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New York enacts Affordable Housing Retention Act

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Highlights

- New York Gov. Kathy Hochul recently signed into law the Affordable Housing Retention Act (AHRA), which for the next four years enables condo conversions of specific buildings in New York City with a presale requirement for effectiveness of 15 percent of tenants and purchasers, rather than just 51 percent of tenants.
- The AHRA's purpose is to ensure the permanent affordability for income-restricted units and provide non-purchasing tenants protection, including rent stabilization, eviction safeguards and, possibly, purchase opportunities.
- This Holland & Knight alert details the new law and what prospective participants can expect and do to take advantage of it.

The New York State Legislature has enacted, and Gov. Kathy Hochul has signed into law, the Affordable Housing Retention Act (AHRA), which for the next four years enables condo conversions of specific buildings in New York City with a presale requirement for effectiveness of 15 percent of tenants and purchasers, rather than 51 percent of tenant buyers.

The purpose of the AHRA is to ensure the permanent affordability for income-restricted units and provide non-purchasing tenants of the converted buildings the tenant protection afforded by rent stabilization laws, Good Cause Eviction Law and the ability to purchase their apartments in a new form of hybrid condominium where city and state agencies and a nonprofit play a role.

Briefly described, the AHRA enables a very limited group of landlords the ability to convert their buildings to condominiums in a very complex procedure requiring approval from multiple city and state agencies.

Background

The AHRA is an attempt by the legislature to reduce the complaints it has received as a result of the changes made to the Martin Act (New York State's Securities Law pursuant to which condominiums are created) caused by the Housing Security and Tenant Protection Act of 2019 (HSTPA), which increased the percentage of sales in order to convert a rental building into a condominium or cooperative from 15 percent of tenants and non-tenant purchasers agreeing to occupy the unit when it becomes available to 51 percent of tenants.

This was done for no apparent reason because there were so few conversions done in the years prior to 2019 and the HSTPA effectively made it impossible for New York City renters to become homeowners. Apparently, the Martin Act changes were included in the HSTPA in order to punish the landlords by not allowing them to convert their building after the HSPTA made the buildings unprofitable.

If the legislature had left the Martin Act alone, hundreds of thousands of tenants would be homeowners today, and the landlords could have used the money to build or renovate more housing. As a result of the HSTPA, since 2019, there have been virtually no rental buildings converted to condominiums.

However, the AHRA has such limited applicability and is so complex that it will do very little to increase homeownership or resulting in more housing. In fact, many of the very limited group of buildings it was intended to assist will not be able to do so. Moreover, the restrictions on landlords contained in the HSTPA gave landlords limited resources to make repairs and renovations, resulting in buildings deteriorating.

The idea behind the AHRA is that the money that landlords can make selling 80 percent of the building will enable them to maintain the entire building until it can sell all the marketable units, which is unlikely to occur.

The issue that seems to have triggered this sudden interest in conversions was due to the fact that many of the buildings that received tax exemptions under programs such as 421-a for a period of 25 to 30 years in which 25 percent or more of the apartments were set aside for low- and moderate-income tenants.

As the building's tax exemption ended, the market-rate tenants had their rent increased to market, but the affordable tenants remained affordable as long as the original tenant remained in the apartment. However, at such time as the original tenant moved, the rent could go to market.

Accordingly, over a relatively short period of time, the entire building would become free-market, which was the original premise that the developers relied upon in participating in the program. Under the 421-a program, the developers could convert the buildings to condominiums, but the affordable apartments were included.

The AHRA also adds Section 352-eeeee to the New York General Business Law and Section 339-mm to the Condominium Act portion of the Real Property Law in order to provide for the conversion of the rental buildings in New York City to condominium ownership in exchange for the creation of permanently affordable housing.

The goal was to provide homeownership opportunities to the market-rate tenants while ensuring the long-term preservation of affordable housing units that are at risk of no longer being affordable or in need of capital to meet ongoing maintenance, repairs and unfunded legislative-imposed mandates.

The AHRA permits property owners to convert market-rate rental apartments to condominiums in exchange for permanent affordability commitments for existing income-restricted units, which is intended to preserve existing affordable housing in perpetuity.

However, in order to convert the buildings, the sponsor must enter into contracts with tenants or bona fide purchasers representing 15 percent of the market-rate units in the building, providing that the affordable income-restricted apartments are conveyed to a nonprofit housing provider (a Qualified Owner) and made permanently affordable. In essence, the market-rate condominium units will subsidize the rent of the units.

Meeting qualifications

In order to qualify as an "eligible project" under the AHRA, a building must meet the following criteria:

- The project must consist of at least 100 apartments and have been built after 1996.
- The building cannot be part of the Mitchell-Lama program or owned by a redevelopment company or limited profit company or subject to certain other public housing programs.
- The building must contain income-restricted rental units that have been subject to a government program that received government assistance.
- The building may not be subject to an existing Regulatory Agreement.
- The building may not be prohibited from being converted to condominium ownership.

Pursuant to the AHRA income-restricted apartments are apartments that are either "low-income units" under Section 42 or 142 of the Internal Revenue Code and subject to a Regulatory Agreement or apartments that were previously "low income units" and, notwithstanding the expiration of the Regulatory Agreements under which they were formed, have been continuously operated as income-restricted units as if they were still income-restricted rental units or apartments located in buildings that received zoning bonuses or are in mandatory inclusionary housing areas, pursuant to the New York City zoning regulations.

In order to convert market-rate apartments to condominium units that can be marketed to the tenants (but not the tenants in the income-restricted apartments) or to the general public, the sponsor must submit a plan (a Preservation Plan) to the New York Attorney General (the AG) to be reviewed and subject to the AGs acceptance.

A Preservation Plan will be required to contain adequate disclosures of all material aspects of the plan including, but not necessarily limited to, what is traditionally found in a Part 23 Offering Plan, as well as issues that must include the following:

- the existence of a regulatory agreement with a relevant housing finance agency containing an extended affordability term for income-restricted units that will go into effect when the condominium conversion of the building is effectuated
- a description of how the interests of the Qualified Owner (i.e., the nonprofit) will be represented on the condominium board, although there seems to be an assumption that the nonprofit owner of the income-restricted units will have a seat on the condominium board especially since the Qualified Owner will own 25 percent to 30 percent of the apartments
- provisions in the condominium's governing documents and the Regulatory Agreement allowing tenants of income- restricted units with access to building-wide amenities for not more than a nominal fee
- specific requirements that vacant income-restricted units will be leased to low-income tenants and that all income-restricted units will remain subject to rent stabilization in perpetuity for as long as the building exists even if the law changes and the tenants would otherwise no longer be subject to rent stabilization

The income-restricted rental units must be conveyed to a "Qualified Owner," which is a nonprofit housing development fund company, community land trust or a charitable corporation with a primary purpose of owning and operating affordable housing for low-income families.

The Qualified Owner must take title to the income-restricted units and is responsible for the ongoing operation, maintenance and compliance of the income-restricted units in compliance with the Regulatory Agreements in effect for the building. The Qualified Owner will also be subject to the supervision of a housing finance agency, which will ensure that affordability and tenant protections are maintained in perpetuity.

The AHRA also provides protections for eligible senior citizens who are over 62 years old and eligible disabled persons (Protected Tenants). Eviction proceedings may not be commenced against Protected Tenants except for nonpayment of rent, illegal use, refusal of reasonable access or other breaches of such tenants' leases.

For Protected Tenants not protected under rent stabilization laws, rent increases would be deemed unconscionable if they exceed the limits set by the Good Cause Eviction Law, regardless of condominium exemptions. If the apartment was subject to government rent regulation before conversion, that regulation continues. The rights granted to the tenants cannot be abrogated or reduced by expiration or amendment of the applicable law.

Market-rate tenants who elect not to purchase their apartments and all tenants of income-restricted rental units have the right to continue residing in their apartments after the condominium conversion. Tenants who fail to purchase their apartments can only be evicted for cause. Apartments that were regulated before the condominium conversion, will continue to be regulated.

Rent increases for unregulated tenants will be limited by the Good Cause Eviction Law if their rent was below 245 percent of fair market rent when their lease commenced. All tenants (both market-rate and income-restricted) must receive all required services and have access to common amenities on a nondiscriminatory basis, with only nominal, reasonable fees for the use of the amenities and the same managing agent must manage all units.

The AHRA, also modified Real Property Law Section 339-mm (i.e., the Condominium Act) to require that the sponsor create and fund two reserve funds.

The condominium board must receive a reserve fund from the sponsor, to be used exclusively for building-wide capital repairs, replacements and improvements necessary for the health and safety of all residents, including those residing in income-restricted units. The required amount of the building reserve fund must be at least 3 percent of the total price of all units and is based on Local Law 70, the New York City Reserve Fund Law.

The Qualified Owner must also receive a capital fund from the sponsor, equal to 0.5 percent of the total price, to be used solely for repairs and improvements to the income-restricted units. This fund is subject to oversight by the housing finance agency and cannot be used for building-wide improvements.

The condominium board is obligated to report on the two funds activity every six months, with penalties are imposed for noncompliance.

Issues caused by AHRA

As enticing as the AHRA might seem as a result of the press releases and stories about it, the new law is extremely detailed, requires participation from multiple parties and will be more expensive and time-consuming than a typical Part 23 Offering Plan. Among the issues to be considered by the sponsor are the following:

> Being able to convert the buildings with a 15 percent presale will necessitate first obtaining approvals from the AG, New York City Department of Housing Preservation and Development (HPD), New York State Division of Housing and Community Renewal (HCR), New York City Department of Finance (DOF) and a nonprofit housing company that will own the income-restricted units. Each of the foregoing agencies will have to agree on the terms of the Preservation Plan.

The income-restricted units must be made permanently affordable as long as the building is in existence, which means that the rent they pay to the Qualified Owner will be based on requirements other than what the common charges would be for the units, which could necessitate the condominium subsidizing the Qualified Owner's common charges and assessments.

The income-restricted units must be rented to low-income families, must be owned by a Qualified Owner, and must be treated the same as the units that are being sold.

The income-restricted units, could be 25 to 30 percent of the apartments in the building while 15 percent of the other units may be sold (the minimum number of units that have to be sold for the Plan to be declared effective, which could leave the sponsor in control of the condominium while the income fluctuates and the sponsor still has to give up control of the Board after five years.

Giving up control could result in the new Board reducing services to reduce costs, which also reduces the sponsor's rent on the unsold units or the Non-sponsor controlled Board could consider raising expenses to improve the building knowing the sponsor will have to pick up more than half the cost.

The holder of the mortgage on the building will have to preapprove the Preservation Plan although the lender's debt may never be paid until most of the market-rate units are sold, if ever.

This could also mean that the sponsor will not be able to refinance the debt on the unsold units when the loan matures and, if the lender has to foreclose, the lender may not be able to sell the unsold units for a significant amount because of all the rights the tenants and city and state agencies have been given.

If the Qualified Owner cannot obtain a tax exemption on the income-restricted units, the taxes on the balance of the units may be higher so the other owners will have to pick up the cost.

The Declaration and By-Laws must provide for a special allocation of common expenses, pursuant to RPL Section 339-m, requiring the Board of Managers to cover the operating expenses of the income-restricted units.

The tenants must be allowed the right to use the amenities at a nominal cost. This could cause purchasers of the market rate units to opt for other buildings, where they do not have to share the amenities.

All income-restricted units must remain rent-stabilized and may never be removed from rent stabilization, even if the law changes to allow it, which means that whatever inflation occurs or unfunded mandates from the city and state will not be paid by the Qualified Owner of the renters whose rents will be capped based on the Good Cause Eviction Law and not the actual cost of operating the condominium.

The preservation plan must provide for a reserve fund for building-wide capital improvements and a dedicated capital fund for repairs to the affordable rental apartments. The cost of these two funds must be funded by and included in the sponsor's closing costs, which will further erode the sponsor's cash reserves and the amounts the lenders receive.

The sponsor must "exercise commercially reasonably good faith efforts" to sell 51 percent of the units within five years. The AHRA defines a "commercially reasonable good faith effort" and states that it "shall not require the offeror to sell dwelling units at a price substantially below the market-rate for comparable units."

The problem is that could still result in the sponsor or holder of unsold units being required to defend its decision to not sell units based on what is "a price substantially below the market rate" and what is a comparable unit? The other issue is likelihood that the offeror may not be able to obtain enough to pay off the debt on the unsold unit based on the market value of these units in a condominium with a non-profit on the condominium board.

The sponsor must amend the Offering Plan annually identifying which units are occupied or vacant and, if occupied, by whom and how long the vacated units have been vacant. There are a great many filings required by the condominium board and the sponsor that will no doubt have to be certified as true, which could result in fines or enforcement actions if all the deadlines and requirements are not met.

The relevant housing finance agency will have oversight authority over a limited-equity housing cooperative, if one is formed to own the income-restricted units. This is an option the Qualified Owner has, which could create a co-op in the condominium, which will increase the operating costs of the condominium.

It also keeps a government agency having supervisory authority over part of a private condominium and could result in the condominium being subject to investigations over how the two entities operate.

The condominium board must report semiannually on all deposits and withdrawals from the reserve fund. The condominium board has control over the Reserve Fund, but it has no involvement with the Dedicated Capital Fund that is the responsibility of the Qualified Owner. What responsibility will the condominium board have over the Qualified Owner's use of the Dedicated Capital Fund? What control will the Qualified Owner or the city and state agencies have over the use of the Reserve Fund?

After the plan is accepted by the AG, the sponsor must post a list of all violations against the building and update it regularly. This is very troubling because unhappy residents will frequently call in complaints to city agencies and, while the inspector is in the building, they inspect other issues contained within hundreds of pages of regulations.

It happens in condominium buildings periodically because the ultimate cost is borne by everyone, but tenants will not bear the cost of the call they make. The problem is that all of the things they could complain about are condominium general common elements, so the cost will be borne primarily by the unit owners.

The Qualified Owner may not take ownership of, or responsibility for, the affordable units without a sizable payment by the sponsor and given a certain degree of control over the operation of the condominium. The former will be costly for the sponsor and the latter will reduce the ability of the unit owners to control their living costs.

If the nonprofit ceases to do business and no Qualified Owner takes over the income-restricted units, based on RPL Section 352-mm, the cost of the income restricted-units could be borne by the unit owners and not the renters.

The sponsor's investors may have to approve all of the foregoing requirements and the conversion.

An open question is what happens if the condominium board disagrees with something the Qualified Owner or the supervisory agencies wants? How will the purchasers' investment in their homes be protected against overreach by city and state agencies and a nonprofit?

The Special Risk section of the Offering Plan will have to enumerate all of the possible risks plus additional risks that the AG's reviewers can envision.

Although not part of the law, landlords must consider the marketability risk of the market-rate apartments as a result of the obligations placed on the condominium board and the for-sale unit owners and the limitations placed on the sponsor, as well as the control the Qualified Owner and multiple city and state agencies will have, the subsidy the affordable tenants will receive from the unit owners, and the allocation of the real estate taxes.

There will also need to be an incentive for the Qualified Owner to participate since there are also risks and costs for the nonprofit.

The foregoing explanation of the details of Section 352-eeeee are also subject to the regulations that will be issued by the AG, which are due in a year. There may also be regulations issued by the New York City Department of Housing Preservation and Development (HPD), New York State Division of Housing and Community Renewal (HCR), and New York City Department of Finance (DOF).

Conclusion

Although being able to convert a rental building with contracts for 15 percent of the market-rate apartments (i.e., the income-restricted apartments) from tenants or anyone claiming that they will live in the apartment when it becomes available, is a very attractive opportunity for landlords, the process will undoubtedly be significantly longer and more expensive than an ordinary Part 23 conversion, which already takes 12 to 18 months to review and can be rejected for minor imperfections.

It is true that the sale of 15 percent will be much easier to achieve than finding 51 percent of the tenants to purchase their apartments, and obtaining the 51 percent may result in lower prices for the first 51 percent of the apartments because the tenants will have leverage.

Unfortunately, the universe of buildings that qualify for Section 352-eeeee is very limited, and achieving the ability to present a Preservation Plan and the Offering Plan to the tenants will necessitate negotiations with the AG, HPD, HCR, DOF and the nonprofit Qualified Owner to take ownership of the affordable units.

Dealing with just two of the agencies is difficult, but having to deal with two state agencies, two city agencies, a nonprofit and a mortgagee will be neither fast nor inexpensive. Thereafter, being able to market the units for an acceptable sales price will not be easy.

The problem with the AHRA is similar to the problem with the 485-x Housing Act: The underlying proposal is laudable, but the Legislature adds something to placate other constituencies, thereby making the legislation unusable.

Thirty thousand units of housing were built under the 421-a program, but adding the requirement to use union labor is resulting in no housing being built under 485-x. Simplify the AHRA or restore the changes made in HSTPA and tens of thousands of New Yorkers will become homeowners, and the developers will be able to afford to build more rental housing.

Holland & Knight is prepared to assist interested parties, but it is unlikely that much can be accomplished before the AG issues its regulations and, possibly, the other city and state agencies do the same.

However, that should not prevent potential sponsors from taking the preliminary steps including doing a feasibility study to determine 1) whether doing a conversion pursuant to GBL 352-eeeee makes economic sense, 2) whether your market-rate tenants would be interested in buying their apartments, which can be done through a CPS 11 filing with the AG, 3) whether your mortgagee(s) and investors (if your investors have the authority to prevent you from doing so) would permit the conversion and d) speaking to potential nonprofits who may be interested in becoming Qualified Owners of the income-restricted units and what they might want to participate.

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