

# DUE DILIGENCE REPORT

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

PREPARED FOR

[REDACTED]

PREPARED BY

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## EXECUTIVE SUMMARY

While it is always our client's business decision whether or not to go ahead with purchases of buildings and we do not directly advise on the prudence of any given purchase, this study reveals several unusually high legal risk factors associated with ownership of these buildings.

## INTRODUCTION

This due diligence report includes our research findings and analysis of the rent regulatory status of each of the residential units of [REDACTED] and [REDACTED], New York, N.Y..

Our due diligence investigation included an analysis of how each free market apartment was deregulated and this report advises on the owner's risks and liability with respect to deregulation of the apartments.

Our research also includes a review of the status of any open violations issued against the building by the Department of Housing Preservation and Development of the City of New York and the New York City Department of Buildings.

We also searched the files of the Supreme Court of the State of New York, New York County, the Civil Court of the City of New York and the Housing Court of the City of New York for pending litigation with respect to this building.

Our investigations have produced the following results.

### **Rent Regulatory Status of the Property's Residential Units**

The property is composed of three separate buildings each holding its own block and lot as enumerated above. Each building consists of 10 residential units spread over five stories. The current, actual use of all but two of the apartments (115-3A & 117-3B ("the hotel apartments")) appear to be consistent with the Certificates of Occupancy for the buildings. A copy of each of the Certificates of Occupancy are annexed hereto as Exhibit "1" for your ready reference.

The seller's managing agent provided its current rent roll reports and on August 2, 2011, allowed a full business day's access to their tenant files. Unsurprisingly, the seller's managing agent was not wholly cooperative with our desire to make copies of its tenant files. However, on several occasions,

we were able to copy certain, selected documents from the files and for each apartment, we took notes based on our review of the files. Our findings from the review of the tenant's files are provided herein. The documents we copied from the tenant files are annexed hereto under exhibit tabs labeled by unit number.

Annexed hereto as Exhibits "2", "3" and "4" are certified Division of Housing and Community Renewal Registration Rent Roll Reports for each of the three buildings, respectively.

Out of the thirty residential units on the property, there are six rent controlled apartments, two rent stabilized apartments and twenty free market apartments. The two unaccounted for apartments are Apartments 113-3B ( ) and 113-B ( ).

( ) tenancy may be subject to rent control if he succeeded to a tenant who moved into the apartment prior to 1971. The tenant file did not indicate when his tenancy commenced but ( ) investigation found that he is a "younger tenant" which gives rise to the possibility that he may have succeeded to an older relative. The initial registration for this building in 1984 shows ( ) as the registered tenant and designates this unit as rent stabilized with a then legal rent of \$160.09 and no lease commencement date. The current legal regulated rent is \$558.99 though the current owner has not filed its 2011 registration with DHCR as of August 2, 2011. Notably, one ( ) signed the current, fully executed lease renewal although he is not a record tenant.

( ) is the current record tenant of Apartment 113-B. She moved into the apartment on or around March 8, 2006, from her presumably rent stabilized, second floor apartment at ( ), New York, N.Y., and pursuant to a buyout agreement between ( ) and the owner of 145 ( ), one ( ), a member of ( ), and who, according to the agreement, is also a member of the seller ( ) here. We note that ( ) was a signatory to the authorization letter furnished by the seller in order to obtain the DHCR rent rolls. ( ) is a building subject to the Loft Law and is duly registered with the New York City Loft Board as an Interim Multiple Dwelling Building which, generally speaking, indicates that the tenancies therein are under transitory regulation until they are brought under rent stabilization after some kind of construction work is done at the building.

The buyout agreement between ( ) and ( ) provides that her tenancy in Apartment 113-B is not subject to rent regulation but that her rent increases shall be made pursuant to orders of the Rent Guidelines Board

as if her tenancy was protected by the rent stabilization law. The buyout agreement also provides that the succession rights provision of the rent stabilization law shall not apply to her tenancy and that she may not be evicted for luxury decontrol. While these agreements are generally enforceable, it does make this tenant the equivalent of a rent stabilized tenancy except that the apartment would become a normal free market apartment when she dies or moves out.

### **The 2000 Permanent Exemption of Nine Units**

The Division of Housing and Community Renewal ("DHCR") Registration Rent Roll Report indicates that in 2000 nine of the thirty units were registered as permanently exempt from rent stabilization with "NYC Coop/Condo" noted under the "Tenant Name" field. Generally speaking, if a unit has been exempt from regulation for more than four years, then an owner need not be concerned about liability arising from the manner a unit was deregulated, i.e. a rent overcharge case. However, if a unit is deregulated by fraud then that four year look back period is inapplicable as there is currently no statute of limitations that an owner can look to escape liability if a past or current tenant challenges the status of a deregulated unit.

If there is fraud in the deregulation of an apartment, then the owner at the time of the finding is subject to treble damages for each unlawfully, regulated unit. Therefore, while these nine units have stood deregulated without question for eleven years, there is a potential for liability against a new owner of the building. Further, it is difficult to imagine what scenario would have deregulated these units without entailing fraud. Further, it should be noted that when one has nine legally identical units, if one unit manages to get an award against management, the other eight are reasonably certain to as well. These nine units could therefore present an overcharge hazard running in the millions of dollars.

The building management's tenant files did not contain any documents to indicate how these nine units became deregulated. Below are charts itemizing each of the units with corresponding notes as to the DHCR registration for each unit in the years prior to 2000 which indicates how the unit appears to have been deregulated in public records.

### **The Hotel Business Operated Out of Apartments [REDACTED] and [REDACTED]**

Apartment [REDACTED] is currently leased to a corporate entity known as [REDACTED] which, according to the building's manager, is operating a hotel business out of the apartment in conjunction with the tenant, [REDACTED]

██████████, of Apartment ██████████. According to the building manager, one ██████████ is the principal of ██████████ ██████████ and ██████████ are Italian nationals who never resided in the apartments but, with the current owner's permission, rent the rooms of the apartments to occupants whose identities or length of stay are not and have never been disclosed. The sole consideration exchanged for permission to sublet is that the owner collects a 10% higher rent, that is, \$3,300 versus \$3,000, as memorialized in the Sublet or Assign Option Rider annexed hereto as Exhibit "5".

The owner's exposure to liability for allowing a hotel operation out of these Class A apartments includes punishment by incarceration in addition to payment of fines and costs of litigation pursuant to the Multiple Dwelling Law.

Multiple Dwelling Law §120 prohibits the use of Class A apartment units for other than "permanent residence purposes" unless certain qualifications are met. One of these qualifications is that the building was built as a hotel in the first place. It also requires that the owner register such units with HPD. Unsurprisingly, each unit in these buildings is currently registered as a Class A apartment.

Multiple Dwelling Law §4(8)(a) defines "permanent residence purposes" as 30 days or more. So, so long as all the rentals are to people who are actually staying there 30 days or more, there appears to be no problem [except, as set forth below, the 2010 deregulation of 115-3A is, at this juncture, unsupported by the necessary renovation documents to substantiate a rent increase based on individual apartment improvements ("IAI")].

In sum, *both* the owner and the hotel company can be fined \$500 and jailed for 30 days for a first offense and \$1000 and six months for a second offense. In addition, if any person receives notice of the violation, then such person is also liable for an additional civil penalty of \$250 plus court costs (which can run into the thousands).

The people liable under this section include: "the owner, mortgagee or vendee in possession, assignee of rents, receiver, executor, trustee, lessee, agent or any other person, firm or corporation directly or indirectly in control of a dwelling or part thereof." Thus, it includes both the owner and the hotel operator and their entire ownership structures *personally*.

### *The Deregulation of Apartment ██████████*

As briefly noted above, Apartment ██████████ was deregulated by "High Rent Vacancy" according to the 2010 DHCR Registration Rent Roll Report (Exhibit "3"). According to the rent roll report, the last rent stabilized tenant

vacated the apartment at some point prior to April 1, 2010, and the unit was presumably deregulated by applying a vacancy increase and performing apartment improvements in order to increase the legal rent to a rate above \$2,000.

On August 2, 2011, we verbally requested copies of the renovation documents with proof of payment to support the individual apartment improvement increase but as of the date of this report, the seller's agent has not produced the documents. Importantly, the seller's agent verbally warned that the proof of improvement documents are insufficient and that not enough renovation work was performed to support the increase applied to the legal rent to bring the unit out of regulation. This could also lead to serious overcharge liability.

*Evicting Any Transient Occupants Left by [REDACTED] and [REDACTED]*



The [REDACTED] and [REDACTED] leases are for a term ending December 31, 2011. Upon the expiration of the lease, although preferably sooner, considering the exposure to liability for allowing the hotel use, the new owner should move to evict the record tenants. Obtaining possession of the units from the record tenants requires commencing a summary proceeding that takes about three to six months to litigate, unless the tenants surrender possession on their own volition. The more complicated risk is in obtaining possession of these apartments from the transient occupants of the apartments, if any, at the end of the lease term. A savvy transient occupant may have the resources to investigate the deregulation of the apartment, yielding lengthy litigation and perhaps a finding of fraud with treble damages liability for the owner.

The following spreadsheets show each apartment's regulatory status, current rental rate, and lease terms together with notes based on our review of the tenant's files.

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Spreadsheets to Follow

APT.	NAME(S) OF RECORD TENANT(S)	LEASE TERM	RENTAL RATE	REGULATORY STATUS	NOTES FROM TENANT FILES
A	[REDACTED]	12/1/10 - 11/30/11	\$2,600	FM	Registered as permanently exempt in 2000, "NYC Coop/ Condo". This is presumably fraudulent. Tenant since 12/1/09.
B	[REDACTED]	6/1/11 - 5/31/2012	\$2,045.00	FM w/ RS increases	Registered as permanently exempt in 2006. Preferential rent rider dated 12/17/2010 is attached under apartment name tab. There are letters from the tenant to the owner stating how pleased she is with the apartment and requesting repairs pursuant to the buyout agreement in 2006. There is also a letter dated January 2011 from the tenant to the owner stating her rent should not be raised because of the "crazy lady next door", she is still "without 100 square feet of" her yard, and flooding when it rains. In that letter, she also challenges a preferential rent rider which was erroneously offered to her with her lease renewal. Tenant is approx. 75 y.o.
1A	[REDACTED]		\$90	RC	No file available.
1B	[REDACTED]	6/1/11 - 5/31/2013	\$1,293	RS	Noise complaint 2006: Routinely pays late according to Fred Marolda (managing agent). Run a private investigation on this tenant. Marolda believes he may not be living there.
2A	[REDACTED]		\$129	RC	No file available.
2B	[REDACTED]	8/1/11 - 7/31/2013	\$1,360	RS	Tenant received SCRIE in 1999-2002; no 2011 registration.
3A	[REDACTED]		\$129	RC	Licenses proceeding currently pending where daughter, Rosanne Maisano, is claiming succession to tenant of record. This 2009 case is currently off calendar for discovery and has been off calendar since January 2010. Landlord is permitted to accept use and occupancy without prejudice. A copy of the court file is annexed hereto under tab "113-3A".
3B	[REDACTED]	6/1/10-5/31/12	\$558.99	Registered as RS, RC Caution as Noted Herein	Tenant wrote in \$528.99 on lease renewal but appears to be paying the correct amount, \$558.99. Augusto Bruno is not the record tenant but signed leases.



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New York, N.Y. 10013

4A		5/1/11 - 4/30/12	\$3,300	FM	The initial registration rent roll report indicates the apartment status in 2001 was "VD-RS". There are no subsequent registrations for the apartment. Daniel Duffy and Chris Telois were the prior tenants pursuant to a one year lease commencing 5/1/10 for \$3,000. Absent fraud, it appears the apartment has been deregulated since 2001.
4B		2/1/11 - 1/31/12	\$3,500	FM	The initial registration rent roll report indicates the apartment was rent control in 1984 and was registered as permanently exempt in 2009. Request documents to 2009 PE, need backup; tenant since 2/1/09



APT	NAME(S) OF RECORD TENANT(S)	LEASE TERM	RENTAL	REGULATORY STATUS	NOTES FROM TENANT FILES
A	[REDACTED]	5/1/11 - 4/30/12	\$2,650	FM	Deregulated by Hight Rent Vacancy in 2006. Request documents to support the individual apartment improvement increase.
B	[REDACTED]				Tenant is 65 y.o.+. Her sister is the rent control tenant in 117-1B. Fred Marolda does not believe she will move in with the sister although Waterbridge indicated so. In the 90's and in 2000 she filed rent overcharge, harassment and rent reduction cases against the owner and was successful in the 2000 overcharge case and the 1996 reduction of services case. See Exhibit "7". We can FOIL these case files upon request. Prior offer of \$150k by Marolda was denied. Tenant has a brother who was a former rent control tenant of the building but moved out years ago though he does go in and out of his sisters' apartments from time to time.
1A	[REDACTED]	8/1/10 - 7/31/11	\$3,000	FM	Registered as permanently exempt in 2000, "NYC Coop/ Condo". This is presumably fraudulent. Current lease is expired.
1B	[REDACTED]	10/1/10 - 9/30/11	\$3,100	FM	The initial registration report shows this apartment as rent control in 1984 followed by a "VD-RS" registration in 2008. There are no subsequent registrations for the apartment.
2A	[REDACTED]	7/1/11 - 6/30/12	\$3,300	FM	The initial registration report shows this apartment as rent control in 1984 followed by a "VD-RS" registration in 2005. It is also registered as permanently exempt on the 2006 Registration Rent Roll. There are no other registrations for this apartment.
2B	[REDACTED]	8/1/10 - 7/31/11	\$3,300	FM	Calderon is a citizen of Ecuador in the U.S. on a nonimmigrant worker visa. Florence Cheung is a citizen of Ontario, Canada. The apartment is registered as permanently exempt in 2000, "NYC Coop/ Condo". This is presumably fraudulent.
3A	[REDACTED]	1/1/11 - 12/31/11	\$3,300	FM	Refer to the body of this report for a full analysis on the liability exposure of this unit which is being used as a hotel operation. Registered as permanently exempt, "High Rent Vacancy" in 2010. Request documents to support the individual apartment improvement increase applied to deregulate the apartment.
3B	[REDACTED]	3/1/11 - 2/28/13	\$3,200	FM	Registered as permanently exempt in 2005, "High Rent Vacancy"




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4A		6/1/11 - 5/31/12	\$3,300	FM	There is a rent prepayment rider for the return of any prepaid rent if the tenant terminates the lease before the expiration of the lease term. Registered as permanently exempt in 2004, "High Rent Vacancy".
4B			\$133	RC	Run an investigation on this unit and the record tenant. Management suspects he is not using the apartment as his primary residence. However, it would be odd to put a building on the market with a suspected nonprimary resident under rent control when actually pursuing that claim to obtain an eviction would obviously make the building more valuable.

117 Elizabeth Street  
New York, N.Y. 10013

APT	NAME(S) OF RECORD TENANT(S)	LEASE TERM	RENTAL RATE	REGULATORY	NOTES FROM TENANT FILES
A	[REDACTED]	5/1/11 - 4/30/12	\$2,450	FM	Tenant moved in 2005. Last registered stabilized tenant was Alex Kwong in 1998. There are no subsequent registrations.
B	[REDACTED]	2/1/09 - 1/31/12	\$3,500	FM	Tenant is a DJ who according to Waterbridge wants to move out at the end of the lease term. The initial registration rent roll report indicates the apartment was rent control in 1984. There are no subsequent registrations for the apartment. This raises serious questions about how the rent was arrived at and in what year and whether the appropriate forms were served. If the forms were served, the tenant would have a limited time to contest the rent. If they were not served, the contest could be forever and the overcharges of 27 years staggering.
1A	[REDACTED]	4/1/11 - 3/31/12	\$3,200	FM	Registered as permanently exempt in 2000, "NYC COOP/Condo." This is presumably fraudulent.
117-1B	[REDACTED]		\$136	RC	Tenant's sister is the rent control tenant in 115-B. There is also a brother, a former rent control tenant of the building, who is in and out of both sisters' apartments.
117-2A	[REDACTED]	5/1/11 - 4/30/12	\$3,300	FM	Lease is guaranteed by guarantors with good assets. Registered as permanently exempt in 2001, "High Rent Vacancy".
117-2B	[REDACTED]	7/1/11 - 6/30/12	\$3,300	FM	Registered as permanently exempt in 2000, "NYC Coop/Condo"; This is presumably fraudulent. There is a 4/21/11 email in the tenant's file where the tenant asks for the name of the new owners.
117-3A	[REDACTED]	9/1/10 - 8/31/11	\$2,832.50	FM	Registered as permanently exempt in 2000, "NYC Coop/Condo"; This is presumably fraudulent. Hartnick is the tenant since 2007; prior roommate Heeyon Change moved out in 2007.

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117-3B		6/1/11 - 12/31/11	\$3,300	FM	Refer to the body of this report for a full analysis on the liability exposure of this unit which is being used as a hotel operation. Registered as permanently exempt in 2000 (presumably fraudulently), "NYC Coop/ Condo".
117-4A		8/1/10 - 10/31/11	\$3,300	FM	Registered as permanently exempt in 2000, "NYC Coop/Condo"; This is presumably fraudulent. Tenant since 2009; On 2010 lease renewal, tenant negotiated the \$150 increase to \$50 while complaining there is no fire escape. According to the file, the building is grandfathered into the old building code. David makes \$100k+, Noah, his brother makes \$25k. No guarantor.
117-4B		1/1/11 - 6/30/12	\$3,200	FM	Gabrielle Katz complains the furnace is too hot in the winter and that the pipes are noisy. There was also a note in the file that she had "problems with her prior landlord." Registered as permanently exempt in 2000, "NYC Coop/Condo". This is presumably fraudulent.

## **DHCR CASE HISTORY**

### **Fuel Cost Revocation/Suspension Order Is In Effect**

On or about July 15, 2011, an application for a fuel cost revocation/suspension order was granted for all three buildings. If you decide to purchase the property, we can submit a request pursuant to the Freedom of Information of Law to obtain a copy of DHCR's entire case files in order to understand what the basis is for this order. A detailed letter from the owner identifying you as a prospective buyer and authorizing the review of the files is required.

### **Maximum Base Rent Applications**

According to the list of cases adjudicated before the Division of Housing and Community Renewal, in the past ten years, the owner has not been able to successfully apply for a maximum base rent increase except in 2003 and 2004 an application was granted for [REDACTED]. We can request full copies of these applications and any ensuing orders. Such requests typically take the DHCR four to six weeks to fulfill. You should require the owner to disclose its entire file for maximum base rent applications as well as copies of any files related to the fuel cost revocation/suspension orders noted in the DHCR case lists.

A copy of the DHCR case lists for each of the buildings are annexed hereto as Exhibits "6" (113), "7" (115) and "8" (117).

### **NYC Department of Buildings (DOB)**

The Department of Buildings classifies each of the buildings as "C4-Walk-up Apartment". This Department of Finance Building Classification is used to classify the premises' tax status, as distinct from its legal use, typically set forth in the Certificate of Occupancy. As noted above, the current, actual use of the building appears to be consistent with the Certificates of Occupancy with the exception of the "hotel apartments". A walk-thru and inspection of the building is necessary to verify the use of the building and confirm exactly how many residential units there are.

The DOB Property Profile Overviews for each of the three buildings are annexed hereto as Exhibits "9" (113), "10" (115) and "11" (117).

#### Open DOB Violations at [REDACTED]

As of August 4, 2011, there are five open Department of Building violations. See Exhibit "9", DOB Property Profile Overview with Open Violations annexed. Two of the five open violations are from 1975. One is from 1978 and the two more recent open violations were filed in 1999 and in 2003. The 1999 and 2003 violations appear to be boiler violations. If you purchase the building, you should receive a credit for each open violation at closing, if they are not certified as corrected and dismissed before closing. See Exhibit "9".

#### Open DOB Violations at [REDACTED]

As of August 4, 2011, there are fourteen open Department of Building violations and three open Environmental Control Board violations at [REDACTED]. From 1994 to 2000, there were six boiler violations issued. The balance of the DOB violations are not available online but we can obtain them from the agency upon request. If you purchase the building, you should receive a credit for each open violation at closing, if they are not certified as corrected and dismissed before closing. This is an unusually large number of DOB violations for a building of this size and could be symptomatic of poor building maintenance leading to as yet undiscovered more serious issues.

The three open Environmental Control Board violations appear to relate to the 1999 apartment improvements performed in [REDACTED] in 1999 which indicates that the rent increases applied to the legal rent to deregulate the apartment in 2000 are somewhat substantiated. However, these violations remain open to date and should be corrected prior to closing since it appears that work was performed without a permit and by an unlicensed contractor. See Exhibit "10".

#### Open DOB Violations at [REDACTED]

As of August 4, 2011, there are two open Department of Buildings violations and two open Environmental Control Board violations at [REDACTED]. Similar to [REDACTED] and [REDACTED], the two open DOB violations are boiler violations. The ECB violations relate to plumbing work performed in 1999 in apartments [REDACTED] and [REDACTED] which indicates that the rent increases applied to the legal rent to deregulate these apartments in 2000 are somewhat substantiated. However, these violations remain open to date and should be corrected prior to closing since it appears that work was performed without a permit. See Exhibit "11".

## **Court Investigations**

### **Housing and Civil Court**

Annexed hereto as Exhibit "18" is a case list printed by the Clerk of the Housing Court, New York County enumerating the cases brought by [REDACTED] LLC against various tenants of the building dating back to 1998. In the timeframe provided to complete this report, we were able to copy five of the most recent case files. These files include:

2011 Nonpayment Proceeding against [REDACTED] ([REDACTED]) – There is no stipulation, order, decision or judgment in the file. This indicates that the proceeding was likely resolved without having to prosecute the case, i.e. tenant paid the arrears owed.

2011 Nonpayment Proceeding against the former tenants of [REDACTED] – There is a request for a final order and for issuance of a warrant of eviction on default. It appears the former tenants were evicted or vacated the premises. The apartment was leased to the current tenant on or about May 1, 2011.

2010 Nonpayment Proceeding against [REDACTED] (113-1B) – It appears the owner was awarded a default judgment and the Marshal requested a warrant to evict Day in December 2010 but the effort was abandoned because Day paid the arrears owed at that time. Fred Marolda indicated that this rent stabilized tenant often pays the rent late. If you purchase the building, we recommend you aggressively serve rent demands each month that he defaults on the rent in order to build a chronic nonpayment holdover case against him. You should simultaneously build a paper trail to demonstrate that there are no conditions in his apartment such as to give rise to a defense to a nonpayment proceeding.

2010 Nonpayment Proceeding against one [REDACTED] ([REDACTED]) – The record tenant since February 2009 is [REDACTED]. [REDACTED] may have been a roommate though there is nothing in the court file to indicate that the landlord was suing a roommate as it was seeking possession of all rooms in the apartment. There is no stipulation, order, decision or judgment to indicate how the case was resolved. It appears to have been abandoned, perhaps because the rent arrears were satisfied.

2010 Nonpayment Proceeding against [REDACTED] and [REDACTED] ([REDACTED]) – There is no stipulation, order, decision or judgment in the file. This indicates that the proceeding was likely resolved without having to prosecute the case, i.e. tenant paid the arrears owed.

Copies of the court files described above are annexed hereto under the respective apartment tab.

Upon request, we can obtain copies of any court file listed under Exhibit "18". In our experience, court files of this kind never show anything that makes the building a more attractive purchase. If there is anything meaningful in the court files, as a general principle, those things would either be neutral or adverse.

### **Civil Court**

Research revealed no general term Civil Court files affecting these buildings. Three Housing Code Violation cases ( [REDACTED] ) were brought against these buildings in 1999. Upon request, we can obtain copies of any Housing Code Violation case.

### **Supreme Court**

Research revealed no Supreme Court files affecting these buildings.

### **February 10, 2011 Transfer of a One-Third Interest in the Property**

On or about February 20, 2011, [REDACTED] transferred a one-third interest in each building to [REDACTED]. Our court investigation included a search of any cases commenced by [REDACTED] or against [REDACTED]. There were no such cases. A copy of the deed memorializing this transfer is annexed hereto as Exhibit "19".