Damaged Buildings

Must a Landlord Restore Tenants to Occupancy?

BY WARREN A. ESTIS AND JEFFREY TURKEL

While rent-regulated tenancies are seemingly indestructible, rent-regulated buildings are not. Some regulated buildings are severely damaged by fire or flood; some suffer cracks, while others collapse in whole or in part. The usual response is that the Department of Buildings will issue a full or partial vacate order, directing some or all of the tenants to vacate while the owner repairs the property. Once repairs are made, the vacate order is rescinded and the tenants are returned to their apartments.

Not surprisingly, some landlords would rather tear down rent-regulated buildings than repair them. Such landlords have succeeded in two circumstances: (1) where the damage is so extensive that rebuilding is infeasible, and (2) where rebuilding is economically infeasible, i.e. where the cost of repairs approaches or even exceeds the value of the restored building.

Two recent cases, *Quiles v. Term Equities*, 22 A.D.3d 417, 802 N.Y.S.2d 679 (1st Dep't 2005), and *Farrell v. E.G.A. Assocs.*, 9 Misc.3d 1118(A), ____ N.Y.S.2d ____ (N.Y.C. Civ. Ct. 2005), address the physical and economic infeasibility defenses. These cases are discussed below.

RENT REGULATIONS

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'Quiles'

On October 29, 1998, the rent-regulated apartment building at 82 West 105th Street in Manhattan was damaged by fire. The Department of Buildings issued a vacate order based on "imminent danger to the safety and life of the occupants."

The tenants thereafter obtained an order from DHCR reducing their rents to $1 per month and allowing them to be restored to occupancy once the building was repaired. The landlord filed a Petition for Administrative Review, seeking clarification that the landlord had no obligation to restore the existing apartments, and could in fact build new apartments without having to offer them to the existing tenants.

DHCR declined to rule on what it deemed to be a hypothetical question. Following the landlord's subsequent request for reconsideration, DHCR advised that its prior rulings did not signify that "the owner may not successfully raise any of these issues in another agency or court proceeding." DHCR went on to state that it had "no authority to convey upon a tenant an unqualified right to be restored to possession where other principles of landlord-tenant law, as enunciated by the courts, afford an owner, under certain circumstances, the right not to restore a tenant to possession of an apartment or a building." DHCR also noted that its $1 rent order did "not explicitly direct the owner to restore the tenant to possession of the apartment or to a newly created apartment."

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The landlord thereafter applied to the Department of Buildings for permission to renovate the existing five-story building, and increase the number of apartments from 16 to 39. The landlord then informed the tenants that it did not intend to restore the apartments to their former state, and that it had no legal obligation to offer any former tenant a newly created apartment.

Various tenants then brought an action alleging wrongful eviction, asserting that the building remained fundamentally intact and should be rebuilt. The landlord, relying on the opinion of its engineer, asserted that the building required a gut renovation. Supreme Court (Lehner, J.), on summary judgment, found for the tenants. Supreme Court held, inter alia, that even if the building had been demolished by fire, the various tenancies were not terminated because the landlord had not applied to DHCR for approval to terminate them.

The First Department reversed, holding that an owner's obligation to seek DHCR's permission to evict a tenant from an apartment presupposes that "the apartment from which the landlord seeks to evict the tenant is in existence." The court then endorsed the physical infeasibility defense, but ruled that there was a question of fact as to whether this particular building was capable of being restored:

> ... a building may be so damaged by fire, without being burned to the ground, that the owner is left with no real choice but to demolish it, and ... in that case the owner is not obligated to offer apartments in the new building to the former tenants of the rent-stabilized and rent-controlled apartments no longer in existence. Thus, the question of whether the building was so damaged by the fire as to have been 'effectively demolished' is critical to a determination of whether defendants unlawfully evicted plaintiffs. Upon review of the evidence on the motion, we find that at trial an issue of fact was raised precluding summary judgment... .[1]

Economic Infeasibility

Any claim of economic infeasibility is premised on the Fifth Amendment to the United States Constitution, which provides that private property shall not be taken for public use without just compensation. Article I, §7(a) of the New York State Constitution is to the same effect.

The economic infeasibility defense goes back at least 50 years. In *Harmor Operating Co., Inc. v. Vent-O-Matic Corp.*, 1 A.D.2d 551, 151 N.Y.S.2d 445 (1st Dep't 1956), the Department of Buildings directed the landlord to demolish or repair a small building that housed a commercial tenant (protected at the time by the Commercial Rent Law) on the first floor. The landlord elected to demolish, asserting that it was not economically feasible to retain the small part of the structure where the tenant was located. The tenant, predictably, objected.

The First Department ruled in the landlord's favor, citing the potential for an unconstitutional taking:

> If, as the tenant urges, out of deference to the tenant's statutory right to occupy the landlord must at great cost cure the violation by repair, serious constitutional issues arise. If as the tenant seems to contend, eviction and demolition may not be permitted except within the provisions of the Commercial Rent Law then the inescapable consequence is that the owner of property of little or no value with its current improvement, if confronted with a violation requiring repairs exceeding an amount the value of the property even in a repaired state, would be obliged to make such repairs so long as a single statutory tenant remains. Sufficiently difficult constitutional questions confront us if the landlord is forbidden to withdraw his property from the rental market and compelled to continue an unprofitable operation, but those difficulties are compounded when the landlord is not only compelled to continue such an operation but to expend unwisely and wastefully large sums to repair property better demolished. The appellant's argument here comes dangerously close to requiring the landlord to dedicate property to a public use without due process or just compensation.[2]

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The Court concluded that where demolition is rendered essential, the tenancy is constructively terminated and the landlord is permitted to evict.

'Eyedent'

For ten years, the leading Appellate Division case on the economic infeasibility defense was *Eyedent v. Vickers Mgt.*, 150 A.D.2d 202, 541 N.Y.S.2d 210 (1st Dep't 1989). In *Eyedent*, the landlord had been directed to repair a rent regulated building where one of the exterior walls had collapsed. The Department of Buildings had issued a temporary vacate order, and the rent regulated tenants had to be temporarily housed elsewhere. The landlord refused to make the repairs and pled economic infeasibility. Civil Court (Friedman, J.) refused to accept that defense, holding that the landlord had let the building deteriorate, and should not be allowed to profit from its misconduct by obtaining a vacant site in a "hot" location. The Court also observed that according to the landlord, the building would have operated at a net loss without the catastrophe, and thus never would have earned a profit. 134 Misc.2d 841, 511 N.Y.S.2d 462 (N.Y.C. Civ. Ct. 1986).

On appeal, Appellate Term reversed, stating:

> It is apparent from the tenor of the housing court's decision that it did not wish to be seen as condoning a situation where buildings are allowed to deteriorate by the owners to the point where there is no other viable alternative but demolition, resulting in the loss of regulated tenancies and further 'gentrification' as former residents are forced out of neighborhoods and replaced by more affluent consumers who can occupy upgraded properties. We are not unsympathetic to these general housing concerns, although it remains dubious whether the courts, in the end, are the forum best situated to address the underlying problem of rebuilding the rental housing stock for lower-income and middle-income tenants. But on the particular facts presented in this case, the weight of the evidence persuades us that we are dealing with dwellings which, unfortunately, have deteriorated 'to the point where [they] can no longer be reclaimed' [citation omitted], and where it is no longer economically feasible to salvage them for the benefit of the petitioner-tenants.[3]

The Appellate Division reversed again, finding that the landlord's economic hardship was self-inflicted, thereby precluding the economic infeasibility defense:

> In view of the landlords' business acumen in this field, we find that the alleged economic hardship the landlords now face was self-inflicted since the facts adduced at the trial indicate that the need to make such repairs could have been anticipated [citation omitted]. Although these premises were more than 100 years old, the landlords, as mentioned supra, did not even order an engineer's inspection before they purchased it.[4]

Oddly, while the matter was pending at the Appellate Term, a fire completely destroyed the premises. The Appellate Division declined to consider the appeal moot, holding that to do so "would be an incentive for unscrupulous owners to permit their property to decay beyond the point of reasonable rehabilitation, and then obtain an unwarranted windfall."[5]

Landlords should be prepared to establish the elements of their case, and, perhaps more importantly, that the casualty to the building did not arise from their negligence or neglect.

'Bernard v. Scharf'

The next major appellate pronouncement on the economic infeasibility defense was in *Bernard v. Scharf*, 246 A.D.2d 171, 675 N.Y.S.2d 64 (1st Dep't 1998). In Bernard, the building at 610 West 112th Street was rendered uninhabitable by a devastating fire on Feb. 7, 1994. Of the 61 apartments in the building, 26 were rent-regulated. The holder of unsold shares ("the owner") argued, and the Appellate Division thereafter found, that it would cost approximately $4.5 million to repair the structure, while the value of the restored building would be between $1 million and $2 million. The owner refused to restore the building on grounds of economic infeasibility. (Note: The owner was represented by Rosenberg & Estis).

After losing in the Civil Court (Wendt, J.) and before the Appellate Term, the owner prevailed at the First Department. The Appellate Division first considered the tenants' claim that the economic infeasibility defense was unavailable because the owner had purportedly underinsured the premises. The Appellate Division ruled that the level of insurance was irrelevant:

> At the outset, we hold that the deficient insurance coverage should not preclude the economic infeasibility defense, because the relevant issue is the economic condition of the building, not that of the owners [citation omitted]. If the building is not worth repairing, repair should not be required.[6]

The Appellate Division then held that requiring the owner to repair the premises would result in an unconstitutional regulatory taking:

> The Court of Appeals has held that a burden-shifting regulation amounts to a taking without just compensation '(1) if it denies an owner economically viable use of his property, or (2) if it does not substantially advance legitimate state interests' [citations omitted].
>
> Compelling appellants to restore the building fails both of these tests. An order to spend over $4 million to create $1 million of value certainly denies the owner any reasonable return on his investment. Additionally, notwithstanding the State's legitimate interest in making affordable housing available for the general public, the restoration order merely 'bestows a state-enacted indirect gift to a preferred supplicant ... underwritten by the improperly burdened property owners,' and 'provides no benefit to the citizenry at large' [citations omitted].[7]

The owner in *Bernard*, however, did not come away unscathed. The Appellate Division held that if the building were not restored, "petitioners may have the right to compensation for the loss of their tenancies and share holdings, as well as damages for appellants' apparent breach of the insurance procurement clause in the cooperative offering plan."[8]

Like *Eyedent*, *Bernard* had an unusual postscript. After the Appellate Division ruled in the owner's favor, title transferred and the new owner elected to restore. The Court of Appeals therefore reversed the Appellate Division's order and remanded the matter to Civil Court with directions to dismiss the proceeding upon grounds of mootness. 93 N.Y.2d 842, 689 N.Y.S.2d 1 (1999).

'Farrell'

The Department of Buildings in *Farrell* had placed a partial vacate order against a rent regulated building. The landlord did not want to restore, and, in fact, sought an order in Supreme Court to compel the Department of Buildings to issue a vacate order against the entire building. Noting that unusual development, the Civil Court in Farrell (Lebovits, J.) concluded that "respondents seek to erect roadblocks to prevent petitioner and other rent-regulated tenants from returning to their homes."

At the trial in *Farrell*, an expert from the Department of Buildings testified that because the landlord had already physically stabilized the building, the Department would rescind the vacate order once the landlord submitted an appropriate engineer's report. The landlord had not done so. The court held then that the landlord's economic infeasibility defense was academic because the landlord had already spent the funds necessary to rescind the vacate order.

The court went on to hold that the landlord, in any event, had failed to prove its case. The landlord failed to convincingly establish the value of the building, or the cost necessary to make the building and each apartment therein habitable. Even if the landlord's numbers were accepted, the value of the restored building would be more than double the cost of the repairs.

The defense of economic infeasibility will, obviously, be determined on a case-by-case basis. Landlords, however, should be prepared to establish the elements of their case, and, perhaps more importantly, to establish that the casualty to the building did not arise from their negligence or neglect.

1. 802 N.Y.S.2d at 682.
2. 1 A.D.2d at 554.
3. 138 Misc.2d 459, 462-63, 528 N.Y.S.2d 270 (App. T. 1st Dep't 1988).
4. 150 A.D.2d at 205.
5. Id.
6. 246 A.D.2d at 175.
7. Id. at 176.
8. Id. a 175.