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What Happens When J-51 Benefits End?

Warren A. Estis and Jeffrey Turkel

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In its landmark ruling in *Roberts v. Tishman Speyer Properties, L.P.*, 13 N.Y.2d 270, 890 N.Y.S.2d 388 (2009), the Court of Appeals held that owners of rent stabilized apartments in buildings receiving J-51 benefits could not seek to recover such apartments through luxury deregulation. The J-51 program is a New York City tax program that encourages owners of residential property to upgrade building systems in exchange for real estate tax abatements and exemptions. The tenants in *Roberts* had sought a declaration that their apartments "would remain rent-stabilized 'until the last applicable J-51 tax benefits…have expired,'"[1] thereby conceding that any prohibition against luxury deregulation ended once J-51 benefits ended.

In two post-*Roberts* cases, the Division of Housing and Community Renewal (DHCR) has been asked to determine whether luxury deregulation is available once J-51 benefits expire, a factual distinction from *Roberts*, wherein J-51 benefits were still in effect. DHCR has ruled that luxury deregulation is available for rent stabilized apartments once J-51 benefits end, but not for rent controlled apartments.

'Schiffren'

The issue first arose in *Matter of Schiffren*, DHCR Adm. Rev. Dckt. No. XE-4100410-RT, issued on Jan. 5, 2010. In *Schiffren*, tenants Alan and Lisa Schiffren moved into a rent stabilized apartment at 98 Riverside Dr. in September of 1989. The building began receiving J-51 tax benefits on July 1, 1995. Those benefits expired on June 30, 2006.

On June 26, 2008—two years after the J-51 benefits expired—the landlord sought to luxury deregulate the apartment under RSL 26-504.1. The landlord alleged that the legal rent for the apartment was over $2,000 per month, and that the tenants' income exceeded the $175,000 threshold. The tenants admitted that their income exceeded the threshold, and DHCR issued an order of deregulation on April 6, 2009, with the deregulation to become effective upon the Sept. 30, 2009 expiration of the lease.

The tenants then filed a Petition for Administrative Review (PAR), alleging in relevant part:

…the tenants assert, in substance, that the high income luxury deregulation provisions are not applicable to housing accommodations which became subject to rent stabilization by virtue of receiving J-51 tax benefits; that the owner received such tax benefits during the tenants' tenancy up through 2005/2006; that the subject apartment therefore was and remains subject to rent stabilization as a result of the receipt of the J-51 benefits; [and] that pursuant to Real Property Law Section 489, rent stabilization coverage continues after the expiration of the J-51 benefits until after the first vacancy thereafter or unless the lease contains a certain specified notice….

DHCR issued an order denying the tenants' PAR on Jan. 5, 2010. DHCR held that in *Roberts*, the Court of Appeals had ruled that "high income deregulation as provided for in Sections 26-504.1 and 26-504.3 of the Rent Stabilization Law (RSL) is not available for apartments receiving…J-51 tax benefits while such benefits remain in effect." DHCR then held that once such benefits ended, the status of the apartment was governed by RSL 26-504(c):

According to Section 26-504(c) of the RSL, if the apartment was subject to rent regulation solely as a result of the receipt of tax benefits, then upon the expiration of such benefits, the apartment shall remain subject to regulation until the occurrence of the earlier of two expressly specified events; the vacating of the tenant or the expiration of the lease in effect on the date the tax benefits expired, provided that each lease given the tenant provided proper notice of the expiration date of the projected tax benefits. Thus, high income rent deregulation is not available for an apartment that falls into this category, even after the expiration of J-51 tax benefits.

However, if the apartment was subject to rent regulation for a reason(s) in addition to the receipt of these tax benefits, then upon the expiration of the tax benefits, Section 26-504(c) directs that the unit continue to be subject to regulation as if the tax benefits had never been granted. Thus, in that instance, upon the expiration of the tax benefits, the provisions of Sections 26-504.1 and 26-504.3 of the RSL become applicable to the apartment and the apartment is subject to luxury decontrol, and an owner may file the appropriate petition for deregulation.

DHCR thus ruled that there is a specific provision in the RSL, §26-504(c), "which expressly addresses the post tax benefit status of rent regulated apartments." According to DHCR, §26-504(c) provides that once the "taint" of J-51 status is removed from apartments that were subject to rent stabilization prior to the receipt of J-51 benefits, those apartments once again become eligible for luxury deregulation.

In the subsequent Article 78 proceeding, *Schiffren v. Lawlor*,[2] New York County Supreme Court Justice Paul Wooten affirmed DHCR's Jan. 5, 2010 order. Specifically, the Supreme Court adopted DHCR's view that RSL 26-504(c) created

two classes of apartments: those apartments that became subject to rent stabilization solely by virtue of receiving J-51 benefits, and those apartments, like the Schiffren apartment, that were already subject to rent stabilization when J-51 benefits were first obtained. The court held that pursuant to RSL 26-504(c), luxury deregulation was not available for apartments in the first category, and such apartments would remain stabilized until vacancy or until the J-51 benefits expired, provided that the tenant had been supplied with appropriate notice.

As to the second category, however, the court ruled that "petitioner's apartment unit was not granted permanent rent stabilized status until vacancy…and…the apartment unit is subject to luxury deregulation even though no §26-504(c) notice appeared in the petitioner's lease renewal."

A notice of appeal has been filed in *Schiffren*, but no appeal to the Appellate Division has yet been perfected.

'Berk'

DHCR recently addressed this issue, in the context of rent control, in *Matter of Berk*, Adm. Rev. Dckt. No. YL-420051-RT, issued on Oct. 26, 2011. In *Berk*, the owner filed for luxury deregulation on June 17, 2008, after J-51 benefits had expired. Although the rent controlled tenant denied that her income exceeded the $175,000 threshold during the relevant years, the Department of Taxation and Finance found otherwise. On Nov. 30, 2010, DHCR's Rent Administrator issued an order of deregulation. The tenant then filed a PAR.

DHCR issued an order granting the tenant's PAR on Oct. 26, 2011. DHCR, this time, denied, at least for purposes of rent control, that there were two categories of rent controlled apartments, i.e., those that became subject to rent control solely by virtue of receiving J-51 benefits, and those that were already rent controlled when J-51 benefits were first obtained:

…Section 26-403(e)(2)(j) of the New York City Rent and Rehabilitation Law…defines those apartments eligible for high income luxury deregulation. Section 26-403(e)(2)(j) also provides that the high income rent deregulation provision does not apply to those housing accommodations which became or become subject to rent regulation by virtue of receiving J-51 tax benefits. The Commissioner notes that the N.Y.S. Court of Appeals in *Roberts* found that there was nothing strained about reading the verb "become" as it is used in the statute to refer to achieving for a second time a status already attained (the apartment having been subject to rent regulation even prior to receiving J-51 tax benefits).

The high income rent deregulation exemption from rent control…is not available for apartments in buildings that have been receiving or have received J-51 benefits. Furthermore, there is nothing in the Rent Control Law which provides for the resumption of the availability of high income rent deregulation after J-51 tax benefits have expired. Accordingly, high income rent deregulation is not available to rent controlled apartments for which J-51 tax benefits have been received such as the subject apartment, even after those J-51 benefits have expired.

Thus, according to DHCR, J-51 benefits under rent control are the rent regulatory equivalent of the mark of Cain, an indelible banishment from the prospect of luxury deregulation.

The *Berk* decision is ironic in light of the Court of Appeals' rationale in *Roberts*. There, the Court of Appeals relied on a comment, made during legislative debate, that luxury deregulation would be unavailable to building owners "who 'enjoy [ed] another system of general public assistance' such as J-51 benefits…."[3] The idea was that owners should not be able to "double dip," i.e., obtain J-51 benefits while at the same time enjoying the benefits of luxury deregulation. According to DHCR, however, in rent controlled buildings, luxury deregulation is prohibited even after the owner stops receiving "general public assistance" in the form of J-51 benefits.

One last point should be made about *Berk*. In general, rent control only applies to tenants who have been in continuous occupancy since June 30, 1971. It is estimated that there are fewer than 40,000 rent controlled apartments left in New York City. Only a tiny fraction of those apartments rent for $2,500 per month, the new luxury deregulation threshold established by the Rent Act of 2011 (L. 2011, ch. 97). In turn, only a fraction of the tenants living in such apartments (1) earn the $200,000 income threshold for luxury deregulation (also amended by the Rent Act of 2011), and (2) live in a building that has ever had J-51 benefits. Accordingly, *Berk*, at best, may only affect a few dozen apartments in New York City.

Days ago, the owner in *Berk* commenced an Article 78 proceeding against DHCR challenging the agency's Oct. 26, 2011 order.

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

Endnotes:

1. 13 N.Y.3d at 282.

2. 2011 WL 2323242, 2011 N.Y. Slip Op. 31511(U).

3. 13 N.Y.3d at 286.

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