

DHCR's Major Capital Improvement Policy Upheld

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In the recent case of [Terrace Court, LLC v. New York State Division of Housing and Community Renewal](#), 2012 WL 443947, the New York State Court of Appeals unanimously held that where a landlord performs major capital improvement (MCI) work in a building, and where that work does not benefit some apartments due to poor workmanship, the Division of Housing and Community Renewal (DHCR) is authorized to permanently deny MCI rent increases for those apartments. In so holding, the Court affirmed a sharply divided Appellate Division, First Department.

The *Terrace Court* case provides an excellent opportunity to examine MCI rent increases, and those instances where DHCR will deny or suspend such increases in whole or in part.

MCI: The Basics

Rent Stabilization Code §2524.4(a)(2) provides that a landlord may file with DHCR an application to raise rents throughout a building where the landlord performs MCI work and the work is (1) deemed depreciable under the Internal Revenue Code, other than for ordinary repairs; (2) for the operation, preservation, and maintenance of the structure; and (3) an improvement to the building or the building complex which inures directly or indirectly to the benefit of all tenants.

Typical MCIs include parapet work, pointing and waterproofing, new elevators, rewiring, and the like. DHCR's determination as to whether work qualifies a landlord for MCI rent increases is usually accorded great deference. See, [Ansonia Residents Ass'n v. New York State Division of Housing and Community Renewal](#), 75 N.Y.2d 206, 551 N.Y.S.2d 871 (1989); [West Village Assoc. v. New York State Division of Housing and Community Renewal](#), 277 A.D.2d 111, 717 N.Y.S.2d 31 (1st Dept. 2000).

DHCR will deny an MCI application where the work is performed on a "piecemeal" basis over a long period of time, rather than as a single, unified project. See, [Executive Towers at Lido v. New York State Division of Housing and Community Renewal](#), 236 A.D.2d 397, 653 N.Y.S.2d 630 (2d Dept. 1997). DHCR will also deny an MCI application outright where the landlord fails to file the application within two years of completing the work, see [Hampton Mgt. v. New York State Division of Housing and Community Renewal](#), 255 A.D.2d 261, 680 N.Y.S.2d 245 (1st Dept. 1998), or where the MCI in question duplicates a prior MCI for which the useful life has yet to expire. See, [SP 141 E 33 LLC v. New York State Division of Housing and Community Renewal](#), 91 A.D.3d 575, 937 N.Y.S.2d 220 (1st Dept. 2012).

DHCR will deny an MCI application where the work in question is not performed in a workmanlike manner, i.e., where the work does not "inure[] directly or indirectly to the benefit of all tenants." For example, in the oft-cited case of [Garden Bay Manor Assoc. v. New York State Division of Housing and Community Renewal](#), 150 A.D.2d 378, 540 N.Y.S.2d 665 (2d Dept. 1989), DHCR denied an MCI application where the pointing and waterproofing work "was done in such a poor manner that it did not qualify as a major capital improvement." See also, [Weinreb Mgt. v. New York State Division of Housing and Community Renewal](#), 204 A.D.2d 127, 611 N.Y.S.2d 545 (1st Dept. 1994) (MCI denied where "the roof continued to leak three years after the work was completed and thus the tenants were not benefited").

A more interesting question arises where, due to poor workmanship, the work benefits some, but not all, tenants. In those instances, DHCR has taken three different approaches: (1) outright denial of the MCI application; (2) permanent denial of MCI rent increases with respect to those apartments that did not benefit from the work; and (3) temporary suspension of MCI rent increases for the non-benefitting apartments, contingent upon the landlord making necessary repairs. Those scenarios are discussed below.

Outright Denial

The rule appears to be that where the percentage of non-benefitting apartments is high enough, DHCR will deny the MCI application outright. Thus, in [Duell LLC v. New York State Division of Housing and Community Renewal](#), 269 A.D.2d 235, 703 N.Y.S.2d 37 (1st Dept. 2000), DHCR denied an MCI application where "a substantial portion of the new windows in the subject building were defectively installed and, as such, did not constitute an improvement to the building justifying a major capital improvement rent increase." The court, however, did not divulge the percentage of the windows that were defective. See also, [Pickman Realty Corp. v. New York State Division of Housing and Community Renewal](#), 299 A.D.2d 552, 750 N.Y.S.2d 518 (2d Dept. 2002); [Wesley Ave. Assoc. v. New York State Division of Housing and Community Renewal](#), 206 A.D.2d 378, 614 N.Y.S.2d 58 (2d Dept. 1994).

Somewhat more enlightening is [Simkowitz v. New York State Division of Housing and Community Renewal](#), 256 A.D.2d 51, 680 N.Y.S.2d 525 (1st Dept. 1994). There, the Second Department upheld DHCR's denial of an MCI application

where there were "inspections revealing that the windows in at least 18 [percent] of the apartments had substantial defects."

Partial Denial

In *Terrace Court*, supra, the landlord performed pointing and waterproofing work at 202 Riverside Drive, a building containing 91 apartments. Thirty seven of the apartments were rent regulated. DHCR's inspectors found that notwithstanding the pointing and waterproofing work, there was persistent water damage in five of the 37 rent regulated units (13.5 percent).

DHCR granted the MCI, but permanently exempted the five apartments from MCI rent increases. The Supreme Court (Solomon, J.) affirmed DHCR's order. On appeal to the Appellate Division, First Department, the majority (Justices Angela Mazzairelli, Dianne Renwick and Nelson Román) voted to affirm. The dissent (Justices Eugene Nardelli and David Friedman) wrote that:

...logic dictates that the proper relief would be to suspend any increases for the apartments in question until petitioner had been given an opportunity to cure the defects, but, once the defects were cured, to permit prospective (only) increases. Permanently barring petitioner from obtaining an increase, when other tenants are paying the surcharge, is irrational. Indeed, as this Court stated as recently as September of this year in a case that presented a strikingly similar issue, "[S]imple common sense dictates suspending an increase rather than revoking it permanently" (*Matter of Langham Mansions, LLC v. New York State Div. of Hous. & Community Renewal*, 76 A.D.3d 855, 908 N.Y.S.2d 10 [2010]).¹

On appeal to the Court of Appeals, the landlord argued that the Rent Stabilization Code mandated temporary suspension of MCI increases with respect to those apartments that did not benefit from the work. The Court saw no such regulatory command. Instead, the Court observed that in the past, DHCR had in some cases permanently denied MCI rent increases where individual apartments did not benefit from the MCI, and in other cases temporarily suspended MCI increases for such apartments until the landlord made necessary repairs. The Court concluded:

It is therefore apparent that DHCR is not limited to temporarily suspending an MCI rent increase; the agency may permanently exempt an apartment in certain situations. Its choice is deferentially reviewed by the courts to determine whether there is a rational basis for the decision and, if so, DHCR's conclusion must be upheld even if a court would have reached a different result (citations omitted).

In a concurring opinion, Judge Robert S. Smith added:

There are a number of cases in which DHCR has ruled that a rent increase based on a major capital improvement should be suspended as to certain apartments until particular problems are fixed. There are also a number of cases...in which DHCR has permanently exempted certain apartments from the increase. I accept the idea that both remedies are sometimes appropriate, and that DHCR has discretion to choose between them. What troubles me is that it is not easy to tell from DHCR's decisions on what basis it is making the choice (internal citations omitted).

In its brief to the Court of Appeals, DHCR attempted to explain when it will permanently deny rent increases and when it will merely suspend those increases. As the Court of Appeals observed:

DHCR claims that one of the relevant considerations in these situations is whether an owner has demonstrated good faith in diligently addressing the problems caused by an MCI. The agency apparently reasons that an owner who does so is more likely to remedy a defective condition (justifying a temporary suspension of the rent increase), whereas an owner who denies the existence of MCI-related problems or does not undertake repairs within a reasonable amount of time is unlikely to extend the benefits of the project to the affected apartments (thereby justifying a permanent exemption from the MCI adjustment).

The Court of Appeals then noted, however, that "the agency's order did not cite this as a basis for its decision and we therefore do not consider it," and added that in future cases, DHCR should explain why it has permanently or temporarily suspended MCI rent increases for affected apartments "to allow for adequate review by the courts."

Based on the foregoing, practitioners should assume the following:

- If the percentage of apartments that have not benefitted from an MCI is high enough, DHCR will likely deny the MCI application outright. It is unclear, however, what percentage will trigger the complete denial of an MCI application.
- If the percentage of apartments that have not benefitted from an MCI is reasonably small (say, under 10 percent), DHCR will probably grant the MCI increase but will permanently or temporarily deny the increase for the non-benefitting apartments.
- DHCR's determination as to permanent versus temporary denial will most likely depend on DHCR's view of the landlord's good faith efforts to make necessary repairs. Thus, landlords, instead of reflexively denying allegations of poor workmanship, should take tenant complaints seriously, conduct physical inspections, and, where necessary, perform corrective work as soon as possible.

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Endnote:

1. 79 A.D. 3d at 50.