SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

ALICE SCHLESINGER

PRESENT: SCHLESINGER Justice

IA PART 16

PART 78

WESTVIEW TASKFORCE, INC., ET AL.

-v-

THE STATE OF N.Y. DIVISION OF HOUSING & COMMUNITY RENEWAL

INDEX NO. 113635/09

MOTION DATE

MOTION SEQ. NO. 01

MOTION CAL. NO.

The following papers, numbered 1 to _____ were read on this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this ~~motion~~ Article 78 petition is denied and the proceeding dismissed in accordance with the accompanying memorandum decision. The Clerk shall enter judgment accordingly.

MAY 14 2010

Dated: May 14, 2010

ALICE SCHLESINGER J.S.C.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Check one: ☒ FINAL DISPOSITION ☐ NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

----------X

In the Matter of the Application of
WESTVIEW TASKFORCE, INC. and JANET M. SHEA, YADIRA CERRATO, HIRAM JACOBS, VIRGINIA CHAMBERS and PETER ALBER, on behalf of the Westview Taskforce, Inc., the official Tenants' Association for the buildings located at 595 and 625 Main Street, Roosevelt Island,

Index No. 113635/09
Motion Seq. No. 001

Petitioners,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules,

-against-

THE STATE OF NEW YORK DIVISION OF HOUSING AND COMMUNITY RENEWAL, ASSISTANT COMMISSIONER RICHMOND MCCURNIN, and NORTH TOWN PHASE III ASSOCIATES, LP and NORTH TOWN PHASE III HOUSES, INC.,

Respondents,

----------X

SCHLESINGER, J.

This extensively briefed and vigorously argued Article 78 proceeding involves the highly regulated procedures and extremely technical rules for determining the allowable rent increase at a particular housing complex located on Roosevelt Island. The complex, consisting of 361 units located at 595 and 625 Main Street and colloquially referred to as Westview, is subject to Article II of the Private Housing Finance Law, also known as the Mitchell-Lama Law. Petitioners are various tenants and the official tenants' association at Westview (collectively referred to as "the Tenants"). Respondent North Town Phase III Houses, Inc. is the housing company that holds legal title to the buildings, and respondent North Town Phase III Associates, LP, a partnership, is the beneficial owner (collectively referred to as "Owner"). Respondent Division of Housing and Community Renewal (DHCR) is the state agency charged with the duty to determine rents.

Specifically at issue in this case is the July 22, 2009 Order issued by DHCR Assistant Commissioner Richmond McCurnin under docket number UDC-68 (Exh. A to petition). The Order begins with a recitation of the procedural history, beginning with the Owner's filing of the rent increase application on or about January 23, 2008. According to the Order, the Owner submitted financial data in support of the application purporting to demonstrate that the present income from rentals and other sources was "insufficient to enable [the Owner] to meet the payments required to be made by the provisions of the Private Housing Finance Law."

DHCR sent a copy of the application to the Tenants, together with DHCR's own financial projections and notice of the Tenants' right to be heard no later than August 6, 2008. DHCR then scheduled a meeting at the premises for August 13, 2008, to enable representatives of the Tenants and the Owner to meet with DHCR staff. In the ensuing months, the agency attempted to assist the parties in negotiations wherein the Tenants explored the possibility of converting the complex to home ownership. In February 2009, when the parties had failed to reach an agreement, the Owner requested that DHCR resume processing its application. The agency gave the parties until the end of March 2009 to submit comments and then extended the comment period to June 29, 2009 at the Tenants' request. The housing company paid in excess of $6000 for the Tenants to retain an accountant to assist them in reviewing the budget and proposed rent increases and preparing their own comments and financial projections.

By Order Issued July 29, 2009 (Exhibit A to petition), DHCR's Assistant Commissioner determined the Owner's rent increase application as follows:

I FIND AND DETERMINE that, owing to causes beyond the control of the applicant, the present rental rate is insufficient to enable it to meet, within reasonable limits, all necessary payments required to be made by the provisions of the Private Housing Finance Law and that such insufficiency cannot be corrected by reasonable economies in the management and operation of said development.

I FURTHER FIND AND DETERMINE that the minimum increase in the maximum average monthly room rentals necessary to enable the said applicant to make the payments required to be made is $51.32. The increase authorized herein is not in excess of the minimum amount necessary to enable the housing company to make the payments required to be made by the provisions of the Private Housing Finance Law.

I, THEREFORE, AUTHORIZE the said applicant to increase the maximum average monthly room rentals to an average of $395.45 per rental room per month, including utilities, effective September 1, 2009.

This Article 78 proceeding ensued.

Discussion

According to the Tenants, the rent increase authorized by DHCR in this case amounts to an increase of about 14.9%. They assert that this increase is not in keeping with the policy behind the Mitchell-Lama program to preserve affordable middle-income housing and that it imposes a financial hardship on many of the Westview tenants. In response to that assertion, counsel for the parties, with the assistance of this Court, agreed upon a temporary restraining order (TRO) pending the determination of this proceeding. The TRO allowed any individual tenant asserting financial hardship due to the rent increase to be temporarily relieved of the obligation to pay the increase upon the submission of an affidavit in an agreed upon form attesting to the hardship. The TRO was to remain in effect through the date of this decision.

The Tenants assert in their petition that DHCR's Order is arbitrary and capricious and must be annulled on five separate grounds:

(a) DHCR permitted a line item for debt service arrears in the amount of $163,800.00 in violation of the 1997 workout agreement purportedly entered into by Westview, DHCR, and the Owner;

(b) in violation of 9 NYCRR §1728-1.5(h), DHCR allocated a portion of the rent increase to cover debt service arrears in the second year of the Budget/Rent Determination Budget cycle;

(c) DHCR failed to account for $1,000,000.00 of lost revenues resulting from the Owner's illegal warehousing of apartments;

(d) DHCR failed to engage in a strict balancing process in the Budget/Rent determination by failing to minimize the impact of the increase on the Tenants, by relying on outdated projections for replacement funding, and by not requiring the Owner to maximize efficiency; and

(e) in violation of 9 NYCRR §1782-1.2-1.6, the rent increase is not based on a forward-looking biennial budget.

DHCR and the Owner oppose each of the five claims, which will be discussed in order below.

An analysis of the competing arguments necessarily begins with a review of the statutory guidelines for DHCR's determination of rent increase applications for buildings like Westview. PHFL §31(1) empowers DHCR to periodically increase rents to enable the housing company to meet its expenses. Specifically, the goal is:

> to secure, together with all other income of the [housing] company, sufficient income for it to meet within reasonable limits all necessary payments to be made or projected to be made ... by the said company, of all expenses including fixed charges, sinking funds, reserves and dividends on outstanding stock ...

In addition, PHFL §28(1) requires the housing company to make specific payments, including payments related to the mortgage indebtedness, from the company's earnings, and not from another source of funds:

> There shall be paid annually out of the earnings of the company, after providing for all taxes, assessments and expenses, a sum for interest on and amortization of the mortgage indebtedness of all mortgages of the company, depreciation charges and reserves if, when and to the extent deemed necessary by the commissioner ... plus a dividend of six per centum on outstanding stock and interest not exceeding six per centum on the outstanding income debentures of the company; the obligation in respect of such payments shall be cumulative, and any deficiency in interest, amortization, depreciation, reserves, if any, and dividends in any year shall be paid either from any cash surplus derived from earnings remaining in the treasury of the company in excess of the amount necessary to provide such cumulative annual sums or from the first available earnings in subsequent years.

The Final Budget for Westview approved by DHCR includes a line item entitled "Debt Service - Arrears" in the amount of $163,800 (See Exh. E to petition). The Tenants argue that the inclusion of this amount violates the terms of a 1997 "Workout Agreement" discussed in the Owner's December 31, 2008 Financial Statement (Exh H to petition, p17, n 4). Specifically, the Tenants point to the following language in the Owner's Statement:

> Under the Workout Agreement, the Deferred Principal Arrears are required to be paid by the Housing Company provided, however, that if expenses in a particular year exceeded income, the Deferred Principal Arrears payments could themselves be further deferred.

The Tenants correctly argue that the housing company's expenses exceeded income for the period at issue. Were that not the case, the above-quoted provisions in PHFL §31(1) would have barred DHCR from ordering the significant rent increase that it did. Therefore, the Tenants contend, the Workout Agreement compelled the agency to defer Debt Service Arrears, rather than include them in the budget.

As DHCR and the Owner establish in their opposition, the Tenants' claim lacks merit. First and foremost, the Tenants have no standing to enforce the Workout Agreement, as they are neither parties nor third-party beneficiaries. As the Owner explains, the Agreement "is actually an Arrears Payment Agreement among the NYS Urban Development Corporation ('UDC,' the holder of the Housing Company's mortgage debt), the NYS Mortgage Loan Enforcement And Administration Corporation, the Housing Company and NTIII ... created to establish a mechanism for the payment of the debt service arrears that had accrued during the period 1987 to 1997 when operating revenues were insufficient to pay the debt service on a current basis." (Owner's Memorandum at pp 9-10). To prevent foreclosure, the Agreement required that certain payments be made going forward toward debt service and debt service arrears.

What is more, the above-quoted note in the Owner's Financial Statement on which the Tenants rely does not compel the deferral of debt service arrears when expenses exceed income; it merely states that arrears "could" be deferred. The terms of the Workout Agreement are complex and do not appear to bar the inclusion of debt service arrears in the Owner's budget, even assuming the Tenants had standing to enforce that Agreement.

In addition, PHFL §28(1) quoted above requires that mortgage indebtedness be paid out of the housing company's earnings, and the First Department has specifically

upheld the authority of DHCR to include debt service arrears as a current operating expense in calculating a rent increase for Mitchell-Lama tenants. *See, e.g., McCarthy v New York State Division of Housing and Community Renewal*, 216 AD2d 4 (1st Dep't 1995), *citing Matter of Arbor Hill Partners v DHCR*, 156 AD2d 896, 898 (3rd Dep't 1989), *lv denied* 75 NY2d 711. Under these circumstances, this Court cannot find that DHCR's inclusion in the rent calculation budget of a reasonable sum for debt service arrears was arbitrary and capricious or a violation of the Workout Agreement.

Similarly unavailing is the Tenants' claim that DHCR's inclusion of debt service arrears in the second year of the budget violates 9 NYCRR §1728-1.5(h). That regulation provides in relevant part that: "Debt service arrears shall be funded in the first year of the budget cycle." Because the DHCR Order under review was not issued until after the first year of the budget cycle had ended, the debt service arrears were made payable in the second year of the budget cycle.

The Tenants' interpretation of the regulation is wholly unreasonable. As required, the Owner submitted a two-year budget with its application and included debt service arrears in the first year, but due to extensions of time granted to the Tenants to complete their analysis, and due to ongoing negotiations, DHCR's Order was delayed. The intent of the regulation presumably is to encourage the housing company to make the payments as soon as possible and thereby minimize the accrual of additional interest. To construe the regulation to bar the inclusion of debt service arrears in this budget and postpone the payment until a future budget cycle would not serve the interests of any party, and simply makes no sense.

A significant part of the oral argument in this case was devoted to the Tenants' next argument, related to the Owner's alleged warehousing of apartments at Westview. The Tenants contend that, beginning in 2004, in connection with the attempted sale of the building, the Owner left apartments vacant so as to maximize the value of the property upon its sale to investors. They further contend that this "illegal warehousing" deprived the housing company of about $1,000,000.00 in lost rental income, thereby resulting in a higher rent increase to the Tenants to cover that lost income. (Petition at ¶26 ff).

As DHCR asserts in response, no mechanism exists to address any alleged lost income. To the extent the Tenants' argument can be construed as a demand for an additional contribution to equity from the partnership, the only contribution that the courts have required is fixed at the time when the housing company is first created. *See New York State Mortgage Loan Enforcement and Administration Corporation v Arbor Hill Houses,* 180 AD2d 926 (3rd Dep't 1992). As such, the partnership was not obligated to contribute to the housing company revenue allegedly lost due to vacant apartments or any monetary damages it may have recovered in its litigation with the potential buyer Sheldrake Organization. Imposing such a requirement on the partnership would be contrary to the above-quoted sections 28 and 31(1) of the PHFL, which require that expenses be paid from housing company earnings and that rents be reasonably set so as to generate sufficient income for that purpose.[1]

---

[1] The Owner denies any "illegal warehousing" and asserts that the Tenants, themselves, had sought to have apartments remain vacant when they were pursuing the purchase of the property. However, the Court need not resolve this aspect of the dispute, as the issue can be resolved on the other points raised.

The Tenants next challenge the DHCR's use of particular budget projections and claim that the agency violated Section 1728-1.2 in that it failed to engage in a "strict balancing process" between the needs of the Owner and the needs of the Tenants. Neither point is persuasive. While the Tenants' financial expert offered opinions which differed from those of the Owner's expert, the Tenants did not establish any departure from accepted accounting practices which compelled DHCR to completely reject the Owner's financial submissions. Nor have they established any basis for this Court to find that DHCR's final budget was somehow inconsistent with accepted accounting practice or the governing law. As DHCR's conclusions appear to have a rational basis, this Court is bound to uphold them and cannot substitute its own judgment. *See Greystone Mgt. Corp. v NYC Conciliation and Appeals Bd.*, 94 AD2d 614 (1st Dep't 1983), *aff'd* 62 NY2d 763 (1984); *Howard-Carol Tenants' Ass'n v NYC Conciliation and Appeals Bd.*, 64 AD2d 546 (1st Dep't 1979), *aff'd* 48 NY2d 768.

Moreover, as the Owner notes, the term "strict balancing process" is one coined by the Tenants, rather than the regulations. While the Tenants properly note that the regulations require DHCR to balance factors such as the economic impact on the Tenants of the rent increase and the Owner's duty to limit the need for rent increases by maximizing revenue and reducing expenditures, it appears to this Court that DHCR did, in fact, do that. The Owner apparently initially sought an increase of about 47%, but DHCR only authorized one amounting to 14.9%. As this increase was the first ordered in over four years, it amounts to about 3.75% per year, which DHCR asserts is in keeping with previous increases at Westview and increases at other similar housing complexes. Therefore, DHCR's Order is rational and reasonable based on the methodology used and the result reached.

Equally unpersuasive is the Tenant's final argument that DHCR violated applicable regulations by failing to base the rent increase on a "forward looking biennial budget." To the extent this argument relates in part to the fact that DHCR's Order was not issued until the end of the first budget year, that argument was addressed and rejected above. What is more, there is no strict time limit for decisions to which the Tenants can point. In any event, 9 NYCRR §1728-1.2 gives the Commissioner authority to reasonably modify the regulations where "necessary to carry out the policy of the Private Housing Finance Law and the policies of the Division of Housing and Community Renewal ..."

In sum, this Court cannot find based on the record presented that DHCR's actions or conclusions in any way violated the express terms of the governing statute or regulations or undermined the intent of the law. Nor have the Tenants established that the inclusion of any particular budget item was wholly improper. As discussed above, it is irrelevant whether the Tenants' accountant, or even this Court, might have reached a different result, as no violation of law has been established based on the primary arguments discussed above or the numerous related arguments raised in the papers, which similarly lack merit.

Accordingly, it is hereby

ADJUDGED that the petition is denied and this proceeding is dismissed; and it is further

ORDERED that the temporary restraining order in effect with regard to the payment of the rent increase be and hereby is vacated.

This constitutes the decision, order and judgment of this Court. The Clerk is directed to enter judgment accordingly.

Dated: May 14, 2010
MAY 14 2010

ALICE SCHLESINGER