STATE OF NEW YORK **DEPARTMENT OF LAW**

REAL ESTATE FINANCE BUREAU

M E M O R A N D U M

Re: Tenant Buyouts **Date: July 9, 2015**

I. Introduction

The Department of Law publishes this memorandum as a guidance document pursuant to State Administrative Procedure Act Section 102(14). It repeals and replaces the New York State Department of Law ("DOL") guidance document dated July 9, 1986 titled "Buy-out Offers" (the "1986 Guidance Document").

For purposes of this guidance document, a "buyout agreement" is a private contract between a building owner and a tenant under which the tenant agrees to surrender their unit in return for some consideration, usually a lump sum payment.

In permitting buyout offers to be made to tenants in rent-regulated units, under certain circumstances and with certain disclosures, DOL takes no position on the legality of these buyout agreements. DOL recommends that tenants seek the advice of counsel on whether acceptance of a buyout offer is a waiver of rights under the rent regulation laws.

II. Martin Act Protections for Tenants

One purpose of the Martin Act is to protect tenants in buildings undergoing conversion to condominium or cooperative ownership from harassment, deterioration of services, and threats of imminent eviction. *See* 1982 N.Y. Laws, ch 555, § 1. *See also Park W. Vill. Assocs. v. Nishoika*, 187 Misc. 2d 243, 244-5 (1st Dep't 2000) ("overarching purpose" of GBL § 352-eeee is to "protect tenancies during the cooperative and condominium conversion process").

As such, the Martin Act and related regulations give tenants certain rights and protections. First, the Martin Act gives tenants a right to purchase, which arises on the date that an offering plan is accepted for filing by the DOL. Tenants in occupancy on the date an offering plan is accepted for filing have an exclusive right to buy the unit they occupy (or the shares allocated to that unit), for a period of ninety days from the acceptance date. *See* General Business Law ("GBL") §§ 352-eee(2)(d)(ix); 352-

eeee(2)(d)(ix); 13 N.Y.C.R.R. § 23.3(n)(i).[1]

Second, the Martin Act provides protections for any "non-purchasing tenant." These non-purchasing tenant protections come into force on the date that a plan is declared effective. The Act defines a non-purchasing tenant as:

> A person who has not purchased under the plan and who is a tenant entitled to possession at the time the plan is declared effective or a person to whom a dwelling unit is rented subsequent to the effective date. A person who sublets a dwelling unit from a purchaser under the plan shall not be deemed a non-purchasing tenant.

See GBL §§ 352-e(2-a)(a)(ii); 352-eee(1)(e); 352-eeee(1)(e).

III. Buyouts of Tenants in Rent-Regulated or Unregulated Units Prior to Plan Submission

A. Policy Guidance

The policy concerns raised by pre-red herring buyouts are the same now as they were in 1986. As such, the guidance on these buyouts set out in the 1986 Guidance Document remains in place.

If there is evidence that a sponsor entered into pre-red herring buyout agreements where tenants were allowed or required to remain in occupancy during some part of the five-month period that is used to determine whether long-term vacancies exist, DOL may seek further information as to the bona fides of those tenants for purposes of the excessive long-term vacancy analysis. After inquiry, DOL may conclude that those tenants are not bona fide.

B. Required Disclosures

Where a sponsor executes buyout agreements with tenants prior to plan submission and the tenants remain in their units for any part of the five-month period that is used to determine whether long-term vacancies exist, facts relating to the buyout agreements should be disclosed to DOL in the affidavit required in Part 23.1(f) of Title 13 of the New York Codes, Rules and Regulations.

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[1] The regulations contained in Part 23 of Title 13 of the New York Codes, Rules and Regulations govern the conversion of occupied of residential buildings to condominium ownership. Part 18 of the same title governs the conversion of occupied residential buildings to cooperative ownership. For simplicity's sake, this guidance document cites to only the Part 23 regulations. Nonetheless, this guidance document applies as well to Part 18 conversions.

IV. Buyouts of Tenants in Rent-Regulated Units After Plan Submission

A. Policy Guidance

Because a tenant in a rent-regulated unit holds tenancy protections under the rent regulation laws, a tenant occupying a rent-regulated unit on the date that a plan is submitted to DOL can, if they choose, remain in a building throughout the conversion process, unless their tenancy is lawfully terminated for reasons unrelated to the conversion. This is because a landlord is prohibited from failing to renew their lease except as set forth in the rent regulation laws. Under the Martin Act, these tenants, if they are in occupancy on the date a plan is accepted for filing, also secure an exclusive right to purchase their unit for a period of ninety days after plan acceptance.

As such, these tenants have a range of choices, most of which are protected by statute. They may remain as rent-regulated tenants in the newly-created cooperative or condominium. They may purchase their unit under the offering plan, during the ninety-day exclusive period, during any extension thereof, or at some later date. Or they may vacate their unit, with or without financial inducement from the sponsor. To ensure that tenants are able to make an informed decision between these options, the DOL's 1986 Guidance Document required, among other things, that buyout offers could be accepted by tenants only after an offering plan is accepted for filing, the earliest date on which full information about the offering is available. *See Abrams v. Long Beach Oceanfront Assocs.*, 136 Misc. 2d 137, 141 (Sup. Ct. N.Y. Cnty. 1987).

With respect to tenants in rent-regulated units, these policy concerns are as relevant today as they were in 1986. For this reason, the policy set out in the 1986 Guidance Document will remain in place as to tenants in rent-regulated units.

After an offering plan has been submitted to DOL, the sponsor may offer buyouts to tenants occupying rent-regulated units only if the following conditions are met:

- **Sponsor must disclose the buyout offer and the DOL's position on buyout agreements in the offering literature;**

- **Buyout offers must not violate anti-discrimination laws, including but not limited to the federal Fair Housing Act of 1968, the federal Fair Housing Act Amendments Act of 1988 and the New York State Human Rights Law; and**

- **A tenant in a rent-regulated unit may not accept a buyout offer until DOL has accepted the offering plan for filing.**

B. Required Plan Disclosures

The buyout offer and the DOL's position on buyout agreements must be disclosed in the offering literature. If the decision to offer buyouts to tenants in rent regulated units is made prior to plan submission, the disclosure of the offers should appear in the version of

the offering plan submitted for review to DOL and distributed to tenants. Otherwise, sponsor should provide the disclosure in a revision to the plan during the red herring period, pursuant to Part 23.1(h) of Title 13 of the New York Codes, Rules and Regulations (a "Revision"). Sponsor must serve a copy of the Revision on tenants. The submission by sponsor of a Revision will not restart or extend the four to six month review period required under Section 352-e(2) of the Martin Act. A sample form of buyout agreement should be included, as an exhibit in Part II of the proposed offering plan or as an exhibit to a Revision.

DOL's position on buyout agreements may be disclosed in a plan as permitted by this guidance document.

Sample disclosure language is below:

> *To the extent permitted by law, Sponsor reserves the right to selectively offer, in its sole discretion, buyout payments in amounts to be determined by Sponsor and subject to tenants' rights to negotiate money or other incentives to some bona fide tenants in occupancy to induce them to vacate and surrender their apartments. DOL takes no position on the legality of buyout agreements and recommends that tenants seek the advice of counsel on whether acceptance of a buyout offer is a waiver of rights under the rent regulation laws.*

V. Buyouts of Tenants in Unregulated Units After Plan Submission

A. Policy Guidance

Because the Martin Act does not give certain tenants in unregulated units tenancy protection until an offering plan is declared effective, these tenants are in a different position than tenants in rent-regulated units.[2] The concerns that arise in the context of tenants in rent-regulated units are not present where tenants in unregulated units are concerned. Thus, without taking a position on their legality, DOL will not prohibit buyout agreements between sponsors and tenants in unregulated units.

- **During the red herring period, sponsor shall have the right, but not the obligation, to enter into a reservation agreement with a tenant in an unregulated unit. In furtherance of reaching an agreement on such a reservation agreement, sponsor shall have the right, but not the obligation, to negotiate with a tenant on the purchase price for the sale to the tenant of the tenant's unit or of any other unit in the offering.**

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[2] Prior to effectiveness, the Martin Act does extend tenancy protections to certain senior citizens and disabled people who reside in unregulated units who elect to become non-purchasing tenants. *See* GBL §§ 352-e(2-a)(a); 352-eee(1); 352-eeee(1).

A reservation agreement is an agreement under which a tenant reserves a unit for purchase at some future date. Entering into such an agreement may be attractive to those tenants who were in occupancy on the date that a plan was submitted to DOL but who will vacate prior to plan acceptance and thereby, not secure the Martin Act right to purchase.

A reservation agreement would work as follows.

In return for a nominal payment (the "Reservation Payment"), the sponsor would reserve a particular unit for purchase by the vacating tenant ("Prospective Buyer") at the price set forth in Schedule A of the red herring or such other price as may be negotiated by the parties, from the date that the reservation agreement was entered into until ninety days after the date the plan is accepted for filing. The sponsor would be required to escrow the Reservation Payment to comply with Sections 352-e(b) and 352-h of the Martin Act and DOL regulations promulgated pursuant thereto.

The Prospective Buyer would be permitted to execute a purchase agreement for the unit and pay the down payment only after the offering plan is accepted for filing. If the Prospective Buyer did enter into a purchase agreement for the unit during the ninety day period following plan acceptance, the Reservation Payment would be credited against any amount due as a down payment for the unit. If the Prospective Buyer did not enter into a purchase agreement for the unit during that period, the Reservation Payment would be surrendered to sponsor. However, DOL reserves the right to require a sponsor to return a Reservation Payment in the event any material adverse change is made to the offer in the period between distribution of the red herring to tenants and the date that the plan is accepted for filing.

A sample reservation agreement is attached hereto as Exhibit A.[3]

B. Required Plan Disclosures

Sponsor must disclose any buyout offer in the offering literature. If the decision to offer a buyout is made prior to plan submission, the disclosure should appear in the version of

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[3] It has been the practice of DOL to impose a "quiet period" from the date that an offering plan is submitted to DOL for review and the date that the plan is accepted for filing. The DOL quiet period was modeled on the quiet period imposed by the Securities and Exchange Commission under the Securities Act of 1933. The purpose of the DOL quiet period is to prevent sponsors of real estate securities offerings from making offers prior to acceptance by DOL of an offering plan. *See* GBL § 352-e(1)(a). The Martin Act provides that any such offer is illegal unless the security offering is exempted under the Act "or by rule or action of the Attorney General." *Id.* To the extent that a reservation agreement, as discussed above, can be construed as a security offering, DOL hereby exempts any such reservation agreement from the requirements of Section 352-e(1)(a).

the offering plan submitted for review to DOL and distributed to tenants. Otherwise, sponsor should provide the disclosure in a Revision to the proposed plan. Sponsor must serve a copy of any such Revision on tenants. The submission by sponsor of such a Revision will not restart or extend the four to six month review period required under Section 352-e(2) of the Martin Act. A sample form of buyout agreement should be included, as an exhibit in Part II of the proposed offering plan or as an exhibit to the Revision.

Sample disclosure language is below:

> *To the extent permitted by law, Sponsor reserves the right to selectively offer, in its sole discretion, buyout payments in amounts to be determined by Sponsor and subject to tenants' rights to negotiate money or other incentives to some bona fide tenants in occupancy to induce them to vacate and surrender their apartments.*

If a tenant in an unregulated unit executes a buyout agreement, sponsor must disclose that fact and disclose the date on which the tenant is expected to vacate the unit, in a Revision to the proposed plan.

Sponsor must disclose any offer of a reservation agreement. If the decision to allow vacating tenants to enter into a reservation agreement is made prior to plan submission, the disclosure should appear in the version of the offering plan submitted for review to DOL and distributed to tenants. Otherwise, sponsor should provide the disclosure in a Revision to the proposed plan and serve the Revision upon tenants. The submission by sponsor of such a Revision will not restart or extend the four to six month review period required under Section 352-e(2) of the Martin Act. A sample form of reservation agreement should be included, as an exhibit in Part II of the proposed offering plan or as an exhibit to the Revision.

If a vacating tenant in an unregulated unit executes a reservation agreement, sponsor must disclose that fact in a Revision to the proposed plan that is distributed to the tenants at black book.