STATE OF NEW YORK DEPARTMENT OF LAW

REAL ESTATE FINANCE BUREAU

M E M O R A N D U M

Re: Determination of the Absence of Excessive Long-Term Vacancies Pursuant to GBL § 352-eee(2)(3) and 352-eeee(2)(e)

September 25, 2013

This memorandum addresses the issues of excessive long-term vacancies and the "normal average vacancy rate" under General Business Law ("GBL") §§ 352-eee(2)(e) and 352-eeee(2)(e).[1]

BACKGROUND

The Martin Act provides that the Attorney General shall refuse to issue a letter stating that the plan has been accepted for filing if an excessive number of long-term vacancies existed on the date that the plan was first submitted to the Department of Law ("DOL"). More particularly, GBL §§ 352-eee(2)(e) and 352-eeee(2)(e) both provide that:

> The attorney general shall refuse to issue a letter stating that the offering statement or prospectus required in subdivision one of section three hundred fifty-two-e of this chapter has been filed whenever it appears that the offering statement or prospectus offers for sale residential cooperative apartments or condominium units pursuant to a plan unless:
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> (e) The attorney general finds that an excessive number of long-term vacancies did not exist on the date that the offering statement or prospectus was first submitted to the department of law. "Long-term vacancies" shall mean dwelling units not leased or occupied by bona fide tenants for more than five months prior to the date of such submission to

[1] This memorandum replaces the DOL memorandum dated July 31, 1996, concerning the calculation of the "normal average vacancy rate."

the department of law. “Excessive” shall mean a vacancy rate in excess of the greater of (i) ten percent and (ii) a percentage that is double the normal average vacancy rate for the building or group of buildings or development for two years prior to the January preceding the date the offering statement or prospectus was first submitted to the department of law.

DEFINITIONS

"Long-term vacancies" are defined as dwelling units not leased or occupied by bona fide tenants for more than five months prior to the date of such submission to the DOL. GBL §§ 352-eee(2)(e) and GBL 352-eeee(2)(e). To be a “long-term vacancy,” the unit must be vacant (i.e., not leased or occupied by bona fide tenants) during the entire five-month period up to the date of submission. If it is leased or occupied by a bona fide tenant during any part of that five-month period, it is a short-term vacancy.

“Vacant” means not leased or occupied by bona fide tenants. The meaning of “leased or occupied by bona fide tenants” is discussed below at page 4.

The “Window Period” means the five month period up to and including the date of submission.

“Excessive” mean a vacancy rate in excess of the greater of (i) ten percent and (ii) a percentage that is double the normal average vacancy rate for the building or group of buildings or development for two years prior to the January preceding the date the offering statement or prospectus was first submitted to the DOL.

The 10-percent test mentioned above is referred to as Prong One and the double the normal average vacancy rate test is referred to as Prong Two. Prong Two is also sometimes referred to as the “Alternative Test.”

The “NAVR Period” refers to the two calendar years before the calendar year of submission of the red herring, and is used in determining whether sponsor can satisfy Prong Two. To provide a concrete example, if the red herring is submitted on June 30, 2013, the NAVR period runs from **January 1, 2011 through December 31, 2012**, but does not include any of 2013.

APPLICABILITY

Conversions of residential rental buildings in the following jurisdictions are subject to GBL §§ 352-eee(2)(e) and 352-eeee(2)(e):

(a) localities in Nassau, Westchester, and Rockland Counties that have opted in, pursuant to GBL § 352-eee(2)(e); and

(b) New York City, pursuant to GBL § 352-eeee.

These sections do not apply to conversions subject only to GBL § 352-e such as privatizations of Mitchell-Lama cooperatives, cooperative to condominium conversions, or conversions of buildings to cooperative ownership under Article XI of the Private Housing Finance Law.

DETERMINATION OF LONG-TERM VACANCY RATE

Affidavit of No Excessive Long-Term Vacancies.

Sponsors must provide together with their submission of a proposed offering plan ("red herring") an affidavit of no excessive long-term vacancies (the "Affidavit"). The Affidavit must comply with all sub-provisions of 13 NYCRR §§ 18.1(f) and 23.1(f).

Rent Roll and Affidavit of Service

Sponsor must also submit a certified rent roll and an affidavit of service of the red herring on tenants. See 13 NYCRR § 18.2(c)(4)(ii)(B-14) or 13 NYCRR § 23.2(d)(3). The rent roll must be dated no more than 60 days before submission of the red herring, and shall include the following information:

1. the identity of the tenants or occupants in each unit;

2. the dates within the Window Period during which units were leased or occupied by bona fide tenants;

3. the term of the most recent lease for each unit including the dates of commencement and expiration;

4. the legal nature of the occupancy of each unit (rent-controlled tenancy, rent stabilized lease, market rate lease, occupancy agreement, month-to-month); and

5. the monthly rent owed on each unit.

If the rent roll does not include this information, sponsor must provide a certified document showing any of this information that is not included in the rent roll.

Calculation of the Number of Long-Term Vacancies

The burden is on sponsor to demonstrate to the satisfaction of the DOL the absence of excessive long-term vacancies. See Matter of 140 West 4th Street Corp. v. Abrams, 152 A.D.2d 847, 847 (1st Dept 1989).

Where a sponsor asserts that a unit was leased or occupied by bona fide tenants during part of the window period, the DOL will attempt to verify that statement. Where questions arise, the DOL may, in its discretion, request additional information such as leases and proof of payment of rent, or an affidavit from the occupant.

Leased or Occupied by Bona Fide Tenants

The determination of whether an apartment is leased or occupied by bona fide tenants is inherently fact-specific. The touchstone for analysis of whether a unit is leased or occupied by a bona fide tenant is whether the tenant was "put into possession of an apartment by a landlord for the purpose of holding that apartment off the rental market and who serves as a mere caretaker for the premises." Matter of Eight Cooper Equities v. Abrams, 143 Misc. 2d 52, 55 (Sup. Ct. N.Y. Cnty. 1989). In other words, the key word is "bona fide."

The following are examples of common situations that arise where units are not considered to be leased or occupied by bona fide tenants:

(a) Units occupied by a superintendent where the unit will be offered for sale under the plan.[2]

(b) Units where a court has issued a warrant of eviction against a tenant prior to the five-month period, notwithstanding whether the warrant has been executed(Matter of Burton Way Assocs. v. Abrams, N.Y.L.J. at 27, col. 1 (Sup. Ct. Albany Cnty. Apr. 24, 1991)). However, where the unit is occupied by someone whom the landlord has diligently but unsuccessfully tried to evict, it will not be considered vacant. Matter of Eight Cooper Equities, 143 Misc. 2d at 55. The difference is whether it is the landlord's inaction, rather than the tenant's recalcitrance, that results in the unit still being occupied.

(c) Units that are occupied by sponsor's employees or associates are considered vacant unless sponsor can demonstrate that the occupancy is bona fide; where the occupancy is for little or no consideration or is upon terms that require these occupants to vacate after the plan is submitted to the DOL, it is not bona fide.

(d) Units that are occupied by sponsor or its principals are considered vacant unless sponsor can provide adequate information to demonstrate that the occupancy is bona fide (e.g., affidavit attesting that occupancy has been continuous for a period of at least three years, copies of tax return, utility bills, and other documents supporting representations of occupancy).

[2] A unit occupied by a superintendent would not count as a long term vacancy so long as the unit is not offered for sale pursuant to the terms of the plan. Such a unit would not be included in the denominator for purposes of determining the long-term vacancy rate and NAVR.

In the following situations, further inquiry is required to determine whether the unit was leased or occupied by a bona fide tenant:

(e) Units where the lease has expired and sponsor asserts that the units are still occupied by a month-by-month tenant but has not provided evidence of continuing payment of rent and occupancy.

(f) Units in which there is (1) either no active utility account (i.e., there is a turn-off date that precedes the Window Period) or a utility account in the name of the landlord, not of a tenant; and (2) a lease that expired before the Window Period; and (3) sponsor has not provided evidence of continuing payment of rent and occupancy.

However, the absence of utility usage, especially where a utility account is still turned on, does not, without more, mean that a unit is vacant. Units may be occupied seasonally or as pieds-a-terre. If seasonal or pied-a-terre use is bona fide, the unit may be treated as "leased or occupied by bona fide tenants."

The Denominator for Determining the Percentage of Long-Term Vacancies

Commercial units, superintendents' units (unless offered pursuant to the plan), non-residential units, and ancillary units such as storage units and maid's rooms are not included in the denominator for purposes of calculating the long-term vacancy rate.

PRONG TWO ANALYSIS
(NORMAL AVERAGE VACANCY RATE)

Burden on Sponsor

If sponsor asserts that the building satisfies Prong Two, sponsor must provide an affidavit or other certified document describing the reasons for the vacancies during that two-year period in detail (the "Prong Two Affidavit"), as well as the information required for the Prong I affidavit, as described above.

Sponsor must also provide a certified rent roll for the two full calendar years preceding the year in which the plan is submitted. Thus, if the plan were submitted on **June 30, 2013**, sponsor must provide a certified rent roll for **January 1, 2011** through **December 31, 2012, inclusive**.

The DOL may reject a plan that fails Prong One if sponsor does not provide information sufficient to determine the applicability of Prong Two. See Matter of Lipkis v. Abrams, slip op. at 3 (Sup. Ct. Albany Cnty. June 28, 1991). Thus, it is sponsor's responsibility to provide information to support a determination under Prong Two as part of its initial submission of the red herring. Sponsor also bears the burden of demonstrating that the long-term vacancy rate, as defined by the GBL, is not more than twice the normal average vacancy rate for the two calendar years preceding the year in which the proposed offering plan is submitted for review.

Determination of "Normal Average Vacancy Rate"

For purposes of calculating NAVR, the DOL will accept at face value sponsor's assertion that units were occupied during any portion of the NAVR Period and treat them as occupied during those months without further inquiry.

In determining the "normal average vacancy rate" for a building or group of buildings, the DOL must make a determination as to whether certain vacancies shall be treated as "normal" or "abnormal" for purposes of carrying out the Prong Two analysis. If the DOL determines that a vacancy is "abnormal," it will be treated as occupied for purposes of the Prong Two analysis.

To determine whether a vacancy is "normal," the DOL looks to the facts and circumstances surrounding the vacancy. For example, the sponsor should not benefit from its intentional acts in rendering units vacant. To provide an extreme example, if a sponsor set fire to a unit, resulting in a vacancy during the NAVR Period, the DOL will treat the unit as occupied for that period (thereby lowering the vacancy rate). Some general factors that can be taken into consideration include:

1. Why have the apartments remained vacant? If the reasons are events or conditions outside the control of sponsor, this fact, taken together with the other enumerated factors, could establish that the vacancy rate is "normal."

2. Is sponsor or prior building owner receiving real estate tax incentives that required the units be registered with DHCR? If so, and habitable units were left vacant, that would dictate against a finding that such vacancies are "normal."

3. How many unrelated owners have owned the premises since the warehousing began? The more times the building has changed hands, the more appropriate it is to determine that the vacancy rate is "normal."

4. How long has the current owner/ sponsor owned the premises? If the current owner has owned the building for more than two years, and no action has been commenced either to rehabilitate, repair or re-let apartments this fact would dictate against a finding that the vacancies are "normal."

5. If there is evidence that the current owner/ sponsor colluded with the previous owner to take advantage of the previous owner's intentional warehousing of units, or if the sale appears not to have been at arms' length, that would dictate against a finding of "normal."

6. What was the condition of the apartments when the current owner took title? If the apartments were uninhabitable, this fact would suggest that the vacancies are "normal" even absent other factors, so long as this owner did not create or contribute to the condition due to lack of maintenance. However, if the current

owner has made no effort to make these apartments habitable, that counsels against a finding of normality. See factor no. 7, below.

7. What efforts has the current owner made to rehabilitate any vacant apartments? If such efforts predated the submission of the offering plan and led to some apartments being rented, that factor supports a finding of normality. If, on the other hand, the current owner did nothing to rehabilitate apartments until the Window Period but then began rehabilitating vacant apartments, that militates against a finding of normality because it shows that sponsor could have rehabilitated and rented apartments but chose to keep them off the market until submission of the offering plan.

The DOL will not predetermine issues of whether a building has an excessive long-term vacancy rate or whether its normal average vacancy rate is less than double its long-term vacancy rate. The DOL may be able to give guidance as to how it might handle specific situations, but no determination can be made under GBL § 352-eee or GBL § 352-eeee until a proposed offering plan is submitted to the DOL for review.