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LEGAL UPDATE

DEREGULATION OF RENT-STABILIZED UNITS:

Protecting your real estate asset following the ruling in *Roberts v. Tishman Speyer*

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Delivering a crushing blow to an already distressed real estate market, New York's highest court recently issued a landmark decision in Roberts v. Tishman Speyer Properties, L.P. On October 22, 2009, the New York State Court of Appeals ruled that the owners of the massive residential complexes of Stuyvesant Town and Peter Cooper Village improperly charged market-rate rents to tenants. In a 4-2 decision, the court held that it was improper for Tishman Speyer Properties, BlackRock Realty and MetLife, the current and former owners of the approximately 11,250 units, to deregulate rent-stabilized units and charge market-rate rents while at the same time continue to receive J-51 tax abatements. Depending on how the state's lower courts apply Roberts, the owners could be on the hook for tens of millions of dollars in rent rebates to tenants who were charged market-rate rents.

Roberts will not only affect the owners of Stuyvesant Town and Peter Cooper Village, but also has the potential to affect all owners and landlords who deregulated rent-stabilized rents while also receiving J-51 tax abatements. Contingent on the outcome of Roberts in the trial court, landlords now face enormous potential liabilities of: (i) rent rebates, (ii) Division of Housing & Community Renewal (DHCR) and other penalties, and (iii) required decreases in rents due to the "deregulating" of units. As Justice Read bluntly wrote in her dissenting opinion in Roberts, "you do not have to be gifted with [the] powers of prophecy to foresee significant, if not severe, dislocations in the New York City real estate industry as a result of today's decision."

Yet, even with the media spotlight on pictures of joyous tenants and nervous owners, if the legal and real estate tax issues are properly handled, the implications of the Roberts decision can have little to no effect on an owner's investment. Eligible improvements include rehabilitations, capital improvements and conversions of lofts as well as other non-residential buildings. By qualifying for a J-51 exemption, a building's assessed value (which serves as the basis for determining real estate taxes) will be greatly reduced, thereby resulting in diminished operating expenses.

The basis for the tenants' complaint in the Roberts case was that the owners acted improperly under the Rent Regulation Reform Act of 1993 ("RRRA"). The owners of Stuyvesant Town and Peter Cooper Village used the RRRA as the basis for deregulating rental units. However, there is an exception in the RRRA providing that decontrol "shall not apply to housing accommodations which became or become subject to [rent stabilization] by virtue of receiving [J-51] tax benefits." The tenants cited this exception as the basis for their position that the decontrol provisions of the RRRA can not be applied to buildings that also receive J-51 benefits.

Now that New York's highest court has issued a decision in favor of tenants with regard to the RRRA exception, the next big question is: how will Roberts affect owners and tenants? In

considering this question as well as the question of whether the "dire financial consequences" mentioned in the decision will ever come to light, it is important to understand that the decision only held that it is a violation of New York law to deregulate rent-stabilized units while simultaneously receiving J-51 benefits. The decision does not state what kind of recovery a tenant can expect from an owner with respect to penalties and back rent. What is more, the decision does not specifically address the methods and procedures tenants should follow to recover possible damages or how the decision will affect the terms of new leases that illegally charge market-rate rent. Each of these issues will inevitably play out as Roberts makes its way through the trial court.

The first major defense available to owners faced with a lawsuit demanding back rent and penalties for unlawful deregulation is retroactive application. Roberts did not rule on whether the decision can be applied retroactively, which would enable tenants to receive compensation for overcharges in back rent. Owners may argue that the Court of Appeals did not rule on the issue of retroactive application because it understood that such a ruling would require owners to pay anywhere between thousands and millions of dollars in back charges. Furthermore, in the interests of fairness and public policy, it is difficult to hold owners liable for massive amounts of back rent when all relevant parties, including owners, lawyers, lenders and legislators, all believed the law was being properly followed.

A second major defense available to many owners is that the statute of limitations has already passed. In the event that some courts hold Roberts can be applied retroactively, many owners may be able to argue that a tenant's claim for overcharging back rent is time-barred by the statute of limitations and should therefore be dismissed. The statute of limitations for a rent overcharge action is four years from the first alleged overcharge. Therefore, a tenant's claim for damages may be denied if the tenant does not commence a lawsuit within four years of the overcharge. This defense may prove to be very valuable to owners seeking to dismiss a complaint without investing a lot of time and money in costly litigation.

Roberts has created considerable confusion among both owners and tenants. While the Court of Appeals decision is most certainly a favorable win for tenants affected by the litigation, its applicability may be limited depending on an individual tenant's situation. Yet, even with all the possible defenses available to owners as well as the misconceptions among tenants that they will now be able to recover large amounts of money, it is safe to say that all parties can agree with the language of the Court of Appeals that "[i]t will take years of litigation over many novel questions to deal with the fallout from today's decision [and] [i]n the absence of meaningful legislative action, uncertainty will reign in an industry already rocked by the bursting of the great residential real estate bubble."

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