

Real Estate Forefront

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The Ruling on Stuyvesant Town and Peter Cooper Village Rent Decontrol

A Synopsis of the Decision and its Implications

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The recent ruling on Stuyvesant Town's decontrolling of apartments left many asking a simple question: how could so many lawyers have misinterpreted the rent stabilization code? The confusion is based on the language in the code that carves out an exception to the exception for decontrolling units. This paper summarizes the basis of this controversy.

History and Background

Stuyvesant Town had been rent regulated since 1974 so the owners thought that the J-51 statute forbidding the decontrolling of units did not apply to them since the language implicitly carved out an exception for them.

In New York City, the J-51 program was created in 1955 to encourage rehabilitation of old apartment buildings. The program, administered by the Department of Housing Preservation and Development (HPD), allows property owners who complete eligible projects to receive tax abatements that continue for a period of years. Rental units in these buildings receiving abatements must be registered with the State Division of Housing and Community Renewal (DHCR) and are generally subject to rent stabilization laws until the J-51 benefits expire.

MetLife, which built Stuyvesant Town and Peter Cooper Village ("the complexes") in the 1940s, first applied for and received J-51 benefits in 1992, but the complexes had been rent-stabilized since 1974.

In 1993, the Rent Regulation Reform Act (RRRA) was passed, which allowed for luxury decontrol or the deregulation of certain rent-stabilized apartments: (1) in vacant apartments where the legal regulated rent was \$2,000 per month or more; and (2) in occupied apartments where the legal regulated rent was \$2,000 per month or more and the combined income of the occupants exceeded \$250,000 per year (subsequently reduced to \$175,000 per year in 1997).

However, the RRRA made an exception to luxury decontrol which stated that the deregulating of units "shall not apply to housing accommodations which became or become subject to the Rent Stabilization Laws (RSL) by virtue of receiving tax benefits pursuant to" the J-51 laws (section 489 of the real property tax law).

It is this clause above that is the basis of this entire controversy.

Most interpreted the above clause to mean that owners of J-51 buildings were not entitled to decontrol units unless their building had been subject to rent regulation prior to gaining J-51 status in which case they were free to decontrol units.

And in fact, DHCR issued an advisory opinion in 1996 clarifying that the provision forbidding J-51 landlords from applying for luxury decontrol only applied to those buildings "where the receipt of such benefits is the sole reason for" being rent regulated. This "advisory opinion," however, was not legislation.

In the same document, DHCR further stated that if luxury decontrol is applied before the J-51 benefits expire, the abatement should be reduced proportionately. In other words, DHCR was clearly aware that some buildings that were granted J-51 abatements could be subject to luxury decontrol due to other provisions.

Over the interim years, the DHCR made changes to the rent stabilization code (RSC) and issued fact sheets laying out this exception to the exception; i.e., that those that had been subject to the RSC prior to earning J-51 benefits could decontrol units. Most owners believed that the RSC entitled them to decontrol their units that met the criteria.

Starting in 2001, MetLife, with DHCR's approval, began charging market-rate rents for units under which the decontrol conditions outlined in the RRRRA were met.

In October 2006, MetLife sold the complexes to Tishman Speyer and a consortium of investors for \$5.4 billion.

In January 2007, the first lawsuit was filed by nine tenants on behalf of a class of current and former tenants, saying that in 2001 to 2002 the defendants "improperly and unlawfully charged" tenants market rents while collecting J-51 tax abatements amounting to nearly \$25 million. They claimed in 2007 that approximately one quarter of the 11,200 apartments had been decontrolled.

The new owners along with MetLife, ("the defendants") moved to dismiss the complaint for failure to state a cause of action, arguing that the RRRRA's exception to deregulation for apartments that "became or become" subject to the RSL "by virtue of" receiving J-51 tax benefits did not apply to the properties because they had been rent regulated for two decades.

In August 2007, the Supreme Court dismissed the complaint, reasoning that the defendant's actions were consistent with "the clear and unambiguous language of the RSL."

The Supreme Court further noted that DHCR's interpretation of the statute:

1. Was consistent with the luxury decontrol laws, which were intended to "restore some rationality to a system" in which high-income tenants enjoyed the bulk of rent-regulated benefits;
2. Entitled DHCR to deference; and that
3. The Legislature's failure to amend the RSL in response to DHCR's interpretation when subsequently amending the luxury decontrol provisions showed that it acquiesced in the construction of the statute.

Most thought that this was the end to the lawsuit, but the plaintiffs appealed.

The Appellate Division's Final Opinion: The Terms in this One Short Sentence were Misinterpreted by the Owners, DHCR and the Supreme Court.

In October 2009, the Appellate Division unanimously reversed the Supreme Court's decision stating that the building owners receiving J-51 benefits forfeit their decontrol rights even if their buildings were already subject to the RSL before gaining J-51 benefits.

In short the Appellate Division in their majority opinion (heretofore referred to as "the majority") ruled that the defendant's definition of "become" -- "to pass from a previous state or condition" or to "take on a new role, essence, or nature" (Webster's Third New International Dictionary of the English Language 195 [1963]) -- could be interpreted otherwise. The majority stated that "there is nothing impossible, or even strained, about reading the verb 'become' to refer to achieving, for a second time, a status already attained."

The majority further disputed the meaning of "by virtue of" stating that "by virtue of" does not necessarily mean the same thing as "solely by virtue of." Seriously.

Moreover, the court ruled that DHCR's interpretation of the exclusion provision did not entitle them to deference because the ambiguity of the language allowed for different interpretations. They stated that the Supreme Court's reading "invite[d] absurd and irrational results."

The majority stated that the language in the RSC does not delineate between the two categories of J-51 beneficiaries -- one, like the complexes, that were rent-stabilized prior to receiving J-51 benefits, for which luxury decontrol was available; and those that only became rent-stabilized as a condition of receiving J-51 benefits, for which luxury decontrol is unavailable until benefits expire. Nor was there any indication that the Legislature ever intended such a distinction.

The majority further claimed that legislative history supports their decision by citing testimony provided by the RRRRA's (State Senate) sponsor when it stated that luxury decontrol was unavailable to buildings that "enjoy[ed] another system of general public assistance" including J-51 benefits. The dissenting opinion countered this by clarifying that this testimony pertained to 421-A tax benefits for new construction, not existing housing.

The Dissenting Opinion: Agreed with the Defense that "Every Word in a Statute Contributes Something to its Meaning."

The dissenting opinion supports the defendant's interpretations of the words "become" and "by virtue of."

The dissent also cites case law stating that once a building became rent-stabilized, "redundant statutory routes would not have been needed to make the building subject to the RSL."

Further as per the “delineating” between the two supposed categories of J-51-benefitted buildings, the dissent cites evidence that New York City rent laws have long distinguished between apartments that became subject to the RSL by virtue of the J-51 tax benefits, and units that were regulated for other reasons at the time they received J-51 benefits.

The dissent then points out the sunset clause of the RRRRA that “forces the legislation to reconsider its terms periodically.” In other words, the Legislature was required by the RRRRA to revisit the terms of the language, and did so in 1997 and 2003 but nevertheless, left the disputed language intact. Of course, many today may question why they left it intact.

Finally, the dissent cites even more case law to suggest, counter to the majority’s opinion, that the Legislature’s failure to amend the RRRRA to remove the disputed language and create a clearer distinction between the two categories of buildings demonstrates their acquiescence in the statute’s construction.

Most compelling, the dissent laments that the majority gives no weight to DHCR’s interpretation of the exception. This is an utter slap in the face to the DHCR which “is vested with a broad mandate to promulgate regulations in furtherance of the rent control and rent stabilization laws” and has been for decades. DHCR adopted its interpretation following a period of “notice-and-comment” allowing for significant participation by both landlord and tenant advocacy groups and interests.

In addition, the dissent indicates that HPD who administers the J-51 program issued a Certificate of Eligibility in July 2003 that reduced the J-51 benefit in proportion to the number of decontrolled units in the building consistent with the RSC: a less severe but nevertheless metaphoric slap in the face to HPD as well.

Conclusion: More Data is Needed to Estimate the Impact of this Decision

The “dire consequences” of this decision, cited by both sides of the argument, are vast, but at this point, still not clear.

Indeed, the DHCR’s opinion letters will be deemed less reliable than in the past. This is unfortunate but abundantly clear, and many real estate transactions are made on the basis of these opinion letters. Therefore, this decision will be a boon to lawyers who will need to be further engaged in real estate sales pertaining to rent-regulated housing.

The financial fall-out from this decision will affect other J-51 buildings that had been subject to the RSC prior to gaining J-51 benefits and had started to de-regulate units. While the New York City Department of Finance lists 180,500 units in 4,000 Manhattan buildings that currently enjoy J-51 benefits, estimating the subset of decontrolled Manhattan units requires more research. According to REBNY, almost no buildings outside of Manhattan will be impacted by this decision because market conditions precluded owners from decontrolling units.

The administration of overcharges to these unlawfully decontrolled units has not been determined. The case was returned to the lower courts. Even if those tenants whose apartments were unlawfully decontrolled as per this ruling will now qualify for an overcharge, the amount of the overcharge will likely not be substantial enough to offset the potential legal fees required to obtain them. It is also not clear that many paying market rents in these buildings will figure out that they qualify for an overcharge and will subsequently seek one in the first place.

On a more macro level, surely, the value of these properties will fall significantly, especially considering that many were sold over the last few years on the premise that their units would be decontrolled in the coming years. Likewise, real property tax collections will decline as well.

More data is clearly needed to estimate the true economic impact of this decision both on a micro level -- within the subset of "unlawfully" decontrolled units -- as well as the overall commercial real estate industry. But what is clear is the need for deeper lawyer involvement in sales negotiations. They may need to include a number of contingency clauses.

Finally, the legislature will need to draft new legislation to once and for all clarify the language in this statute. Hopefully, the new language will prevent this catastrophe from ever happening again.

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