

Co-ops minus 'cooperation'

07/01/2009

In one of the strictest sectors of New York City real estate — co-ops — rule-breaking is on the rise. Real estate brokers and lawyers say that as the economy has eroded, there's been a spike in unauthorized sublets by shareholders who are desperate for cash but can't sell their homes.

Meanwhile, they say, co-op boards aren't always innocent victims. In this down market, some are exacerbating shareholders' problems by becoming overly cautious, even paranoid, in evaluating buyers, or simply dragging their feet on approvals. Others flat-out abuse their power.

"The irony is, co-op boards get stricter in a softening market, which just contributes to the softening market," said Douglas Heddings, head of the Heddings Property Group at Charles Rutenberg Realty and a former co-op board member. "It's a bit of a snowball effect."

The rise of rule-breaking on both sides of the co-op board table illustrates how, in many ways, the existence of co-ops has become a double-edged sword. On the one hand, co-ops' stringent financial requirements have been credited with helping New York avoid the worst of the subprime mortgage crisis. On the other hand, finicky boards also make apartments significantly harder to sell or rent, often depressing already-declining home prices even further.

The majority of co-ops in the city either don't allow shareholders to sublease apartments or have severe restrictions on how and when residents may rent out their homes. According to Richard Siegler, a partner in the real estate department at law firm Strock & Strock & Lavan, boards "believe that subletting is inimicable to good values." He explained that short-term residents are not considered to have the same vested interest in maintaining a building as owners.

Restrictions on subletting were rarely an issue when the market was hot. But now that the economy has soured, more co-op shareholders need cash, but can't sell their homes, making subleasing far more attractive.

"When you have economic downturns and people can't afford to stay and they can't sell,

they seek consent to sublet," Siegler said.

Despite the increased desire to rent, boards are reluctant to change their policies in response to what they view as a temporary market dip.

"Most co-op boards are viewing this as a short-term phenomenon," said real estate attorney Aaron Shmulewitz, partner at Belkin Burden Wenig & Goldman. "They believe that prices will rebound, and they're reluctant to change any policies that will endure longer than a year."

As a result, he said, there's been an uptick in the number of co-op residents who are subletting their apartments without board approval, often claiming a relative is coming to stay or sneaking furniture into the building one piece at a time.

"You're seeing more subletting now, whether legal or illegal," Shmulewitz said. "People can't sell at the prices they need to, so they're subleasing their apartments to tide them over."

Shmulewitz, who represents more than 250 co-op boards, said his firm is dealing with several instances of unauthorized subletting. In one case on the Upper East Side, he said, the board has begun eviction proceedings against a shareholder who had been taking in boarders for a week at a time, hosting tenants in her spare bedroom after posting an ad on Craigslist.

Many shareholders who lease their apartments without permission do so because buyers who can get mortgages are scarce, said Mona Shyman, executive vice president of the Federation of New York Housing Cooperatives & Condominiums.

"I get a lot of calls on illegal subletting," she said. "People want to downsize or upsize, but they can't sell. They're desperate. [Buyers] are not getting approved for mortgages. It's a big problem."

Others circumvent the rules because they need money right away, and getting a subletter approved by the co-op board can take months, Shmulewitz said. Others want to avoid the fees that many co-ops charge for subletting.

"Some people just don't pay attention to the rules," said Adelaide Polsinelli, a Marcus & Millichap broker who is president of the board at 2 Fifth Avenue, a 350-unit co-op building. "Sometimes it's greed rather than financial problems."

But boards are not always blameless, either.

Some co-ops, unaccustomed to the current economic downturn, are making it unnecessarily hard for shareholders to sell their homes, giving some owners few options but unauthorized subletting, sources said.

Shyman said she received a call several weeks ago from an irate co-op shareholder who complained that he had found a buyer for his apartment, but the deal fell through because "the board was procrastinating on approving someone."

"By the time they were approved, [the buyer] said he didn't want to live there anymore and bought somewhere else instead," she said.

The owner then asked to sublet the apartment and was told no, Shyman said, adding that he hinted he might have to consider an unauthorized sublet.

Boards sometimes purposefully delay making a decision if they want to reject someone but don't have a non-discriminatory reason, Shyman said.

While co-ops generally do not have to disclose their motives for rejecting buyers, they can be forced to in court if the potential buyer files a complaint with the United States Department of Housing and Urban Development.

Shyman noted that "misuse of power" on a board happens quite frequently. She cited a recent lawsuit that stemmed from four members of a board meeting secretly and voting on a new rule, excluding the three other members — who happened to be the only members not from the same ethnic background.

Most of the time a co-op board's decisions are motivated entirely by concern for the overall financial well-being of the building, but concern can be misplaced if it turns into paranoia, said Heddings, who has written about the phenomenon on his real estate blog, TrueGotham.

"Having been on a co-op board, I can completely appreciate their need and desire to be cautious," Heddings said. "But people get so wrapped up in their personal lives that it taints their ability to make a solid decision."

For example, he said, some board members, spooked by the financial crisis this fall, seem unfairly biased against Wall Street executives as a result.

"Somebody who comes before the board in a Wall Street position may be very solid, but the board may say, 'We can't take a chance,'" he said.

Ironically, the very restrictions intended to protect a co-op's financials often make the building more vulnerable in a down market.

"If you prevent people from subletting and they can't sell, does that increase maintenance defaults? It does," Shmulewitz said.

Although some high-end co-ops rely on their exclusivity to maintain home values, overly strict guidelines can sometimes drive down sale prices, a fact that some co-ops, like Polsinelli's, are beginning to realize.

"The more restrictions, the less attractive a property becomes," said Polsinelli, who decided last year to increase the number of years residents of 2 Fifth Avenue may sublet their homes.

"I realized that people wouldn't be able to sell for the numbers they wanted to," she said. "We decided if we did something more flexible in subletting, it might increase our values overall. In a bad economy, who wants to be told they can't do things?"

Source: TRD-0709

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