

Top 5 Lawsuits Affecting Income-Producing Real Estate Owners

written by **andrew m. lieb, esq., mph**



There are so many get-rich-quick schemes for investing hard-earned savings in real estate to generate a huge passive income through rentals. Wake up—nothing in life is always roses, and not everyone can be Kiyosaki’s Rich Dad. This is the list of the Top 5 litigation issues that income-producing property owners face incident to living the landlord’s dream.

Purchase/Sale Disputes

Just getting to the closing table is the purchaser’s first challenge. While the real estate brokers may have promised that they negotiated a terrific deal where everyone agreed to the price, financing and deposit, what happens when the current owners have open building permits that require a Certificate of Occupancy and the town decides that the construction wasn’t performed to code? Now, the town requires a variance to grant the Certificate of Occupancy, which may not be forthcoming. After the purchaser’s lender declines the loan incident to this news, the purchaser wants the deposit back, but the sellers say “no way,” arguing that they are complying with the contract of sale by way of making good faith efforts to get the Certificate of Occupancy. This results in litigation that can take several years to resolve. Beyond title defects (i.e., open permits), there can be other issues that prevent

a closing from occurring, such as out-of-possession property lines, seller’s non-ownership status, restrictive covenants preventing an intended use or just the efficient use of the property, existing liens against the real estate, current tenant issues with estoppel letters not being forthcoming—and many others. Prospective purchasers who are pound-smart rightfully know that spending their pennies on proper due diligence as soon as practicable can save real money when getting into the real estate game. Start with a title search, perform environmentals, review all current leases and perform a meet and greet with tenants, while always being sure to check with the Army Corps of Engineers when dealing with waterfront property. Only if everything checks out should you even consider being a purchaser.

Rental/Lease Disputes

If you get past the closing table, make sure only to rent your income producing property pursuant to a tailored lease that addresses your particular real estate needs. Beyond writing down your specific expectations in a House Rules (e.g., allocation of control and costs between tenants to pump the cesspools) that is incorporated by reference into the lease agreement, the lease should also identify what bank will be holding the security deposit in satisfaction of the General Obligations Law. It’s also wise for

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the landlord to have a holdover provision in a tailored lease that multiplies the rent by two or three times in the event that the tenant doesn't vacate the premises after the expiration of their lease term. Further, a clause for attorneys' fees and costs incident to an eviction would serve an income-producing landlord well. Plus, it would be smart to label every cost beyond rent as "additional rent" within the lease so that the landlord will be able to recover a money judgment accordingly incident to an eviction (i.e., failure to so label will result in such monies being unavailable in an eviction proceeding). By the way, landlords should put into their operating budget the fact that if a tenant is out of possession when it's finally time to sue for unpaid rents, a summary proceeding won't be available and a prolonged and costly litigation will be the only option.

Foreclosure

If the tenant isn't paying rent to the landlord, it becomes problematic for the landlord to pay the mortgage and default is often imminent. In such a situation, the income-producing landlord may want to quickly contact the lender and negotiate a forbearance wherein the lender will provide a time period in which the monthly installments will be excused or discounted as a showing of good faith to keep the mortgage from entering into default. Should the property owner not act quickly, a foreclosure will be brought by the lender who holds the note (i.e., the promise to repay as distinguished from the mortgage, which is a security in the real estate in the event of non-payment). If a foreclosure is brought, one must act promptly in filing a legal document called an Answer or risk losing the case merely by default. Should the Answer be properly filed and served thereafter, the property owner should thereafter contact the lender to commence negotiations for a mortgage modification in order to settle the case and avoid losing the property to foreclosure. Understanding the lender's cost-benefit analysis of choosing to foreclose versus negotiating a default workout will be the key to keeping the property at this stage of the Rich Dad scheme.

Ownership Disputes

Many income-producing property owners simply don't have the requisite capital to get into the landlord game on their own in the first place, even with financing. However, that often doesn't stop them, and they become investment sponsors who talk their friends into joining them in the Rich Dad dream. If these friends are merely passive investors in a common enterprise for profits based solely on the efforts of the sponsor, then securities laws become applicable and the Attorney General and the SEC may have something to say about the ownership structure. This won't go well. That is, unless the sponsor undertook initial diligence through making all requisite filings in compliance with both New York's Blue Sky Laws (i.e., Martin Act) and Federal Securities Laws. Still further, if the friends become voting partners in the entity (i.e., a corporation or limited liability company), then everything will be fine and dandy until the partners first disagree in their management

decisions for the real estate. At that time there will be a corporate dissolution lawsuit (i.e., think business divorce), the result of which will be dependent on how the By-Laws and/or Operating Agreement were first written when the entity was initially formed and also how such writings were complied with throughout the entity's entire existence. Alternatively, if the friends became partners through a tenants-in-common ownership structure instead of utilizing such corporate formalities, then a partition lawsuit will ensue in the face of managerial disagreements. To avoid this drama, it would be best to spend those pounds on negotiating a well-drafted partnership agreement (i.e., By-Laws and/or Operating Agreement) between the investors before even considering opening for operations.

Housing Discrimination

If an income-producing property owner obtains ownership through a properly structured investment (i.e., both the financial with the lender and the equity with the partners), drafts a great lease, has reserves to avoid foreclosure, then it should be clean sailing, right? Now, the property owner should just exercise the inherent right to select or decline any tenant with absolute discretion because, after all, it's the landlord's property and this is a country where freedom rings, right? In 1967, the United States Supreme Court made clear that such a right does not exist in the seminal case of *Reitman v. Mulkey*, where the Court held that no private right to discriminate exists. Now, some 48 years later the Supreme Court has spoken again in closing the door on any discrimination in the case of *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc.* This time, the Court ruled that landlords are not only precluded from direct acts of discrimination (i.e., treating people differently on the face of a given act), but that they are also precluded from undertaking acts that have unintended secondary effects on protected classes of persons. The Supreme Court stated that the purpose of permitting these lawsuits, on what is called a disparate impact theory, is to "counteract unconscious prejudices and disguised animus that escape easy classification as disparate treatment." In Suffolk County there are 14 protected classes including Race, Creed, Color, Sex, Gender, Disability, Religion, Familial Status, National Origin, Alienage / Citizenship, Marital Status, Sexual Orientation, Age, and Lawful Source of Income. On top of that, landlords in Suffolk County need to be mindful of the protected classes in Federal, State and Local (i.e., City, Town and Village) statutes, as each exposes a landlord to a discrimination lawsuit. Simply put, not discussing a tenant's demographics in rentals is the best policy for an income-producing landlord who seeks to avoid a lawsuit for direct damages, compensatory damages, punitive damages and attorneys' fees. If you think such a lawsuit won't put you out of the landlord game, think again. ■

Andrew M. Lieb, Esq., MPH, is the Managing Attorney of Lieb at Law P.C. and is a contributing writer for Behind the Hedges: Inside Hamptons Real Estate.