. 22 Realty, LLC v. Fogarty, 1 Misc. 3d 905(A) (N.Y. Civ. Ct. 2003).

94. N.Y.C., N.Y., ADMIN. CODE § 26-511(c)(13) (2005). One could argue § 26-511(c)(7) requires "rental adjustment to be made upon granting of an increase by the commissioner" but the courts have ruled DHCR is entitled to deference in administration of the law if its interpretation is not "unreasonable or irrational." 2502 Bedford Realty Co. v. Woodson, 152 Misc. 2d 897, 898 (N.Y. Civ. Ct. 1992).

95. Global Mgmt. v. Richards, 152 Misc. 2d 759, 761 (N.Y. App. Term 2d 1992).

96. N.Y. COMP. CODES R. & REGS. tit. 9, § 2522.4(a)(4).

97. *Id.*

98. *Id.* § 2522.4(a)(1).

99. *Id.*

100. Shafir v. N.Y. State Div. of Hous. and Cmty. Renewal, 2011 N.Y. Slip Op. 30840(U) (N.Y. Sup. Ct. Apr. 4, 2011), www.courts.state.ny.us/reporter/pdfs/2011/2011_30840.pdf.

101. ASS'N FOR NEIGHBORHOOD AND HOUS. DEV., THE $20,000 STOVE: HOW FRAUDULENT RENT INCREASES UNDERMINE NEW YORK'S AFFORDABLE HOUSING 4 (Jan. 2009), http://www.anhd.org/resources/the$20,000stovereport.pdf.

102. Rockaway One Co. v. Wiggins, 35 A.D.3d 36 (N.Y. App. Div. 2d 2006).

work, a signed contract agreement, and a contractor's affidavit indicating installation completion and full payment.[103] There is no "inflexible rule" on evidence such as an item-by-item breakdown, only that the fact finder should decide based on the "persuasive force of the evidence submitted by the parties."[104]

B. The Impact of Affordable Housing Theft

Since IAI information is not publicly available it is difficult to ascertain the impact of systemic fraud. We know from DHCR's data that IAI "increases upon vacancy make up one of the largest components of increases under the ETPA."[105] A sample study by Make the Road New York found that forty-five percent of the units examined had rent histories showing registered rent above the legal amount with an average monthly illegal rent increase of $211.[106] Sixty-two percent of the fraud identified in the study occurred when a new tenant moved into a vacant apartment.[107] This is a problem. As Marika Dias of Make the Road New York explained, the "incoming tenant usually has no idea what condition the apartment was in previously so they won't challenge the IAI increase—many don't even know the landlord is claiming an IAI increase."[108] For these reasons, experts claim IAI are "probably the single most important mechanism that developers and landlords use to increase rental income from a building."[109] An analysis by the Association for Neighborhood and Housing Development found, "an 'unnatural' decrease in moderate-rent apartments."[110] These unnatural decreases are the result of business plans made by private equity-backed developers that make promises of up to twenty percent returns by driving tenants out and deregulating apartments.[111] Such business plans could not be realized unless an enormous amount of affordable housing is lost and the rent on vacant apartments is dramatically increased.[112]

The latest data shows this trend is continuing. From 1994 to 2012, New York City had a net loss of 152,751 affordable housing units from the rent

103. N.Y. STATE DIV. OF HOUS. & CMTY. RENEWAL, POLICY STATEMENT 90-10 (June 26, 1990), www.nyshcr.org/rent/policystatements/orap9010.pdf.

104. Jemrock Realty Co. v. Krugman, 922 N.E.2d 870, 871 (N.Y. 2010).

105. 35 N.Y. Reg. 13 (Apr. 24, 2013), http://docs.dos.ny.gov/info/register/2013/april24/pdf/rulemaking.pdf.

106. MAKE THE ROAD NEW YORK, RENT FRAUD: ILLEGAL RENT INCREASES AND THE LOSS OF AFFORDABLE HOUSING IN NEW YORK CITY 13 (Aug. 2011), http://www.maketheroad.org/pix_reports/DHCR%20Report.pdf.

107. *Id.* at 15.

108. *Id.* at 16.

109. ASS'N FOR NEIGHBORHOOD AND HOUS. DEV., *supra* note 101, at 4.

110. *Id.* at 10–11.

111. Gretchen Morgenson, *As Investment Firms Buy Up Buildings, Tenants See Bullies*, N.Y. TIMES, May 9, 2008, at A1.

112. Raymond H. Brescia, *Line in the Sand: Progressive Lawyering, "Master Communities," and a Battle for Affordable Housing in New York City*, 73 ALB. L. REV. 715, 722–23 (2010).

stabilization system with the majority lost to high-rent vacancy deregulation.[113] From 2010 to 2012, the DHCR's Office of Rent Administration found 1407 cases of a rent overcharge and awarded tenants $5.5 million in overcharge, interest and penalties.[114] This is despite DHCR's present policy of requiring high standards to look beyond four years. More telling are the results from the new Tenant Protection Unit ("TPU"), which is a unit within DHCR designated to be proactive in investigating and prosecuting violations of law.[115] In two years, the TPU performed 1100 landlord audits and found that in as many as forty percent of cases, "landlords did not have proof of apartment improvements used to justify rent increases."[116]

Losing affordable housing has consequences that reverberate across New York City. Housing is considered unaffordable if rent consumes over thirty percent of household income. Tenants are considered severely rent burdened if rent consumes over fifty percent. In 2011, slightly more than half of New York City households had unaffordable rents and one-in-five tenants were severely rent burdened even with the help of government subsidies.[117] These families must cut many necessities, especially food, transportation, health care, and retirement savings.[118] The burden on families is compounded by the rising cost of essentials such as childcare, education, and food and the simultaneous budget cuts to social support programs.[119] This confluence of factors upon low-income communities has led to "historic highs in homelessness" in New York City that "are not part of a nationwide trend."[120]

The lack of supervision is not new to the history of rent laws in New York. These same problems of market incentives for fraud without oversight in IAI are similar to what brought down the self-regulated system in the 1980s. The economic incentives for landlord abuses are simply too overwhelming in the New York City housing market. Professor W. Dennis Keating, an expert in

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113. STRINGER, *supra* note 4, at 20.

114. THOMAS P. DINAPOLI, OFF. OF THE STATE COMPTROLLER, PRESERVING AND EXPANDING AFFORDABLE HOUSING OPPORTUNITIES 4 (Dec. 2014), http://osc.state.ny.us/audits/allaudits/093015/14d1.pdf.

115. N.Y. COMP. CODES R. & REGS. tit. 9 § 2520.5(o). The legality of the TPU is being challenged by landlords in *Portofino Realty Corp. v. Div. of Hous. & Cmty. Renewal*, No. 501554/2014 (N.Y. Sup. Ct., Kings Cty., Feb. 24, 2014).

116. Mireya Navarro, *Tenants Living Amid Rubble in Rent-Regulated Apartment War*, N.Y. TIMES, Feb. 24, 2014, at A20.

117. THOMAS P. DINAPOLI, OFF. OF THE STATE COMPTROLLER, THE CONTINUED DECLINE IN AFFORDABLE HOUSING IN NEW YORK CITY 1–2 (June 2013), http://www.osc.state.ny.us/osdc/affordable_housing_3-2014.pdf.

118. JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., AMERICA'S RENTAL HOUSING: EVOLVING MARKETS AND NEEDS 32 (Dec. 9, 2013), http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/jchs_americas_rental_housing_2013_1_0.pdf.

119. JANET VIVEIROS & LISA STURTEVANT, CTR. FOR HOUS. POL'Y, HOUSING LANDSCAPE 2014 at 5 (Feb. 2014), http://media.wix.com/ugd/19cfbe_43635cdd41214c659797cd6ba1863792.pdf.

120. STRINGER, *supra* note 4, at 12.

housing law and policy, has found that, "[t]his is particularly true where gentrification indicates a strong demand that threatens the displacement of tenants unable to pay market rents. An effective system of rent regulation that protects tenants against exorbitant rent increases and displacement . . . demands active intervention by public agencies."[121]

The problem with IAI is that the DHCR, outside of the TPU, is acting reactively, not proactively. This is compounded by the inaction of the New York legislature, which has put pressure on the courts to respond to this growing crisis. The lack of accountability has bred an environment where the illegal theft of affordable housing is considered a low risk cost of doing business.

C. Court of Appeals Confronts Rent Overcharge Fraud

The Court of Appeals is well aware that "[a]ffordable housing is an essential need."[122] This awareness has been in continuous conflict with the four-year statute of limitations on rent overcharge claims. Courts had refused to examine any evidence of a fraudulent overcharge if it occurred outside the statute of limitations.[123] The problem with this model is that there is every incentive for the landlord to lie and little oversight from the government unless the tenant makes a complaint during a very narrow window of time.

The Court addressed the problem when it created the fraudulent scheme exception. In 1992, a building owner rented an Upper West Side apartment to Shlomo Baron on the condition that it would not be his primary residence. The building owner believed since the apartment was not his primary residence that rent stabilization would not apply. The lease was set for $2400 per month instead of the legal rent of $507.85. Mr. Baron then subleased the apartment for $3250 to musician Cyndi Lauper and her actor husband David Thornton.[124] Chief Judge Kaye explained that without an exception to the four-year rule, a landlord can transform an illegal rent into a lawful basis for all future increases by simply escaping detection for four years.[125] The purpose of the statute of limitations "was to alleviate the burden on honest landlords to retain rent records indefinitely, not to immunize dishonest ones from compliance with the law."[126]

The Court of Appeals reasoned that, due to the fraud, the base rent was a nullity and therefore no statute of limitations could apply to the illegal rent.[127] The fraudulent scheme exception was put into place "so that no wrongdoer may

121. W. Dennis Keating, *Landlord Self-Regulation: New York City's Rent Stabilization System 1969–1985*, 31 WASH. U. J. URB. & CONTEMP. L. 77, 132 (1987).

122. Santiago-Monteverde v. Pereira, 24 N.Y.3d 283, 292 (N.Y. 2014).

123. *See, e.g.*, Newgarden v. Theoharidou, 247 A.D.2d 367 (N.Y. App. Div. 2d 1998).

124. Michael Cooper, *Girls Just Want a Bargain Apartment? Court Favors Lauper*, N.Y. TIMES, July 1, 2005, at B1.

125. Thornton v. Baron, 833 N.E.2d 261, 264–65 (N.Y. 2005).

126. *Id.* at 265.

127. *Id.* at 264.

benefit at the expense of the public."[128] Without the exception, the statute's purpose of "preserving a stock of affordable housing" would be undermined.[129]

Five years later, DHCR asked the Court of Appeals to limit the fraudulent scheme exception to only cases that, factually similar to *Thornton*, included illusory tenancies.[130] Illusory tenancies are fake tenants used to get greater rent increases than a landlord is legally allowed. The Court refused. The Court sought a balance in *Grimm* by stating "a mere allegation of fraud alone, without more, will not be sufficient" but "evidence of a landlord's fraudulent deregulation scheme to remove an apartment from the protections of rent stabilization" would require looking back beyond four years.[131] The three dissenters attacked the majority decision for not defining "what it takes to prove such a 'fraudulent scheme.'"[132]

DHCR and the lower courts have attempted to explain what constitutes a fraudulent scheme. The current standard is the three-factor *Pehrson* test, which examines whether:

> (1) The tenant alleges circumstances that indicate the landlord's violation of the Rent Stabilization Law (RSL) and Rent Stabilization Code (RSC) in addition to charging an illegal rent. (2) The evidence indicates a fraudulent scheme to remove the rental unit from rent regulation. (3) The rent registration history is inconsistent with the lease history.[133]

Grimm's fraudulent scheme exception to the four-year rule has since been applied to landlords using fictitious tenants,[134] to leases restricted to "transient" tenants raising the rent from $280 to $450,[135] large unexplained increases in rent without rent stabilization riders,[136] large unexplained increases in a one-bedroom apartment illegally partitioned into three bedrooms,[137] leases that do not match the registrations,[138] large increases and unexplainable misregistrations,[139]

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128. *Id.* at 265.

129. *Id.* at 265.

130. Grimm v. Div. of Hous. & Cmty. Renewal, 938 N.E.2d 924, 928 (N.Y. 2010).

131. *Id.* at 929.

132. *Id.* at 930.

133. Pehrson v. Div. of Hous. & Cmty. Renewal, 34 Misc. 3d 1220(A), 2011 N.Y. Slip Op 52487(U) 1, 4 (Sup. Ct. 2011), http://www.nycourts.gov/reporter/3dseries/2011/2011_52487.htm.

134. Conason v. Megan Holding, LLC, 109 A.D.3d 724 (N.Y. App. Div. 1st 2013), *aff'd as modified by* 25 N.Y.3d 1 (2015).

135. Campbell v. Div. of Hous. & Cmty. Renewal, No. 19809/2012 (N.Y. Sup. Ct. decided July 1, 2013).

136. Dignam v. 305 Riverside Corp., 2012 N.Y. Slip Op. 31019(U) (Sup. Ct. 2012), http://www.nycourts.gov/reporter/pdfs/2012/2012_31019.pdf.

137. Zheng v. Mak, 2012 N.Y. Slip Op. 30634(U) (Sup. Ct. 2012), http://www.nycourts.gov /reporter/pdfs/2012/2012_30634.pdf.

138. Smith v. Div. of Hous. & Cmty. Renewal, 2010 N.Y. Slip Op. 31648(U) (Sup. Ct. 2010), http://www.nycourts.gov/reporter/pdfs/2010/2010_31648.pdf.

139. TYL Realty Corp. v. Boder, No. 74218/2012, NYLJ 1202578791384 (N.Y. Civ. Ct.

removal of a "preferential rent" where the legal regulated rent is questionably increased immediately after the statute of limitations expires,[140] and owners who ignored the fact the apartment was rent-stabilized.[141] The courts have held that rental history alone is not enough to demonstrate fraud.[142]

The last word from the Court of Appeals on rent fraud came in a pair of cases. First was the case of Kelley S. Boyd. In 2004, a long-term tenant moved out of a Washington Heights apartment and the landlord allegedly renovated the apartment raising the rent from $571.70 to $1750. The landlord claimed the immediate tenant was informed of the increase but left after a few months. A new tenant moved into the apartment and paid an additional vacancy increase. Ms. Boyd moved into the apartment in 2007 and filed a rent overcharge claim with DHCR in April 2009. Ms. Boyd stated based on the condition of her apartment when she moved in that the landlord could not have spent the $39,000 needed to legally raise the rent with an IAI in 2004. DHCR found no reason to look back beyond the four years based on Ms. Boyd's complaint and found no overcharge. Ms. Boyd challenged DHCR's decision in court. The initial court ruled Ms. Boyd provided no basis for disturbing DHCR's decision.[143] The Appellate Division, in a three-to-two decision, disagreed. The Appellate Division found that the tenant's description of the apartment still having original fixtures and low-quality appliances, in addition to the rental history, constituted substantial indicia of fraud.[144] Accordingly, DHCR's finding the landlord "could have" made the renovation instead of investigating to see if they did renovate was arbitrary and capricious.[145]

The Court of Appeals ruled in a seventy-three-word unanimous decision that DHCR's ruling was not arbitrary and capricious because the "tenant failed to set forth sufficient indicia of fraud."[146] The Court provided no other information on what constituted fraud and how one proved IAI fraud.

DHCR, which successfully advocated for the reversal of the Appellate Division's decision in *Boyd*, stated in its reply brief that the present IAI statutes

decided Nov. 5, 2012) (New York Law Journal).

140. 1290 Ocean Realty LLC v. Massena, 46 Misc.3d 1223(A), 2015 N.Y. Slip Op. 50256(U) (Civ. Ct. 2015), http://www.nycourts.gov/reporter/3dseries/2015/2015_50256.htm.

141. Kreloff v. Div. of Hous. & Cmty. Renewal, 2014 N.Y. Slip Op. 30843(U) (Sup. Ct. 2014), http://www.nycourts.gov/reporter/pdfs/2014/2014_30843.pdf; 410 St. Nicholas LLC v. Khalid, No. 81657/2011, NYLJ 1202569108703 (N.Y. Civ. Ct. decided Aug. 16, 2012) (New York Law Journal).

142. *See* White v. Div. of Hous. & Cmty. Renewal, 2013 N.Y. Slip Op. 30376(U) (Sup. Ct. 2013), http://www.nycourts.gov/reporter/pdfs/2013/2013_30376.pdf.

143. Boyd v. Div. of Hous. & Cmty. Renewal, 2012 N.Y. Slip Op. 31260(U) (Sup. Ct. 2012), http://www.nycourts.gov/reporter/pdfs/2012/2012_31260.pdf.

144. Boyd v. Div. of Hous. & Cmty. Renewal, 110 A.D.3d 594, 594–95 (N.Y. App. Div. 1st 2013).

145. *Id.* at 595.

146. Boyd v. Div. of Hous. & Cmty. Renewal, 23 N.Y.3d 999, 1000–01 (N.Y. 2014).

make "proper enforcement difficult"[147] and that under the current legal regime fulfilling the DCHR's mandate is "challenging at best."[148]

The *Boyd* litigation leaves open the question of how to prove IAI fraud. The Appellate Division has found tenant affidavits and contractor estimates, "among other things," sufficient.[149] Housing Court judges have found housing maintenance code violations levied by the New York City Department of Housing Preservation and Development relevant to proving that renovations were not completed[150] and have accepted testimony from a past tenant regarding the apartment remaining unchanged after alleged improvements.[151] While these decisions provide methods for showing fraud, they are not methods readily available to most tenants. In 2010, the median annual income of rent-stabilized households was $37,000,[152] which makes paying for a contractor examination financially impossible for many people who are the likely targets of fraud. Even harder is finding previous tenants of apartments and then convincing them to assist strangers with litigating against their prior landlords. The most logical direction for fraud detection to grow are photographs of apartment conditions and affidavits with greater specificity from tenants but it remains to be seen what level of specificity and expertise the courts and DHCR will require.

The last word from the Court of Appeals is *Conason v. Megan Holding, LLC*.[153] Megan Holding sued for nonpayment of rent in 2009. Ms. Conason claimed breach of warranty of habitability and rent overcharge as a defense.[154] At trial, the judge found the landlord's testimony "entirely incredible."[155] With the help of a neighbor, the superintendent, and records from utility companies, the tenants were able to show that the landlord used an illusory tenancy and fictitious IAI to boost the rent from $475.24 to $1800.00.[156] The Court of Appeals in a four-to-one decision found that the "tenants alleged substantial evidence pointing to the setting of an illegal rent in connection with a stratagem devised by Megan to remove tenant's apartment from the protections of rent stabilization."[157] The court compared *Boyd* as a case where a tenant "merely alleged" an increase in rent as compared to *Partnership 92 LP* where "ample

147. Brief of Respondent-Appellant Div. of Hous. & Cmty. Renewal in Response to Briefs of Amici Curiae at 9, Boyd v. Div. of Hous. & Cmty. Renewal, 16 N.E.3d 1243 (N.Y. 2014) (No. APL 2014-00052), 2014 WL 2997747, at * 9.

148. *Id*. at 13, 2014 WL 2997747, at * 13

149. Bogatin v. Windermere Owners LLC, 98 A.D.3d 896 (N.Y. App. Div. 1st 2012); *see also* Rossman v. Windermere Owners LLC, 2011 WL 11449543 (N.Y. Sup. Ct. 2011).

150. DL Major Constr. Co. v. Carchi, 43 Misc.3d 1219(A), 2014 N.Y. Slip Op. 50722(U) (Civ. Ct. 2014), http://www.nycourts.gov/reporter/3dseries/2014/2014_50722.htm.

151. St. Marks Assocs. v. Damion, No. 95928/2008 (N.Y. Civ. Ct. decided Dec. 27, 2011).

152. Lee, *supra* note 2, at 15.

153. Conason v. Megan Holding, LLC, 29 N.E.3d 215 (N.Y. 2015).

154. *Id*. at 216–17.

155. *Id.* at 218.

156. *Id*. at 217–18.

157. *Id*. at 223.

basis" existed of fraud.[158] The lone dissenter warned that the decision would lead to "endless litigation" and leave owners with "no certainty as to the value of residential rental property" as courts wrestle with what constitutes a colorable claim of fraud.[159]

IV.
PROPOSED SOLUTIONS TO REDUCING FRAUDULENT IAI

New York City tenants have had their rents increase eleven percent while their incomes have remained stagnant after adjusting for inflation between 2005 and 2012.[160] This is not sustainable. But the real estate lobby is a force for the status quo in Albany. Through contributions and other means "[t]he real estate lobby enjoys a powerful influence in local New York politics."[161] From 2005, the year *Thornton* was decided, to July 2013, the Real Estate Board of New York ("REBNY") and the thirty-seven companies comprising its leadership contributed $43.9 million to state and local candidates, committees, and political action committees.[162] Large landlords are able to funnel substantial donations given through quasi-anonymous limited liability corporations ("LLCs") as a way to influence politicians to ignore the needs of millions of renters. These donations are especially influential to upstate legislators in Albany who have no constituents benefiting from rent stabilization.

The Court of Appeals has also signaled with *Boyd* the limits of its desire to intervene and an intention to let the lower courts and DHCR define fraudulent scheme for now. At the same time, the court in *Conason* was unequivocal as to the importance of the fraudulent scheme exception. While allowing freedom in finding fraud is useful for confronting the myriad ever-evolving and creative techniques of the greedy, it does little to inform tenants, advocates, judges, and honest property owners of how to proceed going forward. For rent stabilization to protect tenants "who could not compete in an overheated rental market,"[163] the regulations must work in a manner where unscrupulous landlords understand that they "cannot escape liability for excess payments of rent under *any* circumstances."[164]

158. *Id*.

159. *Id*. at 226 (Pigott, J. dissenting).

160. BILL DE BLASIO & ALICIA GLEN, HOUSING NEW YORK: A FIVE-BOROUGH, TEN-YEAR PLAN 5 (2014), http://www.nyc.gov/html/housing/assets/downloads/pdf/housing_plan_hires.pdf.

161. Kessler v. Grand Cent. Dist. Mgmt. Ass'n, 158 F.3d 92, 130 (2d Cir. 1998).

162. Susan Lerner, *"Moreland Monday" Analysis of REBNY Contributions Raises Serious Issues for Commission to Consider*, COMMON CAUSE (Aug. 5, 2013), http://www.commoncause.org/states/new-york/press/press-releases/moreland-monday-analysis-of-rebny-contributions-raises-serious-issues-for-commission-to-consider.html.

163. Manocherian v. Lenox Hill Hosp., 643 N.E.2d 479, 480 (N.Y. 1994).

164. Estro Chem. Co. v. Falk, 100 N.E.2d 146, 148 (N.Y. 1951).

A. Enforcement by More Active Regulators

As Walter Mondale said, "[s]ometimes you need the hand of government to ensure that honest people can carry on in business."[165] The laws are meaningless if the agency tasked with enforcement is left to wither on the vine. DHCR is required to ensure that the rent stabilization code "provides safeguards against unreasonably high rent increases and, in general, protects tenants and the public interest."[166] The current hands-off approach to administering IAI, however, fails to accomplish this goal.

More active prosecutions by DHCR, such as an expansion of the TPU, would reduce the legal uncertainty by building precedent. This would likely increase settlement rates while deterring other landlords from committing IAI fraud.[167] To accomplish its mission, DHCR must be given the resources—financial and personnel—required to oversee the homes of millions. From 2000 to 2014, DHCR's Office of Rent Administration had staffing reduced thirty percent and examiner staffing decreased thirty-three percent.[168]

If DHCR is unable or unwilling to enforce the law, then the New York State Office of the Attorney General should act. There is precedent for this action. The Attorney General intervened in the early 1980s,[169] with the failure and virtual collapse of the CAB.[170] The Attorney General is endowed with broad powers to prosecute repeated fraud or illegal acts[171] and may use these powers to prosecute rent overcharges.[172] The Attorney General should use these investigatory powers to protect affordable housing and promote the rule of law.

B. Follow the MCI Model

One simple change that would help combat fraud is for IAI to be treated more like MCI. While MCI is not a perfect model, it incorporates important safeguards including increased transparency and limits on rent increases. Amortizing over 96 to 108 months instead of forty would still provide a healthy return to property owners. Landlords would still be incentivized to improve the

165. Walter Mondale, THE GOOD FIGHT: A LIFE IN LIBERAL POLITICS 19 (2010).

166. N.Y.C., N.Y., ADMIN. CODE § 26-511(c)(1) (2005).

167. *See* Richard A. Posner, *The Behavior of Administrative Agencies*, 1 J. LEGAL STUD. 305, 316 n.15 (1972) (arguing that "the more cases of a given type an agency brings, the larger will be the body of applicable precedents and this will tend to reduce uncertainty and so increase the proportion of cases that are settled").

168. DINAPOLI, *supra* note 114, at 5.

169. Weisner, *supra* note 33, at 694 n.12.

170. *Id.* at 695.

171. N.Y. EXEC. LAW § 63(12) (McKinney 2015).

172. State v. Winter, 121 A.D.2d 287 (N.Y. App. Div. 1st 1986); State v. Solil Mgmt. Corp., 128 Misc. 2d 767 (N.Y. Sup. Ct. 1985) *aff'd mem.*, 114 A.D.2d 1057 (N.Y. App. Ct. 1985), *appeal denied*, 492 N.E.2d 1233 (N.Y. 1986); *see also* Wiener v. Abrams, 119 Misc. 2d 970 (N.Y. Sup. Ct. 1983) (holding that the AG had power to investigate fraud and issue subpoenas given the specific facts of that case).

housing stock while reducing the economic burden on tenants. IAI should also follow suit to implement a six percent cap to rent increases. A cap allows landlords to benefit from renovation but establishes limits to deter misuse. Both MCI and IAI should be temporary surcharges. It is fair to allow property owners to finance improvements through rent increases but there is no fairness in allowing these rent hikes to be permanent so that a single refrigerator can bring in hundreds of dollars in profit during an appliance's lifespan.

Most importantly, property owners should be required to submit evidence of the IAI prior to the increase of rent. Placing the burden upon tenants who have no knowledge of the apartment's condition before their tenancy is a policy that invites abuse. The challenge is expanding the examination process to be efficient enough for landlords to get their approvals without delaying the re-letting of apartments. Increasing staff at DHCR and allowing online submissions that include scanned documents and photographs could streamline the process. The format of evidence should also be standardized, including item-by-item breakdowns to allow for quicker examinations.

After an approval of an IAI from DHCR, the tenant should be mailed a notice from the agency that lists the alleged improvements and information on how to file an overcharge claim if they believe the IAI claim was fraudulently made. But notice to the next tenant is not enough. A common tactic for fraud is a short-term, often illusory tenant who moves in after an increase and departs after only a few months.[173] To combat this common technique DHCR should randomly audit submissions with onsite inspections to establish better accountability.

C. Reform the Four-Year Rule

Leases are considered contracts and are subject to a six-year statute of limitation.[174] Property owners are able to go back six years to collect payments or for violations of substantial obligations of a lease.[175] Tenants should have reciprocal rights in reviewing rent overcharge claims for this same period of time. CPLR § 213(A) should be abolished and CPLR § 213 should dictate the base date of overcharge claims. Landlords should not be allowed to avail themselves of the protection of the statute of limitations unless they have a signed copy of the rent stabilization rider proving they informed the tenant and registered the IAI with DHCR. This small change in law would put tenants on a

173. *See, e.g.*, Martin v. Broadway Sky, LLC, 2012 N.Y. Slip Op. 30059(U) (Sup. Ct. 2012), http://www.nycourts.gov/reporter/pdfs/2012/2012_30059.pdf; 506 W. 150th St., LLC v. Prier, 36 Misc. 3d 1201(A), 2012 N.Y. Slip Op. 51143(U) (Civ. Ct. 2012), http://www.nycourts.gov/reporter/3dseries/2012/2012_51143.htm.

174. N.Y. C.P.L.R. 213 (McKinney Supp. 2015).

175. *See* Westminister Props. v. Kass, 163 Misc. 2d 773 (N.Y. App. Term 1st 1995) (finding landlord could not bring claim because the six year statute of limitation had passed).

level playing field with landlords while establishing reasonable business practices as the rule instead of the exception.

D. Enact Right to Counsel

If the State of New York is unwilling to protect affordable housing, then changes could be made to allow the private bar to better fill the justice gap. While litigation is a poor substitute for proper regulation, it is better than nothing at all. New York City Housing Court has been described as a "one-sided eviction apparatus" for pro se tenants.[176] As retired judge Emily Jane Goodman observed, "Housing Court is the most unbalanced, unfair and unjust court in our system, and the biggest problem is lack of legal representation."[177] This echoes the complaint of Justice Douglas, who said nearly fifty years ago: "Default judgments in eviction proceedings are obtained with machine-gun rapidity, since the indigent cannot afford counsel to defend. Housing laws often have a built-in bias against the poor."[178]

The simplest solution to this injustice would be increasing access to attorneys. A "civil Gideon" or right to counsel would allow for more educated examinations of the impenetrable thicket including potential IAI fraud.[179] One randomized study in Manhattan Housing Court found legal counsel for tenants was the sole factor for "significantly more beneficial procedural outcomes than their pro se counterparts."[180] A recent examination of a limited right to counsel by the City of New York Independent Budget Office found the program would save $143 million annually in homeless shelter costs alone.[181] Bringing in more attorneys in to protect tenants would reduce the information asymmetry that

176. Paris R. Baldacci, *Assuring Access to Justice: The Role of the Judge in Assisting* Pro Se *Litigants in Litigating their Cases in New York City's Housing Court*, 3 CARDOZO PUB. L. POL'Y & ETHICS J. 659, 667 (2006). These are not problems unique to New York City. *See generally* Barbara Bezdek, *Silence in the Court: Participation and Subordination of Poor Tenants' Voices in Legal Process*, 20 HOFSTRA L. REV. 533 (1992).

177. Mireya Navarro, *Support Builds for a Push to Provide Tenants with Lawyers in Housing Court*, N.Y. TIMES, Dec. 17, 2014, at A27.

178. Williams v. Shaffer, 385 U.S. 1037, 1040 (1967) (Douglas, J. dissenting).

179. *See generally* Raymond H. Brescia, *Sheltering Counsel: Towards a Right to a Lawyer in Eviction Proceedings*, 25 TOURO L. REV. 187, 203–04 (2009) (arguing New York would better prevent homelessness and preserve affordable housing with a right to counsel); Rachel Kleinman, *Housing* Gideon*: The Right to Counsel in Eviction Cases*, 31 FORDHAM URB. L.J. 1507 (2003) (arguing meaningful access to justice in eviction proceedings require the right to counsel); Ken Karas, *Recognizing a Right to Counsel for Indigent Tenants in Eviction Proceedings in New York*, 24 COLUM. J.L. & SOC. PROBS. 527 (1991) (arguing indigent tenants have a Constitutional right to counsel); Andrew Scherer, *Gideon's Shelter: The Need to Recognize a Right to Counsel for Indigent Defendants in Eviction Proceedings*, 23 HARV. C.R.-C.L. L. REV. 557 (1988) (arguing that rights are meaningless unless tenants are able to obtain enforcement).

180. Carroll Seron, Martin Frankel, Gregg Van Ryzin & Jean Kovath, *The Impact of Legal Counsel on Outcomes for Poor Tenants in New York City's Housing Courts: Results of a Randomized Experiment*, 35 LAW & SOC'Y REV. 419, 429 (2001).

181. Memorandum from Elizabeth Brown, Indep. Budget Office, to George Sweeting (Dec. 10, 2014), http://www.ibo.nyc.ny.us/iboreports/2014housingcourtletter.pdf.

exists for unrepresented tenants who bear the burden to recognize, understand, and articulate a complaint of fraud. This is even more important after *Boyd*, as the pleadings of fraud may become more challenging. Attorneys scrutinizing cases would provide a strong disincentive to the theft of affordable housing with greater possibility of detection and the active threat of treble damages.

E. Close the LLCs Loophole

Real estate donors take advantage of what the *New York Times* describes as "a quirk in campaign finance laws that allows them to give far above the limits for individual donors by moving money through dozens of limited liability corporations, most of them corresponding to specific buildings or properties."[182] LLCs are treated as individual people, allowing the donation of $60,800 annually to statewide candidates instead of the $5000 limit on corporations.[183] This significant difference has given the real estate industry disproportionate power in Albany. The loophole allows LLCs to donate under the company name, making the identity of the true donors difficult to trace.[184] This lack of transparency is ripe for abuse and played a role in the investigation and conviction of several politicians including Assembly Speaker Sheldon Silver and Senate Majority Leader Dean Skelos.[185] Treating LLCs like corporations and making them subject to the $5000 contribution limit would close this loophole.[186] This change could help break the legislative logjam in Albany and refocus the legislature's attention on the social and economic needs of the state, as opposed to the desires of those providing millions in quasi-anonymous campaign contributions.

F. Eliminate Deregulation

As the rent prices continue to rise we need more affordable housing, not less. The biggest incentive for fraud is not merely the rent increase owners can charge with an IAI, but the removal of rent stabilization through vacancy deregulation. No tinkering with rent regulation will matter if there are no units left. Rent regulation was created in response to a housing emergency, not as an anti-poverty program. The rent is too damn high and making rents higher is not the answer. Removing the largest incentive for fraud by eliminating the failed 1993 experiment of vacancy and luxury deregulation would reduce the frequency

182. Nicholas Confessore, *Landlords Try to Woo Albany Democrats on Rent Laws*, N.Y. TIMES, Aug. 8, 2008, at A1.

183. Thomas Kaplan, William K. Rashbaum, & Susanne Craig, *After Ethics Panel's Shutdown, Loopholes Live On in Albany*, N.Y. TIMES, Dec. 8, 2014, at A1.

184. Danny Hakim, *Developers Raise Stake in Politics*, N.Y. TIMES, June 10, 2007, at 37.

185. William K. Rashbaum, *Realty Firm's Power Laid Bare*, N.Y. TIMES, Dec. 19, 2015, at A1.

186. Ciara Torres-Spelliscy & Ari Weisbard, *What Albany Could Learn From New York City: A Model of Meaningful Campaign Finance Reform in Action*, 1 ALB. GOVERNMENT L. REV. 194, 210 (2008).

of fraud going forward and ensure affordable housing for future generations of New Yorkers.

V.
CONCLUSION

Rent stabilization not only protects tenants but "provides predictability to landlords, and significantly enhances the social, economic and demographic stability of New York City."[187] Our system and our city are under attack by a sizeable minority of unprincipled property owners exploiting the unwatched corners of rent stabilization law. This is not a new phenomenon. For as long as the government has attempted to regulate rents, there have been landlords overcharging tenants.[188] To combat their greed, we need more transparency, accountability, and better incentives. It is far easier to preserve what little affordable housing exists than to replace it once it has been taken away. It is imperative that the city and state government take bold action now, or hundreds of thousands of middle- and working-class families will be permanently priced out of the City.

187. 390 W. End Assocs. v. Harel, 298 A.D.2d 11, 16 (N.Y. App. Div. 1st 2002).

188. *See, e.g.*, *Tenants Coerced by Threat of Suit*, N.Y. TIMES, July 3, 1920, at 23.