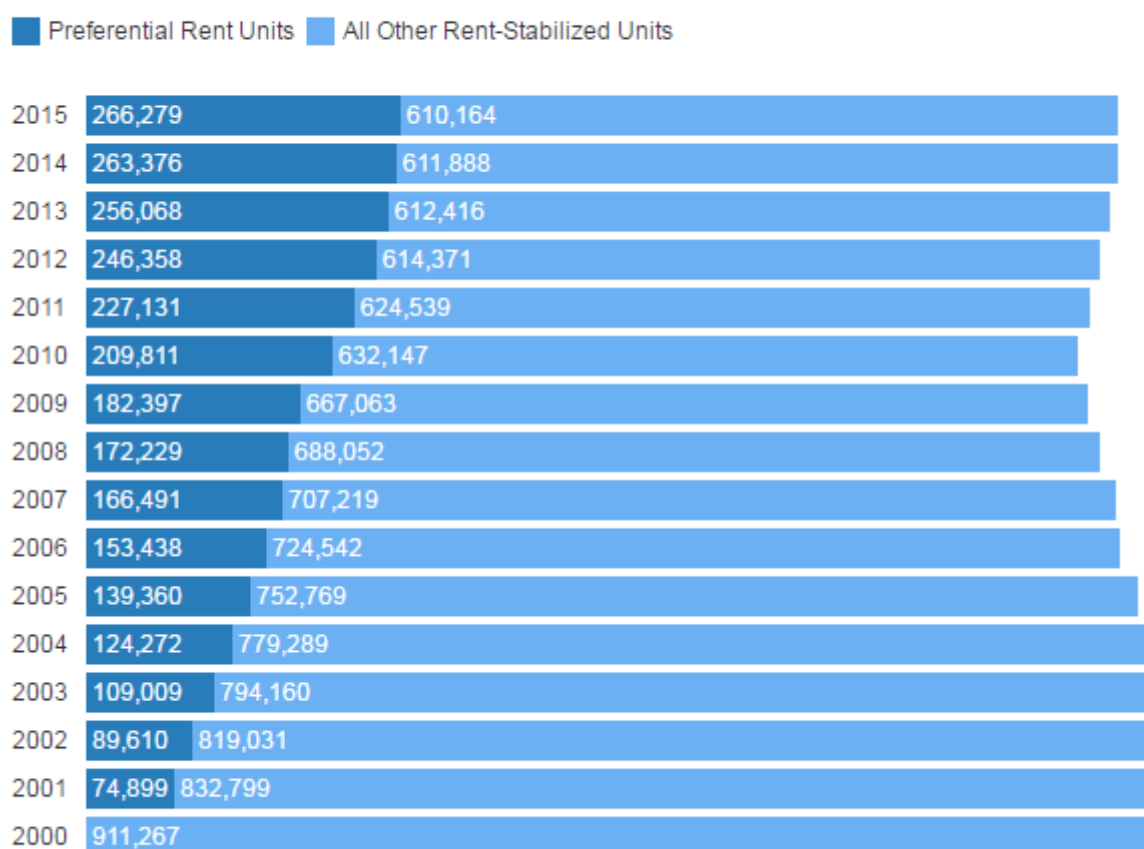


Preferential Rents: Benefit or Threat?
UNHP

Last year, UNHP began noticing a column for [preferential rents](#)—negotiated rents that are less than the legal rent—and a column for the legal rent on an increasing number of multifamily sales set-up sheets. Our colleague, Sally Dunford, at the West Bronx Housing and Neighborhood Resource Center ([WBHNRC](#)), became involved with tenants in a building where the new landlord told them that he was terminating all the preferential rents and was going to charge the legal rent on all the apartments. And as we were researching this blog post, [ProPublica released an exposé](#) in April 2017 with detailed reporting on rent stabilization laws and the shocking increase in preferential rents in NYC since 2001. In this piece, UNHP aims to discuss how preferential rents, once considered a benefit to tenants, could undermine the financial stability of multi-family buildings and its lenders as well as threaten the tenancy of Bronx residents, 70 percent of whom are already vulnerable to displacement. ([Regional Plan Association 2017](#))

Preferential Rents Become More Common Every Year

In 2000, New York State had 62 preferential rent units. Fifteen years later, it had 266,279. More than 95 percent of all rent-stabilized units in the state are in New York City.



Source: ProPublica

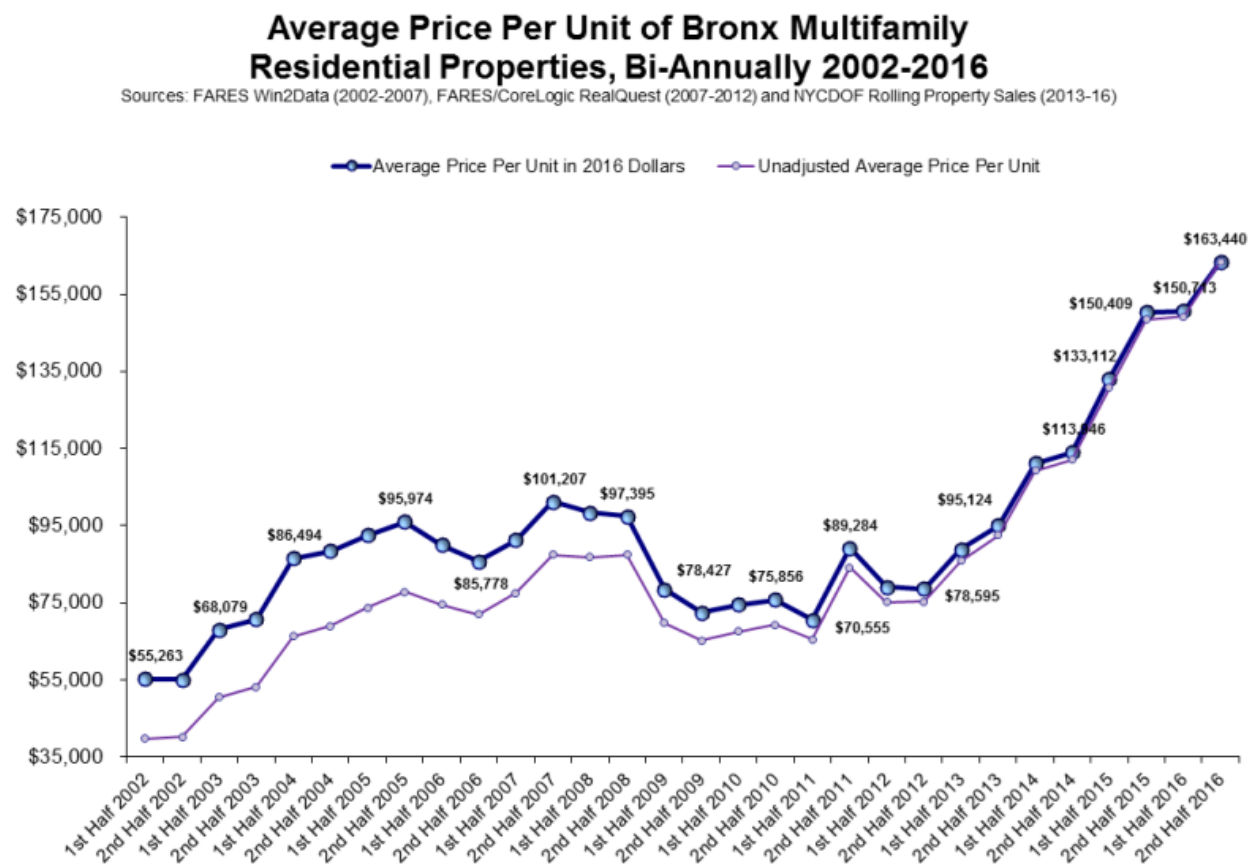
Around 2001, UNHP first became aware of preferential rents in our meetings about [rising prices and speculation](#). Some private property managers indicated that they were charging lower, or preferential, rents because the legal rents were higher than what they could realistically collect. Offering the preferential rent helped retain long-time residents and maintained a steady cash flow into the building. At that time, tenants received leases with the preferential rent listed, and lease renewal increases were based on the preferential rent as long as the tenant remained in the unit. Once the tenant moved out, the landlord could charge the next tenant the higher legal rent.

In 2003, New York State passed a renewal of the rent laws with a small, but dramatic change to preferential rents. The change allowed an owner to increase the rent from a preferential rate to the maximum legal rate upon lease renewal of the existing tenant. Then-State Senator and current Attorney General Eric Schneiderman [described this 11th hour change](#) as “a declaration of nuclear war on rent-regulated tenants in New York.” Fourteen years later and Schneiderman’s harsh statement seems to aptly describe what is happening with preferential rents in NYC today.

The change in the law markedly shifted the balance of risk and benefit to favor the landlord, and precipitated a massive increase in the number of preferential rents from 109,009 in 2003 to 266,279 in 2015; a 144 percent jump. Landlords were no longer bound to keep the preferential rent for the entire tenancy, but could now offer a preferential rent as a placeholder until the time when they could collect a higher rent from a different tenant. Tenants, when they understand the implications of accepting a preferential rent, are bearing all the risk of future displacement if the rent is raised.

Preferential Rents by Borough		
Borough	Number of Regulated Units with Preferential Rents	Median Preferential Rent Discount
Bronx	42,209	\$307
Brooklyn	47,454	\$303
Manhattan	38,073	\$453
Queens	46,446	\$354
Staten Island	2,482	\$423
New York City Independent Budget Office		

The number of units with preferential rents in the Bronx, although less than Brooklyn and Queens, is significant. This [NYC Independent Budget Office \(IBO\) chart](#) excludes the 96,900 units added into rent regulation after 1974 in exchange for certain public financing incentive programs, but the IBO data agrees with the ProPublica chart that there were 862,254 regulated units registered with the New York State Division of Housing and Community Renewal in 2013



The uptick in the number of preferential rents, indicating upside potential in rental income, could be a factor in the rapid rise of multifamily prices UNHP is seeing in the Bronx. The upside does not account for the data that the Bronx has the highest percentage of tenants who are severely rent-burdened, [paying more than 50% of their incomes towards rent](#), preferential or not.

The per-unit price of multifamily residential properties in the Bronx doubled between the second half of 2012 and the second half of 2016. Current set-up sheets that real estate brokers circulate to market residential apartment buildings in the Bronx indicate sellers are currently seeking prices between \$200,000 and \$250,000 per unit. As we've sought to understand what is driving these fast-rising prices, we noted the frequency with which preferential rent is being shared on the rent rolls of these properties for sale. We aggregated the rent roll data on eighteen current set-up sheets and discovered that more than 45 percent of the apartments had preferential rent. The average difference between the preferential rent and the higher legal rent was \$524 per month.

Bronx Sample of Set-Up Sheet The Difference Between Legal and Preferential Rent

Bronx Neighborhood	Preferential Rent Apartments	Total Apartments	Average Preferential Rent Discount	Potential % Increase
University Heights	17	45	\$ 523.35	14%
Kingsbridge Bldg 1	20	55	\$ 199.75	6%
Kingsbridge Bldg 2	11	27	\$ 807.18	23%
Kingsbridge Bldg 3	14	55	\$ 434.79	10%
Kingsbridge Bldg 4	10	36	\$ 682.90	13%
Kingsbridge Bldg 5	14	36	\$ 750.50	19%
Morrisania	10	12	\$ 722.10	30%
Mt. Hope	16	35	\$ 541.88	18%
Fordham	3	11	\$ 340.00	6%
Fordham-Bedford	16	30	\$ 433.69	12%
Kingsbridge Bldg 6	63	91	\$ 379.21	18%
University Heights	7	23	\$ 657.00	13%
University Heights	19	35	\$ 700.84	24%
Bedford Park	19	27	\$ 626.32	27%
Melrose	6	10	\$ 422.17	12%
Woodlawn	10	20	\$ 414.20	16%
Crotona	8	30	\$ 301.25	11%
Crotona	16	48	\$ 502.25	12%
	279	626	\$ 524.41	16%

Bronx multifamily sale set-up sheets are sharing both the preferential rents in the property and the legal maximum rents. The above chart shares data from set-up sheets in different northwest Bronx neighborhoods. In our sample, more than 45% of units had preferential rents and the average difference between the preferential rent and the higher legal rent was \$524 per month.

We have yet to meet a regulated lender who says they will lend against the rent that could potentially be achieved by terminating preferential rent; however, as noted in [earlier blog posts](#), there has been a sharp increase in non-regulated lenders and investors in the multifamily market. This raises the possibility that some of these players may be more open to underwriting based on the higher legal rent as they lend or invest.

The prevalence of preferential rents in the set-up sheets is matched by the leases we see at our work with individual tenants at the UNHP [Northwest Bronx Resource Center](#). UNHP works with tenants, primarily senior citizens and people with disabilities to provide rental assistance. UNHP reviewed fifty tenant leases and 14 percent of leases had preferential rents, with the difference between the preferential and legal rent ranging from \$126 to \$1,360 per month. For tenants already struggling to pay the rent, this kind of increase would predict certain nonpayment of rent and an initiation of the eviction process. In the cases we see at the NWBRC, preferential rents, while lower than the maximum legal rent, often exceed 30% of a tenant's income.

[Rent stabilization](#) offers tenants two major protections: it ensures that increases in rent are regulated and tenants have the right to renew their rental leases. Today, tenants in rent-regulated units under a preferential rent lease have been stripped of a significant part of that protection. In the [ProPublica piece](#), Meridian Properties' agent notes that, 'Although he doesn't like to revoke preferential rents, he added, there's nothing wrong with it: "It's the same as having a [deregulated apartment](#).'" In our work with residents and local tenants groups it is clear that Bronx tenants with preferential rents do not understand this. In [CASA's](#) recently released paper, "[Resisting Displacement](#)" it is also clear that preferential rent can be a "deterrent to organizing," with landlords using the threat of discontinuing the preferential rent to keep tenants from reporting violations or harassment. UNHP expressed [concern in a recent blog](#) about tenants not calling 311 to complain about building conditions due to doubling up, renting rooms and undocumented legal status; loss of a preferential rent is another reason to hesitate to complain.

There are also [serious concerns](#) that the legal rent filed with the [New York State Homes and Community Renewal \(HCR\) agency](#), and its Division of Housing and Community Renewal (DHCR), on the preferential rent apartment may not be correct. In a review of preferential rents in response to an [ongoing 2014 lawsuit](#), the [DHCR reported](#) that in a sample of buildings, 55 percent of cases where landlords are charging the preferential rent, they filed "legal rents" that were unsupported.

While landlords are [required to submit maximum legal and preferential rents to the DHCR](#), the division rarely checks to make sure the legal maximums are in compliance. When tenants receive a rent history from the State, this disclaimer is attached: "[DHCR does not attest to the truthfulness of the owner's statements or the legality of the rents reported in this document](#)." In a system where [tenants may be the only ones monitoring legal rents](#), tenants receiving a preferential rent may not even look at the legal rent that is on their lease or track its changes.

In the northwest Bronx, charges of unsupported legal rent filings are substantiated by the experience of the WBHNRC. In a response to the editor regarding the [Norwood News story "Rent Rolls Questioned"](#), their executive director, Sally Dunford, wrote that while landlords are required to give new tenants a Lease Rider showing what the last tenant was paying and how the landlord calculated the rent on the new lease, this does not always happen. Additionally, landlords are supposed to complete and file a rent registration form stating what the legal rent is and provide a copy to the tenant; again Sally reports that this does not always happen. Without this information, tenants may never know what the landlord is telling the State he or she is charging. Tenants can access their apartment's rent history form at the State's Office of Rent Administration, but tenants do not always know they have a right to request a rent history and may have a hard time understanding the information, which should date back to 1984 when the State began keeping a record.



UNHP has been working with a tenant who receives preferential rent for her 1 BR Bronx apartment in the Fordham-Bedford neighborhood. She came to our offices because she could not understand why she was getting such large increases when the legislative increase was so small. This graphic shows the percentage increase in her preferential rent each year and compares it to the Rent Guidelines Board (RGB) allowable increases on legal rents. The significant yearly increases are affecting the ability of this tenant to remain in the unit. The graph also illustrates that while RGB increases have been very low, tenants with preferential rents can still experience large rental increases. In 2017, the RGB legislated a 0% increase for a one year lease, and the tenant's landlord is proposing a 25.54% in her preferential rent.

If an error in the calculation of the legal rent is suspected, tenants can file an [overcharge complaint](#). However, the process is a lengthy one; it can take two-to-three years to reach a determination. In the interim, the landlord could cancel the preferential rent at lease renewal and start charging the legal rent (which could be substantially higher) while the case is being reviewed. The tenant runs the risk of harassment and reduced service from the owner while the overcharge case is decided. The process can be strenuous on tenants, especially for those who lack computer literacy or fluency in English.

The possibility that the legal rent may be inaccurate should be a concern to lenders and investors. A finding by the [State of an illegal rent](#) can bring rent reductions and damage awards to tenants, significantly reducing the cash flow in the building.

Recommendations:

Preferential rents may seem like a benefit to tenants in the short-term, but in reality tenants are not protected against significant rent increases up to the maximum legal rent allowed on their unit. The prevalence of preferential rents in NYC not only creates housing instability for the tenants, it also can be a destabilizing risk for the finances of the property and the lender. Addressing the problem of preferential rents is complicated. As a result, action needs to be taken at several different levels.

Enforcement by NYS Homes and Community Renewal (HCR) and DHCR of existing rent regulations, in a housing climate of displacement, record NYC homelessness and rising sales values, is essential to protect low-income tenants from homelessness.

- NYS HCR must ensure that enforcement of annual rent registration forms and determination of the legal rent forms at occupancy. All forms, including rent histories, should be easy to understand.
- Expedited review of rent overcharge forms by HCR.
- Verification by HCR of maximum legal rent submissions and increases due to MCI, Rent Guidelines Board increases, vacancy allowance and AIA.
- NYS legislature should strengthen protections of preferential rent tenants, ensuring increases are based on RGB and that the preferential rent is the base rent for tenancy.
- If a preferential rate is offered, then the City should verify the increase four years prior to an appeal or proven overcharge.
- The lending community should require more support information on rent rolls from borrowers. Lenders should request a detailed rent history on a percentage of apartments and should specifically seek back-up information on rents with substantial differences between the preferential rent and the legal rent and rents that are extraordinarily higher than other rents in the building.
- Data sharing could be a crucial tool in supporting and enhancing quality research around this and other issues. Thoughtful data sharing has led to more efficient and effective governance. The multitude of data they collect can be used to proactively identify and prioritize properties. Understanding the limitations around proactive enforcement of the State agency is also key.