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Renters on the Rise Developers Get Creative

By Lisa Iannucci

Last December, The William Beaver House, located at the heart of New York's Financial District, sat with 209 of its 320 units unsold—units priced from $900,000 to well over $2 million each. Unfortunately, while sales had gone well for the 47-story luxury building during the previous few years, the recent economic troubles let to a somewhat desperate situation for the owner of the lavish property.

Help arrived for the building in the form of CIM Group, a real estate investment company based in Los Angeles. Taking advantage of a very productive rental housing market, CIM bailed out the owner of William Beaver House and then offered the unsold units as one-year rentals, ranging from $3,200 to $8,500 per month.

Feeling the Pressure

As the housing market in many parts of the country has foundered, many developers have opted to—or been financially pressured to—convert portions of developments originally intended as condo units into rental properties. New York City hasn't been hit as hard as other markets, but the pace of new development and sales has definitely slowed, and some developers have shifted gears in order to remain profitable (and in some cases, just solvent) in the altered market.

"It's legal to convert to a rental, unless it's perpetuating sponsor control of the building, in which case the board does have a right to challenge the sponsor's lack of sales," says Bruce Cholst, a partner with the Manhattan-based law firm Rosen Livingston & Cholst. "In a newly constructed building, as long as the sponsor discloses up front that he reserves the right to not sell all apartments but rent some in perpetuity and may maintain control of the board in perpetuity, it is legal."

In 2010, however, then-New York Governor David Paterson signed a bill that made short-term, 'vacation' apartment rentals of less than 30 days illegal in New York starting on May 1, 2011. The measure was drafted largely to prevent owners and tenants from renting out their apartments on a per-night basis. A recent article in The New York Times focused on this problem in San Francisco, where such conversions to tourist rentals are widespread, though largely illegal under San Francisco's rent-control laws.

Benefits and Drawbacks

The benefit of living in a rental conversion or mixed building is that the renters have use of the amenities and the finishes without owning the condo. "That's a big allure now," said Daniel Hedaya, president of Platinum Properties in Manhattan. "People are not looking to commit to purchasing, but want that level of living, so this is a great alternative."

Other buildings have followed suit in the conversion-to-rental trend, such as 25 Broad Street downtown, as well as the Upper West Side's The Corner, a luxury building which recently rented all of its apartments between $3,000 to $18,500 per month.

"A lot of buildings have vacillated during construction, that's the risk," says Craig Delsack, a real estate business attorney in Manhattan. "It's the economic pressure on the developers who always have the right to lease unsold units and, if the rental market starts firming up—which it has been—they can garner a good cash flow from renting out. For example, earning $12,000 a month—or $144,000 for over a year—can keep the apartment off the market."

To prevent the building from becoming a transient community, however, he says the leases must be 12 months in duration

“If the condo owner is in a building where 80 percent of the other residents are renters, it does diminish their resale value,” he says. “And if the unit owner sees that the landlord is getting $12K a month, maybe they'll move so they can do it too. The unit owners won't like the devalued fair market value of the apartment, not owning any pure condo building—they are, instead, owning in a rental building.

When it comes time for an owner to want to sell their unit, they may also run into difficulty if the building is less than 50 percent owner-occupied. “The building must be at least 50 percent owner-occupied to sell, according to Fannie Mae rules, otherwise it limits the owner to selling to only a cash buyer,” says Delsack.

Owners' Voices

Regardless of the percentages, existing condo owners still have some say in how their building is run. “If the sponsor is being negligent with dumping these apartments—if the transient tenants are creating noise, trashing the place, etc.—their recourse is to go back to the sponsor and let him know he's devaluing it,” he says. “If the sponsor is bringing in residents who are tearing the place apart, they can sue the sponsor and enforce these leases.”

In Commack, Long Island, Alvin Wasserman, director of Fairfield Properties, says that he hasn't noticed the rental conversions becoming a trend where he is, because he doesn't have developer owned units.

However, he has a different rental issue. When the economy turned, the buildings didn't have any limitations regarding subletting and, as a result, some buildings restricted it while others capped it at 10 percent. “In today's economy, there are owners who are being forced to sell because they are having economic difficulties and they are appealing to the board to change the policy now, so they can sublet,” says Wasserman. “The rental market is very strong on Long Island and they can rent it quickly. Some are and some aren't changing the policy.”

Wasserman explains that it's a difficult decision for the boards because banks have become much more restrictive on financing and refinancing requirements. “Part of the consideration to finance and/or refinance is how many units are sublet in the building,” he explains. “When it comes time for someone to get refinancing, banks don't like to see the sublets, they want to see owner-occupied units. The board's dilemma they are facing now is between balancing the requests of the owners who are having financial difficulties and being responsible for the overall financial health of the property.”

Unfortunately, even though renting the unoccupied building might help with the building's bottom line, having a building with a strong percentage of renters not only comes with a financial repercussions, but a stigma too.

“There may be some kind of a perception among buyers that the building, which is filled with renters, is loosely run,” says Cholst. “That it may be more transient or party-prone, or maybe a minor stigma even without the financing.”

Hedaya says that bringing in renters shouldn't change the community dynamics of the building. “Approval requirements in buildings like these are high,” he says.

When it comes to complaints about renters, Hedaya explains that a neighbor issue is always there, regardless if it is a renter or buyer. “You're going to have those common issues where someone makes a complaint about a neighbor,” he says. “You never know who you're going to live next to.”

However, there's occasionally a bad egg in every batch. “If it's a sublet, the management company would notify the owner,” says Wasserman. “In Nassau County, the owner would be given a chance to rectify the problem with the subtenant depending on the severity of the problem. The management company can also ask the owner to terminate the lease of the subtenant, but it depends on how severe the problem is.”

However, renters do have rights. For example, unless it's outlined in the offering plan that the renters have to pay for additional privileges that the owners already have, the renters' rights are the same as the owners. The renters pay their monthly rent and fees to the landlord, typically the sponsors. The only thing they can't do is vote.