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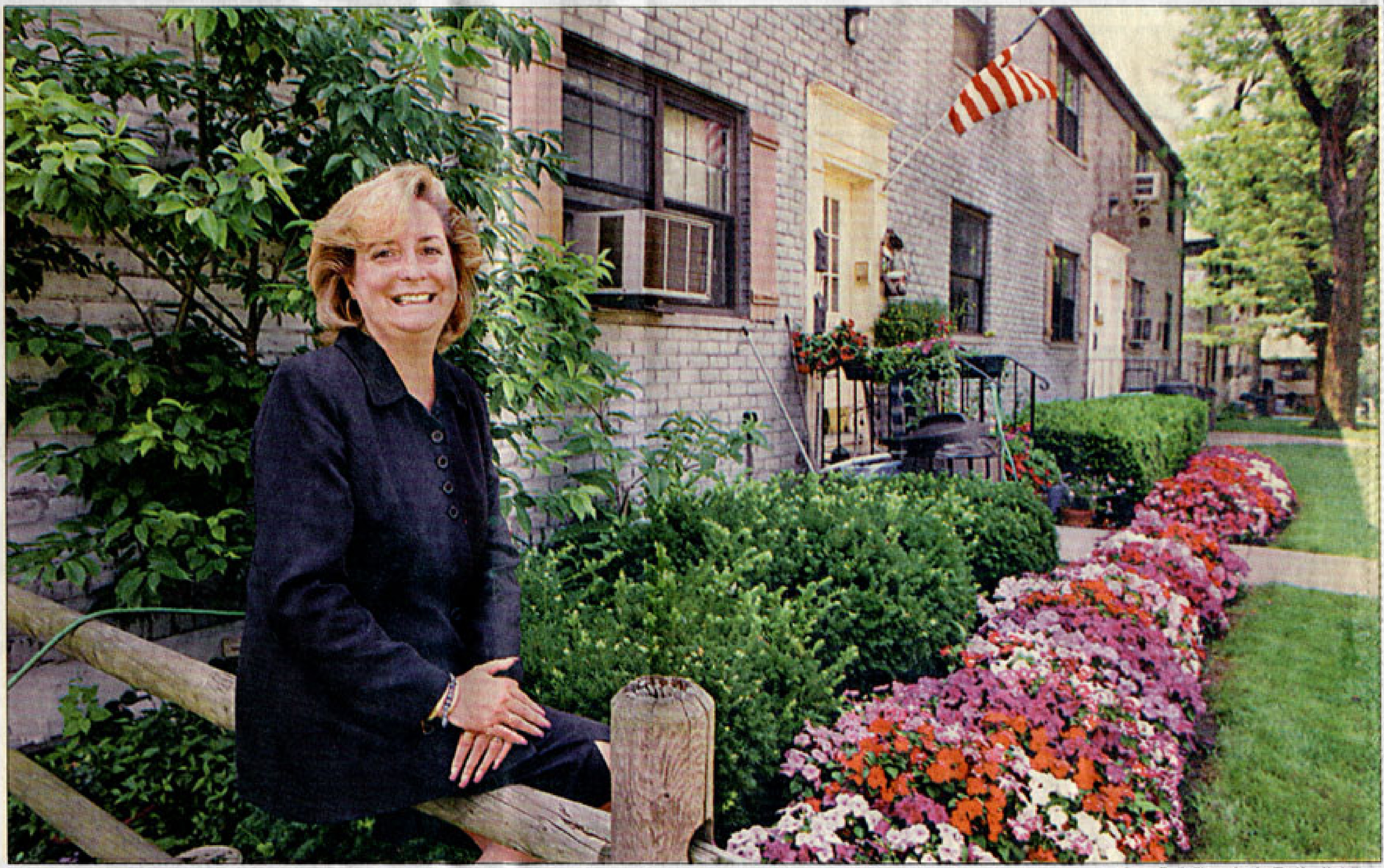

Emile Wamsteker for The New York Times

Sometimes, subletting can be costly. Ruth Farrago, the president of a co-op in Queens, remembers a subtenant who ruined an apartment.

Subletting: From Stopgap to Cash Cow

By DENNIS HEVESI

Owners, and sponsors, who once turned to renting in desperation now find it increasingly profitable.

SUBLETTING of co-ops — not so long ago a possible indicator of a building's dire financial straits and even, for some shareholders, the last gasp before abandoning their apartments — isn't what it used to be. For one thing, it's become increasingly profitable.

Take, as an extreme example, the recent sublet of a sublet of a sublet of a sublet.

''It started with an original lease of $2,200 a month for a one-bedroom in the East 40's,'' said Roger Novatt, the managing director of Sumitomo Real Estate Sales. ''The people were transferred out of town, and the owner would not let them break the lease. So they sublet the apartment for $2,750.''

''And the same thing happened to the $2,750 people — a business transfer out of town,'' Mr. Novatt said. ''So they sublet for $3,250 a month.''

The apartment is now renting to a fourth tenant for $4,000 a month, with the profits going, after each switch, to the previous sublettor. ''It's totally illegal in terms of board regulations, but some buildings just don't pay attention to what's going on,'' Mr. Novatt said. ''The shareholder could rent to a nice, quiet young lady and end up with trapeze artists.''

Subletting of sublets, Mr. Novatt added, ''is happening all over the city, in fancy buildings as well as walk-ups, but primarily in the Midtown area.''

New York City's rental market has become so tight and jarringly expensive, particularly in Manhattan, that subletting is an increasingly alluring prospect for some shareholders — individual owners as well as sponsors who have retained ownership of numbers of apartments in buildings they converted — sometimes to the chagrin of co-op boards and resident shareholders.

At the same time, with sales of apartments booming, the availability of units for subletting has dropped, exacerbating the city's housing shortage and further squeezing up rents. ''Just five, six years ago when people were unable to sell but could either no longer afford the apartment or had to move, they would sublet,'' said Stuart M. Saft, the chairman of the Council of New York Cooperatives and Condominiums. ''It was the only liquidity in the market.''

''And because of the large number of these people involved, the boards permitted it,'' Mr. Saft continued, ''because if a board strictly imposed a 'no sublet' policy, they could find themselves voted out of office.''

''Now, come forward to 2000, where the market is much stronger and selling is not a problem,'' Mr. Saft said. ''The economics have changed because, as a result of the housing shortage, there are people who want to sublease their apartments as a profit center, a way of producing income.''

Though unaware of the sublet-of-a-sublet phenomenon in the boroughs outside of Manhattan, Barbara Frechter, the president of Glenjay Realty in Forest Hills, Queens, can certainly attest to subletting's shift from act of desperation to profit plan.

''In the early and mid-90's, most people could not sell, and a lot of people who couldn't sublet walked away from their apartments, just left them,'' said Ms. Frechter, a former president of the Long Island Board of Realtors, which includes Queens. ''The interesting thing is that people who started out subletting from necessity are now subletting as an investment, because in a lot of cases they are making a profit.''

The motive is hardly peculiar to individual shareholders. Speaking as a sponsor with an interest in 1,500 apartments in 30 co-ops in Brooklyn, Queens, the Bronx, Manhattan, Westchester and Rockland, Susan Hewitt, the president of the Cheshire Group, said a major problem for some buildings is that their sponsors ''are making so much money renting that they won't sell their apartments.''

''And they are effectively holding these co-ops hostage as quasi-rental buildings,'' Ms. Hewitt added, saying that she strongly prefers to sell. ''Frankly, we're in the business of increasing the value of the apartments in a co-op,'' she said, ''and we feel that's best achieved by increasing owner-occupancy.''

The shift in subletting's focus has recast, though hardly dissipated, the contentiousness that has laced the issue since the surge in co-op conversion began in the early 1980's.

Thomas Dallal for The New York Times

David Ellingrud faced intense sublet scrutiny.

There are struggles over where a board should draw the line on when and to whom to rent, and constant concerns about a co-op's quality of life. A point of continuing conflict is the ratio of owner-occupants to renters, and how that weighs against the building's ability to refinance its underlying mortgage and for prospective buyers to obtain loans for individual apartments — commonly called end loans.

Still heard are charges of favoritism toward owner-occupants over shareholders who need or want to move —

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and vice versa. There is also a recent court ruling that sent shudders through co-op boards because it held a board member directly liable for damages in a discrimination case involving a sublet.

And for would-be renters, there is the board approval process, which can rival applying for a mortgage in the intensity of financial disclosure.

Except for laws barring discrimination, a co-op board's policy on subletting is based on what is written in the development's proprietary lease. "There are some buildings," Ms. Hewitt pointed out, "that very self-consciously want to operate with few restrictions, to be analogous to condominiums, which have unrestricted subletting. And there are other buildings that restrict subletting because they want to have 'a family feeling.' "

Mr. Saft of the council of cooperatives said the courts have upheld the right of co-op boards "to limit or not permit subletting at all, or to establish conditions on subletting."

"A co-op board can say, for instance, that you can only sublet if you've lived in your apartment for, say, five years. Or you can only sublet one out of every three years," Mr. Saft said.

THE courts have also ruled in favor of co-ops when it comes to defining who is a guest or a sublettor. "People are going away for the summer or for a year," Mr. Saft said, "and are allowing someone to stay in the apartment while taking the position that that person is a guest, not a sublettor, because there is no fee being paid and no document called a sublease."

"But there are cases that hold that if someone is staying in an apartment and the owner is not there, that person is not a guest but a subtenant," Mr. Saft said, "even if no rent is being paid. People are surprised to hear that."

But it was the co-op boards that were taken aback in April when the Court of Appeals, New York State's highest court, ruled in a case called Biondi v. Beekman Hill House that a board president was personally liable for punitive damages as a result of the board's rejecting an interracial couple for a sublease.

The primary action in the Biondi case was that the couple was denied a lease under circumstances that the courts found to be racial discrimination, and that the board president had acted in bad faith. The couple won, and the president's bid for indemnification through the co-op's insurance policy was denied by the Court of Appeals.

"The underlying problem in cooperatives," said Robert Taylor, a partner in Rovegno & Taylor, a law firm in Forest Hills that specializes in real estate, "is that you need good people to run it, and if there's going to be personal exposure for actions of the board collectively, then it's one more reason why somebody might not want to risk his or her personal finances."

"It also means, as far as subletting is concerned," Mr. Taylor said, "that the boards are going to have to be very careful."

Subletting has always been a balancing act for the boards, primarily over what weight to give to preserving the co-op's sense of community against the immediate financial needs of individual shareholders and, in the longer term, the building's ability to obtain favorable rates when the underlying mortgage has to be refinanced.

By the early 90's, with the co-op market in a downward slide, "some buildings that had restrictions on subletting eased up because of those concerns about abandonment," Ms. Frechter of the Long Island realty board said.

"If a person abandoned the apartment, the bank that held the mortgage was obligated to pay the maintenance," she continued. "But a lot of banks would let the maintenance accumulate, regardless of pleas from the co-op; they would pay it, but not for months."

G. Paul Burnett/The New York Times

Susan Hewitt, president of the Cheshire Group, said that subletting is so profitable, some sponsors won't sell.

"In the meantime, the co-op had to make up that difference," Ms. Frechter added, "and the cash flow was definitely hurting."

Ms. Hewitt said that quality-of-life and financial issues often become entangled. "Part of the compelling reason for people to live in a co-op is stability, a feeling that they recognize their neighbors," she said. "And that's particularly important in a place like New York."

For resident shareholders, "sublets are a pain," Ms. Hewitt said. "They hate subletting, because these are the people who don't know not to put pizza boxes down the compactor chute."

It can get worse than that.

Ruth Farrago is the president of the board of Hyde Park Gardens, a 746-unit garden apartment co-op in Kew Gardens Hills, Queens. Ms. Farrago recalls too well some hellish tenants.

"There was an owner who resides in California who hired a real estate agent to sublet his apartment," she said. "The agent sublet without the owner's approval and signed the owner's name on the lease."

For the first five months, no rent was paid. Eviction proceedings started. "But by the time they got to court, the agent had put somebody else in the apartment," Ms. Farrago said, "so the legal documents were no good."

THE second subtenant was no better. "A year and a half later, we were finally able to get the second tenant evicted," she said, "and when the marshal went in to remove the furniture, the apartment had been trashed."

The walls, the floors, the bathroom had all been torn apart; garbage was strewn throughout. "When they lifted up the furniture, roaches just came flying out," Ms. Farrago said.

For the owner living in California, she said, "it was a total loss: no rent; he had to pay legal fees, the cleanup, and he was still responsible to pay us the maintenance."

Struggles over subletting can lead to "something like class warfare," said Ms. Hewitt, whose company has helped bring stability to several financially troubled co-ops in the last decade.

Jack Manning/The New York Times

Edward Howe of the National Cooperative Bank said that a high level of owner occupancy can reduce mortgage rates.

"We're the holders of unsold shares in a building in Yonkers where the co-op had great difficulty getting end loans, both because the market was depressed and because there were questions about subletting," she said.

Eventually, those financial problems lifted. "But the issue lived on," Ms. Hewitt said. "The central dispute at the annual meeting for two years running turned on subletting, with great hostility. The resident shareholders perceived those who sublet as having escaped, or as profiteering off their building. The sublettors claimed their economic right to their investment. Each side invoked moral authority."

Some boards face the sublet disharmony only when they refinance. They find themselves in a bind because, among other things, lenders require that their sublets be brought below a certain percentage.

"This produces all kinds of tensions," Ms. Hewitt said. "Do you grandfather people who already are subletting? Do you distinguish between investors and shareholders who outgrew their apartments? If a board reviews sublet applications on a case-by-case basis, what constitutes hardship? All of these are touchy issues for most co-ops."

Edward Howe, the managing director of the National Cooperative Bank, which has provided underlying mortgages for more than 2,000 buildings in the metropolitan area, said much of that pressure has been reduced in recent years.

"Five, six years ago, if a property was less than 75 percent owner-occupied, it was extremely difficult for the building to get financing and for individuals to get end loans," Mr. Howe said.

Today, if a co-op is 25 percent owner-occupied, financing is "readily available" at about 8.5 percent, Mr. Howe said. And for a building that is 90 percent owner-occupied, the rate is about 7.75 percent — a three-quarter percentage point difference.

A typical underlying mortgage in the boroughs outside of Manhattan might be $1.5 million, he said, "so the difference would be about $9,500 a year in payments."

"The real difference, however," Mr. Howe said, "is that five years ago, a building that was 25 percent owner-occupied couldn't get financing."

Most co-ops are now "seasoned," pay their bills and are selling units because end-loan financing is available, he said. The current rate for an end loan in a building that is only 25 percent owner-occupied would be about 9.5 percent, while in a building that is 90 percent owner-occupied it would be about 8 percent. "For a $100,000 apartment with an $80,000 mortgage, that's about $1,000 a year difference in payments," Mr. Howe said.

"Five years ago, subletting was really taboo, and it's not the case anymore because the rental market is so strong," he said. "But this could all change again. It's kind of like being married — one day it's good, one day it's not."

If the pressure is off the boards in these heady times, it is surely on the renter.

"PEOPLE have to demonstrate mortgage-level disclosure, and it's driving them crazy," said Douglas Wagner, the president of Benjamin James Associates, a Manhattan brokerage company that specializes in rentals.

The demands certainly vary in the other boroughs, but at least in Manhattan, Mr. Wagner said, "It's worthy to note that when an applicant submits a complete board package, they've also submitted the first month's rent, a security deposit usually equal to two months' rent and some sort of co-op fees, which would include application fees of $200 to $500, nonrefundable, even if they don't get the apartment."

Then, typically, there are annual sublease fees of perhaps $600 to $1,200 that are passed along to the subtenant.

"So just to get out of the gate, the person has put down 30 pages of personal information, rent security and related co-op fees, which usually prohibit them from putting money down on anything else," Mr. Wagner said. "And then they have to wait three to six weeks for the approval meeting."

David Ellingrud, 24, has run the gantlet.

Mr. Ellingrud, an analyst for a management consulting firm, graduated from Dartmouth two years ago and with four friends from school, rented a $5,000-a-month duplex in an Upper East Side brownstone.

Now he is "tired of living like the dorm at school," he said.

Initially, Mr. Ellingrud and one of his roommates began looking for a place to share. "We bought one of those lists where you think you're going to find something and avoid the broker's fee," he said. "We looked on our own, and, I swear, one day we probably visited 40, 50 buildings, no exaggeration" — studio after studio for $1,800, $2,000.

"But two people in a studio?" he said.

"When we did see a one-bedroom, it was for like $2,200," Mr. Ellingrud said, "and when you go there it's more like a studio where they put up two walls to make a bedroom and a living room where if you were sitting on a couch, the TV would be in your lap."

Then, on his own and working through a broker, Mr. Ellingrud submitted his application to sublet a studio on East 71st Street for $1,500 a month.

"There's a lot of paperwork," he said. "I have a personal information form. You need a letter from your job, which is standard; a lease application form, bank statements.

"Then I needed my W2's for the last two years, my full 1040's for the last two years. I had to complete an asset statement. I had to have my bank certify that the amount of money I had in my account was actually there; had to have a bank officer sign my form. Then I also needed three letters of recommendation; co-workers, friends, that I'm a clean, quiet guy." The package was submitted at the end of June.

Finally, on Wednesday evening, Mr. Ellingrud met with the admissions committee. "I dressed conservatively," he said, "one of my better shirts."

He got in. ■