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RENT REGULATION

Substantial Rehabilitation Of Buildings as Family Units


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Rent Stabilization Code §2520.11(e), as supplemented by DHCR Operational Bulletin 95-2 (OB 95-2), exempts from rent stabilization "housing accommodations in buildings completed or buildings substantially rehabilitated as family units on or after January 1, 1974." In the recent case of *Bartis v. Harbor Tech*, 2014 WL 2861558 (Sup Ct Kings County), Justice Debra Silber ruled that buildings converted on or after Jan. 1, 1974 from commercial to residential use are exempt from rent stabilization, even if the owner has not satisfied all of the substantial rehabilitation requirements set forth in the code and in OB 95-2.

Silber's ruling provides an occasion to examine the substantial rehabilitation exemption, particularly as it applies to apartments that were created from non-residential space.

ETPA

The Emergency Tenant Protection Act (L. 1974, c. 576, §4)(ETPA) was a 1974 enabling act that empowered localities within New York State to declare a housing emergency. The New York City Council immediately declared the necessary emergency, bringing the ETPA into effect in New York City.

ETPA §5(a)(5) states that a locality could not declare a housing emergency with respect to "housing accommodations in buildings completed or buildings substantially rehabilitated as family units on or after January first, nineteen hundred seventy-four." The intent of ETPA §5(a)(5) was easily discernible: "to encourage rehabilitation of substandard housing units or under-utilized buildings," so as to "increase…the number of affordable, decent housing units." *Nelson v. Yates*, 127 Misc2d 234, 237 (NYC Civ Ct 1984). Owners would thus be able to recoup their rehabilitation costs "free of a stabilized rent." *Wilson v. One Ten Duane Street Realty*, 123 AD2d 198, 201 (1st Dept 1987).

Early Controversies

Notwithstanding the absence of any supporting language in the statute, several lower courts interpreted ETPA §5(a)(5) as mandating "an increase in the number of residential dwelling units," i.e., that buildings must have more units after the rehabilitation than before. *Hickey v. Bomark Fabrics,* 111 Misc2d 812, 815 (NYC Civ Ct 1981), aff'd 120 Misc2d 597 (App Term 1st Dept 1983). In *Hickey*, the Civil Court went so far as to rule that "[a]bsent unusual circumstances…a rehabilitation which does not at least double the number of family units in the building cannot be deemed a substantial rehabilitation." 111 Misc2d at 816. See also *Estate of Romanow v. Heller*, 121 Misc2d 886 (NYC Civ Ct 1983); *483 Court Street Assoc. v. Lunghi*, 129 Misc2d 1044 (NYC Civ Ct 1985).

In *Nelson v. Yates*, supra, however, Judge (now Justice) Charles E. Ramos, discerned no legislative intent that a substantial rehabilitation must increase the number of dwelling units:

> It should also be noted that any effort to increase the number of housing units would have required the subdivision of rooming house units into even smaller rooms which would further diminish the quality of the housing units. Such a result would be contrary to both the letter and spirit of the term 'substantial rehabilitation.'
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> If the legislature wishes to discourage rehabilitation or wishes to encourage rehabilitation *only* when new housing units are created, the legislation must so specify. A limitation of the character of the holding in *Hickey* must be provided by the legislature. It is not for this court to legislate. (italics in original).[1]

It appears that where non-residential space is converted to residential units, an owner need not comply with the requirements of OB 95-2.

The Appellate Division, First Department resolved the issue in *Pape v. Doar*, 160 AD2d 213 (1st Dept 1990), stating:

> Several courts interpreting the statutory provision have perceived an intent to increase the number of residential units. While this is a vital social goal, we are unable to perceive such intent in the history, language or context of the legislation. As we have previously noted, the provision is designed to give owners an investment incentive to recoup rehabilitation costs free of stabilized rents. In many situations, the rehabilitation will occur within the identical physical space previously occupied by residential units. In this context, the only manner in which additional units may be created is to construct

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smaller units. Had the legislature intended to dictate such a specific restriction on the layout of rehabilitations qualifying for this exemption, it surely would have so specified."[2]

Another controversy arose as to what, precisely, comprised a "substantial rehabilitation." In *Eastern Pork Prods. v. New York State Div. of Hous. and Community Renewal*, 187 AD2d 320 (1st Dept 1992), the owner had converted 12 class "B" units on the first, second and third floors of its building into "single floor-through suites." The occupied rent-controlled apartment in the basement, however, was untouched. DHCR ruled that no substantial rehabilitation had taken place, because, according DHCR, "(1) every apartment in the building had to be rehabilitated (the basement apartment was not); (2) the building must have been totally vacant during the rehabilitation (the basement apartment was not); and (3) the entire interior of the building had to have been 'gutted.'"[3]

The intent of ETPA §5(a)(5) was easily discernible: "to encourage rehabilitation of substandard housing units or under-utilized buildings," so as to "increase…the number of affordable, decent housing units."

The First Department disagreed, writing: The words 'substantially rehabilitated' in ETPA §5(a)(5) are not technical terms, but are rather general, commonly used terms which may not be limited by judicial or administrative construction, and should be accorded their commonly understood meaning.

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If the Legislature had intended to require 'the gutting of the entire interior of the building' while all apartments and rooms are vacant in order for the exception to apply…the Legislature could easily have so specified.[4]

OB 95-2

On Dec. 15, 1995, DHCR promulgated OB 95-2, entitled "Substantial Rehabilitation." The point of the operational bulletin was to set forth "the circumstances under which the agency will find that a building has been substantially rehabilitated." OB 95-2 acknowledges that DHCR, in drafting the operational bulletin, "recognizes a recent court decision wherein it was found that a building did not have to be completely vacant to qualify for the exemption, and wherein it was ruled that the agency could not interpret 'substantial' to mean total reconstruction of the building." That "recent court decision," i.e., *Eastern Pork*, had been issued some 37 months before DHCR promulgated OB 95-2.

To briefly summarize OB 95-2, DHCR will find that a substantial rehabilitation has taken place where 75 percent of 17 enumerated building-wide apartment systems (such as plumbing, heating, and gas supply) "have been completely replaced with new systems." OB 95-2 additionally provides that the rehabilitation had to have been commenced in a building "that was in a substandard or seriously deteriorated condition," further stating that "[w]here the rehabilitation was commenced in a building that was at least 80% vacant of residential tenants, there shall be a presumption that the building was substandard or seriously deteriorated at that time."

'Bartis'

In *Bartis*, the owner converted several commercial buildings into loft units in or about 2000. The tenants argued that the rehabilitation did not satisfy the requirements of OB 95-2. The landlord argued that where commercial space is turned into residential space, a substantial rehabilitation has occurred irrespective of whether OB 95-2 has been satisfied. Specifically, the owner relied on the First Department's determination in *22 CPS Owner v. Carter,* 84 AD3d 456 (1st Dept 2011). There, the First Department wrote:

Because the purpose of the exemption from rent stabilization based on the substantial rehabilitation of a building is to encourage landlords to renovate buildings and add new residential units to the housing stock, the conversion of a purely commercial space into an almost purely residential space, creating 23 residential units when none existed, is a substantial rehabilitation so as to exempt the building from rent stabilization (internal citations omitted).[5]

In *Bartis*, the court granted summary judgment to the landlord, holding that OB 95-2 and RSC §2520.11(e) were irrelevant to the court's inquiry:

The circumstances here do not involve a 'primarily commercial' building to which some renovations were made or a previously rent-regulated building which was rehabilitated. Rather, defendant has made a prima facie showing that the subject buildings underwent a conversion from commercial to residential use after January 1, 1974, at a cost of approximately $3.5 million for the conversion.

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The Operational Bulletin… provides, with respect to the 75% requirement, that '[a]t least 75% of the building-wide and apartment systems contained on the following list must each have been completely *replaced* with new systems' (emphasis added). These provisions are reasonably interpreted to apply only when an already rent-stabilized building is being upgraded to remove the building from rent stabilization by satisfying the substantial rehabilitation exemption. Moreover, this provision conflicts with the circumstances present here, namely where a commercial building has been completely converted to residential use. As defendant points out, replacement of building-wide systems has no relevance where, as here, no 'individual housing accommodations' previously existed and completely new residential loft units were created from scratch."

Accordingly, it appears that where nonresidential space is converted to residential units, an owner need not comply with the requirements of OB 95-2. Notwithstanding, owners are best advised to comply if possible, in that courts may not interpret *22 CPS Owner* as broadly as Justice Silber did. In addition, there could be disputes as to whether the prior space was truly "commercial" or "nonresidential" in nature.

1. 127 Misc2d at 237.
2. 160 AD2d at 215.
3. 187 AD2d at 322.
4. Id. At 323.
5. 84 AD3d at 457.