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RENT STABILIZATION

Newly Created Apartment Is Luxury Deregulated

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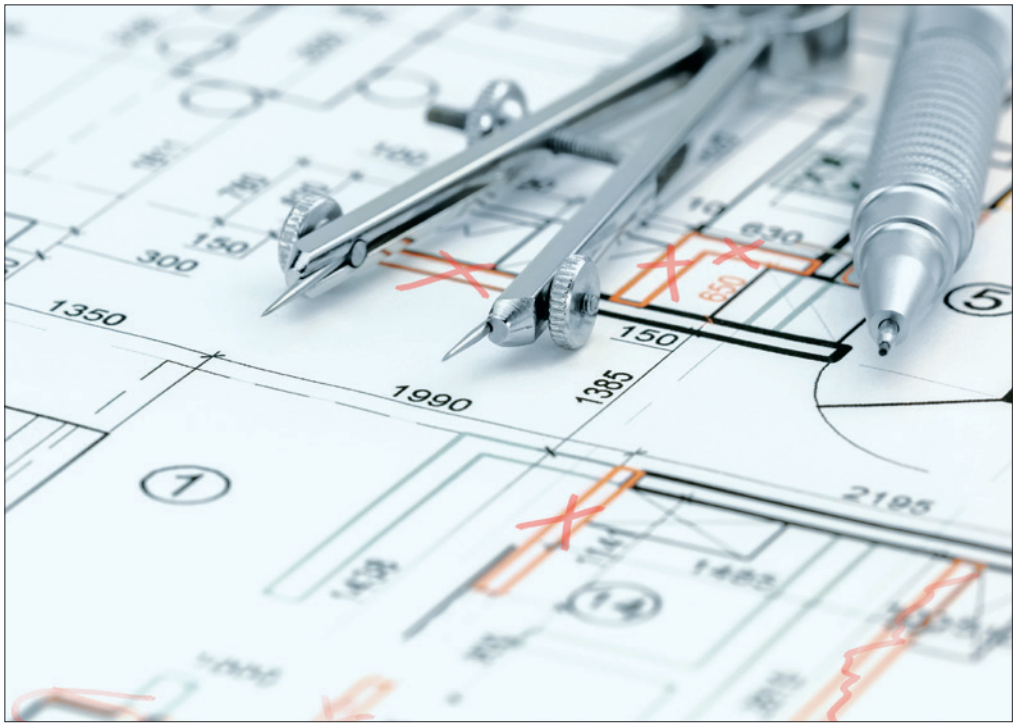
One of the smartest things the landlord of a rent-stabilized building can do is to use existing space in the building to create an apartment that did not previously exist. Such work—if properly done—acts as a foolproof vaccination against tenant claims of rent overcharge. Pursuant to Justice Gerald Lebovits' July 12, 2016 decision in *Rubin v. Decker Assoc.*, 52 Misc.3d 1208(A) (Sup. Ct. N.Y. Co. 2016), creating a new apartment, under the proper circumstances, can also defeat claims of rent-stabilized status.



ISTOCK

The First-Rent Rule

One of the primary features of rent stabilization is that the current rent for a given apartment is a function of the rent previously charged. Thus, a tenant renewing his or her lease is charged a guideline increase (assuming there is one under the de Blasio/RGB regime) over the existing rent. An incoming tenant, similarly, will pay a statutory vacancy increase above the rent paid by the last tenant.

But what happens when the landlord, between tenancies, alters the apartment in some fundamental way? For example, a landlord might combine two apartments into one, or split one apartment into two. Under such circumstances, the existing and new apartments are so fundamentally different that the existing rent no longer serves as a logical antecedent for calculating the present rent.

DHCR's predecessor, the New York City Conciliation and Appeals Board (CAB) developed the "first-rent rule" to govern such instances. CAB held that where the outer perimeters of an apartment have been substantially altered, the landlord is entitled to a first, market rent that the tenant

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cannot challenge. For example, in CAB Opinion No. 9,358, the agency allowed the landlord to charge a first rent where he consolidated three apartments on two different floors into a single duplex.

'300 West 49th Street Assoc.'

In *300 West 49th Street Assoc. v. New York State Div. of Hous. and Community Renewal*, 212 A.D.2d 250 (1st Dept. 1995), the Appellate Division, First Department endorsed the rent agency's un-codified first-rent rule. There, the First Department wrote:

> If the rental history of a stabilized apartment is no longer applicable due to the creation of a new unit with completely different perimeter walls, there would be no rational method which DHCR could utilize to calculate the legal rent since the stabilized rent is based upon a continuous chain of rental history. By way of example, such allowance might be granted if a two-bedroom apartment were split into studio apartments or two smaller dwellings were consolidated to form one large apartment. In either circumstance, the rental history of the prior units would be inapplicable to the newly created apartment for the purposes of determining the stabilized rent as the former unit or units no longer remain.

In Operational Bulletin 95-2, issued on Dec. 15, 1995, DHCR for the first time promulgated a formal definition of the first-rent rule:

> First rents: Where a landlord significantly changes the perimeter and dimensions of an existing housing accommodation, or creates a housing accommodation in space previously used for non-residential purposes, the DHCR may find that the resulting housing accommodation was not in existence on the applicable base date. Such a finding may entitle the landlord to charge a market 'first rent,' subject to guidelines limitations for further rent adjustments.

Pursuant to Justice Lebovits in 'Rubin,' creating a new apartment, under the proper circumstances, can defeat claims of rent-stabilized status.

Notably, neither *300 West 49th Street* nor Operational Bulletin 95-2 dealt with an apartment where the first rent was above the threshold for high rent vacancy deregulation pursuant to RSL §26-504.2. In such circumstances, the first rent, i.e., whatever the landlord and the tenant agree to, becomes the lawful stabilized rent for the apartment, and all increases thereafter are based upon that first rent.

What makes the creation of a new apartment so desirable is that the tenant can in no way challenge the legality of the first rent. As noted, a claim of rent overcharge involves a comparison between the prior rent for an apartment and the current rent. Where the former apartment or apartments are obliterated, and a new apartment is created, there is no basis for comparison, and hence no possibility of a rent overcharge.

Another advantage of creating a new apartment is that the legality of the first rent does not depend upon how much money the landlord spent to create the new unit. Thus, if a landlord takes two $900-per-month apartments and combines them at a cost of $10,000, the legal rent is whatever the landlord and tenant agree to; the fact that the landlord might not have spent enough to justify that rent on an individual apartment improvement basis is irrelevant. Nor does the landlord have to establish or document the precise scope of work; the landlord need only prove that the two apartments were combined. Once the landlord does so, the tenant has no chance of prevailing on a claim of rent overcharge.

'Devlin'

All of the foregoing assumes that the landlord's work has resulted in an apartment that did not previously exist. Some landlords have had expansive notions about what it means to create a new apartment, and courts have not hesitated to rule in such instances that the landlord may not charge a first rent.

Once such instance is *Devlin v. New York State Div. of Hous. and Community Renewal*, 309 AD2d 191 (1st Dept. 2003). In *Devlin*, the existing apartment consisted of one bedroom, one bathroom, one kitchen, and one living room. Between tenancies, the landlord removed 86 square feet from the bedroom and added

it to an adjacent apartment. This change required the landlord to extend the existing fire escape and move electrical service from an old adjoining wall to the newly enlarged apartment next door. DHCR held that a new apartment had been created, but the First Department disagreed:

> [I]t cannot be said that former apartment 5D no longer exists; it has simply been shrunk, at the landlord's instigation. If we were to uphold DHCR's ruling, the ramifications would effectively vitiate a fundamental underpinning of our city and state rent regulation regime, that available housing units and their rents be maintained at a stable and predictable level. Moreover, to allow a landlord to significantly increase the legal rent on a unit merely by the expedient of modifying the unit's dimensions in a minor manner would encourage subterfuge as a means of improperly manipulating rent stabilization.

'Rubin'

In *Rubin*, a different question arose: Where the first rent for a newly combined apartment exceeds the threshold for vacancy luxury deregulation, is the apartment deregulated? Justice Lebovits answered that question in the affirmative.

In this case, unit 805 was combined with four other units to create apartment 8F. The new apartment was five times the size of unit 805. The landlord charged a first rent, which exceeded $2,000 per month, the luxury deregulation rent threshold at the time.

The tenant of 8F argued, inter alia, that apartment 8F remained rent stabilized. Lebovits disagreed, writing:

> Some landlords have had expansive notions about what it means to create a new apartment, and courts have not hesitated to rule in such instances that the landlord may not charge a first rent.

> The perimeter walls of apartment 8F were substantially moved when defendant created apartment 8F. Because perimeter walls were substantially moved, defendant was permitted to charge a 'first' rent for the newly formed apartment. The ETPA excludes from rent regulation units with legally regulated rent over $2,000. Defendant has proved that the first rent charged after apartment 8F was created was $6,995. A New York State Housing and Community Renewal [sic] opinion letter provides that 'if the first rent, negotiated between landlord and tenant, is $2,000 per month or more…the combined apartment would be high-rent vacancy decontrolled.' Because the first rent that defendant charged exceeded $2,000, apartment 8F is expressly decontrolled from rent stabilization.

The landlord in *Rubin* executed its plan to perfection: The entirety of the space comprised by new apartment 8F is permanently exempt from rent stabilization. DHCR has lost all jurisdiction and control over the unit. The landlord can charge any rent it wants, and is free to select a new tenant when the current lease expires.

'Altman'

The recent case of *Altman v. 285 West Fourth, LLC,* 127 AD3d 654 (1st Dept. 2015), as well as amendments to the RSL made pursuant to the Rent Act of 2015 (L. 2015, ch 20, pt. A), have raised the question of whether, to effectuate luxury deregulation, the rent must exceed the deregulation threshold (1) at the time the outgoing tenant vacates, or (2) at the time the incoming tenant moves in. As *Rubin* establishes, landlords who create new apartments can completely sidestep the issue. First, however the rule is interpreted, a landlord who creates a new unit does not have to justify or prove the legality of the first rent charged. Second, the question of when the rent for the apartment had to increase above the threshold for deregulation is obviated, as "the apartment" no longer exists.

Conclusion

The creation of new units has always been the gold standard for raising rents and avoiding rent overcharge claims. As *Rubin* makes clear, creating a new unit has the added benefit of permanently deregulating that unit if the first rent charged exceeds the luxury deregulation threshold.