Finkelstein Newman LLP

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Newsletter

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EMINENT DOMAIN: PUBLIC TAKING, PRIVATE GOOD?

According to a recent United States Supreme Court decision, the government's use of its authority to seize private land for private development is not unconstitutional so long as the government can establish that there is a "public purpose" to the proposed taking. While the Fifth Amendment of our Constitution provides that the government may take private property for "public use," that phrase was usually equated with the development, expansion, or improvement of schools or roads or other public projects. Over time, however, the U.S. Supreme Court has held that "public use" may be interchangeable with "public purpose," thus allowing states to take private land and turn it over to private developers so long as a "public purpose" (such as economic development of blighted areas) was achieved. Now, under the U.S. Supreme Court's decision in *Kelo v. City of New London* any project that is deemed necessary to economic development–whether in response to blight or not–may be seen as fulfilling the underlying legal requirement. But has anything really changed as a result of *Kelo*? Do private property owners have a cause for concern?

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FINKELSTEIN NEWMAN CLOSES $85 MILLION DEAL!

Last month, Finkelstein Newman LLP assisted a client in selling its two apartment buildings located on the Upper East Side for $85 million. The first building had six stories and 21 residential units, while the second apartment building had 31 stories and 147 apartment units. Conversion of the two buildings into high-end condominiums is contemplated.

Finkelstein Newman worked intensively with lenders from Fannie Mae and American International Group, Inc. (AIG), in order to close the deal in under sixty days.

This deal represents one of a number of transactions that Finkelstein Newman has completed over the last several months. Transactions of significance have included a $54.5 million sale of two large mixed-use buildings located in Soho, and the sale of an 80 unit apartment building in Brooklyn for over $8.5 million.

If you require assistance with a real-estate transaction, please contact partner Jonathan H. Newman at 212-619-5400 x 205 or email him at JNewman@FinkelsteinNewman.com.

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DHCR PROPOSES CODE AMENDMENTS

The New York State Division of Housing and Community Renewal ("DHCR") recently proposed amendments to the Rent Stabilization Code that are intended to clarify questions relating to "preferential rents" and "major capital improvements."

"Preferential Rents"

Prior to 2003, once a rent lower than the legal regulated rent – or a "preferential" rent – was established, all future increases were based upon that lower amount. This "rollback" in the legal rent was not readily rescindable. As part of the Legislature's extension of the rent laws in 2003, amendments were enacted allowing building owners to collect the full legal regulated rent despite the prior existence of a preferential rate. However, several questions surfaced as to whether an owner needed to reflect the legal regulated rent together with the preferential rent in every renewal lease, whether preferential rents in effect prior to June 2003 were subject to the new changes, and whether the legal regulated rent listed in the annual rent registration, but not in a lease, was binding.

The current proposed amendments seek to clarify these uncertainties and provide that the legal regulated rent is:

- the amount delineated in either the vacancy lease or renewal lease in which the preferential rent is defined; or
- for vacancy or renewal leases in effect on or before June 19, 2003, the amount "set forth in an annual rent registration served upon the tenant in accordance with the applicable provisions of law . . . ."

The proposed amendment also makes clear that if the legal regulated rent is indicated in an initial vacancy lease or renewal lease, it is not necessary to continue to include that amount in future renewal leases. However, owners and managing agents should include rider clauses in their leases reinforcing that any preferential rates charged are temporary and withdrawable in nature. Such a precaution will help to avoid misunderstandings and possible litigation.

Major Capital Improvements

The new amendments also seek to alleviate some of the problems related to major capital improvements ("MCIs") completed in mixed-use buildings.

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If you were to ask Susan Kelo–the property owner that took her case to the country's highest court–she would likely respond with an emphatic, "Yes!" But the answer may well be that the *Kelo* decision did little to change the government's powers, particularly as far as New York State is concerned. In *Kelo*, the cash-strapped city of New London, Connecticut, signed a contract with a major corporation to build a massive office complex. Included in this urban development plan was the development of nearby waterfront property for a new marina, hotel, and new housing–ostensibly for the corporation's new employees. The city's problem was that Susan Kelo and her neighbors already lived in the proposed redevelopment area. New London used its "eminent domain" powers to seize all property in Kelo's neighborhood, but Kelo and her neighbors refused to vacate. They argued that the Fifth Amendment only applied to takings for "public" purposes, and that a development benefiting private interests, particularly in the absence of adverse economic conditions, was not supported by the Constitution. New London countered that the projected increase in employment and tax revenue justified taking Kelo's home, even though a private entity would have actual use of the land. In the end, the country's highest court allowed the takings.

The U.S. Supreme Court's decision in *Kelo* reinforces what has already been recognized as the definition of "public use" used by the New York courts. The Metrotech project to revitalize downtown Brooklyn, and the revitalization of Manhattan's Times Square, are just two examples of private companies benefiting from the government's exercise of eminent domain or "takings" powers. The most recent example is the Hudson Yards development surrounding the Jacob Javits Convention Center. The Hudson Yards development spans 360 acres, and insiders anticipate that 93 commercial and 50 residential units will be seized by the government through its eminent domain powers. By comparison, 200 commercial units and 50 residential units were seized for the Metrotech project, which covered only six acres in Brooklyn.

Of course, the government cannot act without some repercussion, for property owners subject to a taking must receive "just compensation." New York's statutes, such as the Eminent Domain Procedure Law ("EDPL"), and the New York and United States Constitutions, define and govern the procedures whereby land may be taken, and all require that property owners be provided "just compensation." While that value is calculated by an appraiser of the government's choosing, should there be a dispute, the property owner may litigate the valuation in a judicial forum. In addition to compensation for the seized property, other forms of assistance for commercial and residential tenants are available including compensation for relocation costs. In a further effort to protect property owners and tenants, New York State Assemblyman Richard L. Brodsky recently proposed legislation that would require the State to compensate displaced residents by 150% (rather than 100%) of the market rate of their unit.

While the government will not exercise its eminent domain powers on a whim, legislatures throughout the country are attempting to impose restraints. As a direct result of the *Kelo* decision, lawmakers in no less than 21 states (including the proposal by Assemblyman Brodsky) have introduced legislation to limit eminent domain's use. And, ironically, Connecticut Governor Jodi Rell has called for a moratorium on the use of eminent domain within that state until the legislature has had a chance to reform the current laws. Although legislative changes are likely to trigger yet another round of constitutional challenges, governmental taking for public and private development is here to stay and will likely remain a viable urban renewal and development strategy for the foreseeable future.

If you have questions about eminent domain, please contact partner Lucas A. Ferrara at 212-619-5400 x 211 or email him at LFerrara@FinkelsteinNewman.com.

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DHCR PROPOSES CODE AMENDMENTS

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Previously, the DHCR required building owners to disclose the amount of residential and commercial income generated by the building. This information was then used to calculate a rent increase ratio. However, this method actually deterred building owners with high commercial income from performing MCIs since the governing calculation methodology provided owners with lower allowable rent increases.

The proposed amendments would establish a new formula for mixed-use buildings based upon relative commercial and residential square footage, in place of the previous rental-income method. This new approach should both remove the previous deterrence aspect and provide enhanced benefits to both residential and commercial occupants.

The text of the proposed amendments can be found at:
http://www.dos.state.ny.us/info/register/2005/June8/pdfs/rules.pdf.

If you have questions regarding these or other issues governing rent regulation, please contact partner Robert Finkelstein at 212- 619-5400 x 227 or email him at RFinkelstein@FinkelsteinNewman.com.

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