J-51 Renovations

Court Addresses City Program, Four-Year Rule

BY WARREN A. ESTIS AND JEFFREY TURKEL

IN its recent decision in *East West Renovating Co. v. New York State Division of Housing and Community Renewal*,__AD3d__, 791 NYS2d 88 (1st Dept. 2005), the Appellate Division, First Department, ruled that (1) an owner's failure to attach a J-51 rider to the tenants' lease barred the owner's claim of destabilization, and (2) the Division of Housing could properly consider events occurring more than four years before the tenants' overcharge complaint to determine whether the apartment was rent regulated.

The court's decision presents an excellent opportunity to discuss both the four-year rule and the interplay between rent stabilization and an owner's receipt of J-51 benefits.

J-51

New York City's J-51 program, implemented by §11-243 of the New York City Administrative Code, is administered by the New York City Department of Housing Preservation and Development. The program grants partial tax exemption and abatement benefits to owners who renovate residential properties.

Owners of rent regulated buildings frequently apply for and receive J-51 benefits for such routine work as boiler installations, new windows, elevator upgrades and the like. The receipt of J-51 benefits under such circumstances has no effect on the building's rent regulated status. Put another way, a rent stabilized building will be rent stabilized before, during and after the receipt of J-51 benefits.

The analysis becomes more complicated when the renovation is recent and substantial. Section 5(a)(5) of the Emergency Tenant Protection Act (L. 1974, ch. 576, §4) exempts from stabilization coverage "housing accommodations in buildings completed or substantially rehabilitated as family units on or after" Jan. 1, 1974. Thus, a building that has been gut renovated for residential use after Dec. 31, 1973, is theoretically exempt from stabilization coverage.

Where an owner receives J-51 benefits in connection with such a renovation, however, the apartments will indeed be rent stabilized by virtue of Rent Stabilization Law §26-504(c), which covers "[d]welling units in a building or structure receiving the benefits of section 11-243...." Thus, if the owner of a building renovated after Dec. 31, 1973, wants to obtain J-51 benefits, the owner must simultaneously accept the burden of rent stabilization.

But not forever. Section 2520.11(o)(2) of the Rent Stabilization Code states that once J-51 benefits expire, an apartment will be deregulated upon lease expiration if the owner has given the tenant the appropriate lease notice or rider. Accordingly, housing accommodations will become destabilized where:

> ...each lease and each renewal thereof of a tenant in residence at the time of the expiration of the tax benefit period includes a notice, in at least twelve point type informing such tenant that the housing accommodation shall become deregulated upon the expiration of the last lease or rental agreement entered into during the tax benefit period, and states the approximate date on which such tax benefit period is scheduled to expire.

Before 1983, owners defending rent overcharge complaints were required to provide the agency with a rental history for the apartment all the way back to the date the apartment first became stabilized. The rent agency would then use the first stabilized rent as the basis for calculating all subsequent increases. If actual rents exceeded legal rents, the owner was directed to refund the difference.

By 1983, however, the rental history could extend as far back as 14 years. If the owner did not have complete records, i.e., if even one lease was missing from the rental history chain, the rent agency would use a "default formula" to calculate the legal rent. The formula usually resulted in a substantial rent reduction and a correspondingly substantial refund.

Four-Year Rule

The Legislature addressed this issue in the Omnibus Housing Act (L. 1983 ch. 403). In addition to providing for the annual registration of rents, the act added section 26-516(a) to the Rent Stabilization Law. That section provided that the base rent for purposes of calculating subsequent rent increases would no longer be the rent charged on the date the apartment first became stabilized, but would instead be the "rent indicated on the annual registration statement filed four years prior to the most recent registration statement. ..."

The act also amended the Rent Stabilization Law to provide that Division of Housing and Community Renewal (DHCR), when determining a complaint of rent overcharge, was forbidden to examine "the rental history of the housing accommodations prior to the four-year period preceding the filing of [an overcharge] complaint . . ." (material in brackets supplied). Thus, the four-year rule was born.

RENT REGULATIONS

Warren A. Estis

Jeffrey Turkel

'East West'

In *East West*, tenants Joseph Vitale and Anthony Pescatore first rented a West Side apartment in 1992. The initial two year lease stated in a rider that the apartment was "not subject to the rent stabilization code of New York City." The owner would later claim that notwithstanding said representation, the lease also contained a rider stating that the apartment would remain rent stabilized until (1) J-51 benefits expired on or about July 1, 1993, and (2) the initial lease thereafter expired on Sept. 30, 1993.

A rent stabilized building will be rent stabilized before, during and after the receipt of J-51 benefits, which are given for routine work such as boiler installations, new windows and elevator upgrades.

After 1993, the tenants executed various deregulated leases for the apartment. In 1999, the tenants filed a failure to renew lease complaint with DHCR. In 2000, the tenants filed a rent overcharge complaint. The owner responded by stating that the apartment had become deregulated when J-51 benefits expired in 1993, more than four years before the overcharge complaint was filed.

DHCR's Rent Administrator denied the tenants' overcharge and failure to renew lease complaints. The Rent Administrator found that the tenants had been duly served with a J-51 rider, and that their apartment was deregulated.

The tenants then filed a Petition for Administrative Review, denying that they had ever received or signed the J-51 rider. The matter was then referred to an Administrative Law Judge (ALJ) to hear and report.

At the hearing before the ALJ, the owner was not able to produce the original J-51 rider, and instead produced copies that were purportedly signed by the tenants. The owner also produced testimony purporting that the tenants had received and signed the rider. The tenants' forensic document expert, however, testified that the documents were not authentic. The ALJ agreed, and also noted that even if the rider had been signed, it was negated by other language in the lease which stated that the apartment was not rent stabilized. The ALJ,

Warren A. Estis *is a founding partner at Rosenberg & Estis.* **Jeffrey Turkel** *is a partner at the firm.*

who also found "the discrepancy in testimony between Mr. Pescatore and Mr. Vitale to be disturbing," recommended that the apartment be declared subject to rent stabilization. The Rent Administrator adopted the ALJ's recommendation, and was affirmed on administrative appeal by DHCR's Commissioner.

The matter was then remanded to the Rent Administrator to calculate the lawful rent and any refund to which the tenants might be entitled. In a Feb. 6, 2003 order, the Rent Administrator directed the owner to refund $33,444.90 to the tenants, including treble damages and interest.

The owner then filed a Petition for Administrative Review. On April 21, 2003, the Commissioner upheld the Rent Administrator in all respects. The Commissioner ruled that the overcharge was willful, and that even ignoring the authenticity issue, "the conflicting riders would have been confusing and would not have properly notified the tenants of the termination of rent stabilization benefits at the end of their vacancy lease."

The owner then brought an Article 78 proceeding to challenge DHCR's April 21, 2003 order. The owner asserted that DHCR's factual finding as to the authenticity of the J-51 rider was erroneous, and that the four-year statute of limitations against rent overcharge complaints barred DHCR from even reaching the authenticity issue.

Decision Affirmed

Supreme Court (Zweibel, J.) affirmed DHCR's order. The court first held that DHCR properly concluded that the J-51 rider had never been served on the tenants, and that in any event, would have been negated by the leases other rider, which inaccurately recited that the apartment was not rent stabilized. The court also rejected the owner's reliance on the four-year rule, stating:

> The key findings in this case were based on the regulatory status of the apartment and not on rent registration statements or the rent history, review of which is precluded by RSL §26-516(a)(2) and RSC §2526.1(a)(2)(ii). As DHCR argues, petitioner's failure to provide the notice of rights required pursuant to RSC §2522.5(c) and the notice of the expiration date of J-51 benefits and the resultant erroneous deregulation of the apartment upon the expiration of the vacancy lease was obviously not a 'rental event' as claimed by petitioner and the finding that the apartment was subject to rent stabilization was not the same as an overcharge calculation and "do not implicate the legislative concerns underlying the four-year statute of limitations in the Rent Stabilization Law...."

In its March 8, 2005 decision, the Appellate Division, First Department affirmed Justice Zweibel's order in all respects. With respect to the J-51 issue, the First Department wrote:

> These circumstances require that the lease include a notice that the apartment was to become deregulated on or about June 30, 1993. With ample record support, DHCR found that the lease contained no such notice and that a purported copy of the notice produced by petitioner and purporting to bear the tenants' signatures was neither signed nor received by them. DHCR further held that even if the purported copy were authentic, it would not avail petitioner in view of another provision in the lease explicitly stating that the apartment was not subject to any regulation. These findings rationally support the determination that the apartment did not become destabilized after expiration of the J-51 benefits, and that petitioner willfully overcharged the tenants a free-market rent.

As for the four-year rule, the Appellate Division stated:

> In fixing the overcharge, DHCR set a base date of Jan. 20, 1996, four years prior to the filing of the overcharge complaint, and calculated the lawful increases forward from that date based on the free market rent that the tenants were paying immediately prior to the base date. We reject petitioner's argument that by so doing, DHCR improperly considered events surrounding the execution of the 1992 lease more than four years prior to the filing of the rent overcharge complaint in January, 2000, in violation of Rent Stabilization Law. . . §26-516(a)(2). DHCR's consideration of events beyond the four-year period is permissible if done not for the purpose of calculating an overcharge but rather to determine whether an apartment is deregulated (cf. *Matter of Hargrove v. DHCR*, 224 AD2d 341, 664 NYS2d 767 [1997]; *Matter of Condo Units v. DHCR*, 4 AD3d 424, 771 NYS2d 380 [2004]).

Owners beware: The four-year rule will not protect you if the status, rather than the rent, of the apartment is primarily at issue.

Susan Baumel-Cornicello, who successfully represented the tenants, reports that the owner's time for to move for leave to appeal has expired. Accordingly, *East West* is now the law of the First Department.