No. 2

In the Matter of Terrace Court, LLC,

Appellant,

v.

New York State Division of Housing and Community Renewal,

Respondent,

Robert Katel, et al.,

Intervenors-Respondents.

Thomas R. Newman, for appellant.

Christina S. Ossi, for respondent.

Seth A. Miller, for intervenors-respondents.

New York State Tenants & Neighbors Coalition, Inc. et al; Community Housing Improvement Program of New York City et al., amici curiae.

GRAFFEO, J.:

In this appeal we consider whether the Division of Housing & Community Renewal (DHCR) is authorized to grant a major capital improvement rent increase while at the same time permanently exempting particular apartments from the obligation

to pay additional rent when circumstances warrant. We hold that DHCR has been granted such authority and, on this record, it was not arbitrary or capricious for DHCR to permanently exempt five apartments.

Petitioner Terrace Court, LLC is the owner of a residential apartment building located at 202 Riverside Drive in Manhattan. The building contains 91 apartments, 37 of which are rent regulated. Terrace Court spent approximately $1.2 million to upgrade the building, which project involved pointing work and the replacement of masonry, lintels and parapets.

An owner of rent-regulated apartments may seek to pass along the costs of a "major capital improvement" (MCI) to its tenants by filing an application with DHCR once the work is completed (see Rent Stabilization Law [Administrative Code of City of NY] § 26-511 [c] [6] [b]; Rent Stabilization Code [9 NYCRR] § 2522.4 [a] [2] [i]). In May 2004, Terrace Court applied to DHCR to increase the rents of its regulated apartments on the basis that the construction project qualified as an MCI. It sought an additional $42.58 per month for each room in the 37 apartments. Some tenants objected to the proposal because the construction work had resulted in water from the exterior of the building seeping into their apartments and these conditions had not been rectified.

The tenants' association sent affidavits to DHCR, including a report from an architect who inspected the building

and found that the leaks were consistent with water intruding from outside the building. The association also informed DHCR that the Department of Buildings issued a violation to Terrace Court in December 2004 regarding water-damaged apartments and alleged that the owner had not adequately performed the work on the building's facade. Terrace Court maintained that the project had been properly completed (it submitted reports from its experts to corroborate this claim) and that, in any event, it had addressed the tenants' complaints. The owner also advised DHCR that the violation from the Department of Buildings had been dismissed because the water in the identified apartments had been caused by a bathroom leak on an upper level of the building.

In September 2005, approximately 16 months after submission of the MCI application, a DHCR inspector and a Terrace Court employee inspected five allegedly damaged apartments. Each of these residences had walls in various states of disrepair and exhibited staining, discoloration, blistering or cracking. Actual moisture was detected in two of the apartments.

The Rent Administrator granted Terrace Court's MCI application in December 2005 and raised the monthly rents by $40.20 per room. The order, however, permanently exempted the five inspected apartments from the increase based on the tenants' complaints and the agency's inspection. Terrace Court filed a petition for administrative review (PAR) challenging the inspector's findings and claiming that DHCR lacked the authority

to permanently exempt the five apartments. It asserted that the increases related to those residences should have been temporarily suspended until the problems were resolved. DHCR denied the PAR and determined that the permanent exemption for the five apartments was appropriate because the water conditions "existed in the apartments when work was completed just prior to the owner's filing of the application for an MCI rent increase" and the apartments still exhibited water damage at the time of the DHCR inspection.

Terrace Court then commenced this CPLR article 78 proceeding, asserting that it was arbitrary and capricious for DHCR to permanently exempt the five apartments from the rent adjustment. The tenants of the exempted apartments intervened in the proceeding and Supreme Court denied the petition. The court concluded that the imposition of permanent exemptions was supported by DHCR's "determination that the pointing work was not done effectively for the five exempted apartments" (2008 NY Slip Op 32125 [U]).

The Appellate Division affirmed, with two Justices dissenting (79 AD3d 630 [1st Dept 2010]). It held that DHCR acted rationally and did not abuse its discretion as there was ample proof that the pointing work had not been performed properly with regard to the exempted apartments. The court found that no regulation, DHCR policy or judicial precedent limited the agency to denying an MCI increase in its entirety or granting a

temporary suspension of the adjustment. The Appellate Division further observed that there can be instances in which DHCR may have "ample reason to believe that [a] landlord would make (or had made) the necessary repairs in a diligent fashion" but that, on the record in this case, the agency "did not believe that [Terrace Court] intended in good faith to address the situation, especially after it vociferously denied the existence of a problem and then engaged in unsuccessful efforts to fix it."

The dissenters found no rational basis for the permanent exemption of the five apartments because such a determination was alleged to be inconsistent with DHCR's preexisting policy of temporarily suspending an MCI increase for apartments until necessary repairs are made and, in this case, the agency had not provided an adequate justification for departing from that practice.

Terrace Court appealed to this Court as of right and now challenges DHCR's decision to permanently exempt the five apartments as arbitrary and capricious, and violative of the agency's settled policy to temporarily suspend MCI increases until repairs are completed. According to the owner, temporary suspensions are mandated by a regulation and DHCR's action was unreasonable as a matter of law in the absence of an explanation by the agency regarding its departure from precedent.

It is true, as a general proposition, that administrative agencies are required to follow their own

precedent (see e.g. Matter of Lantry v State of New York, 6 NY3d 49, 58 [2005]) and an agency that deviates from its established rule must provide an explanation for the modification so that a reviewing court can "determine whether the agency has changed its prior interpretation of the law for valid reasons, or has simply overlooked or ignored its prior decision" (Matter of Charles A. Field Delivery Serv. [Roberts], 66 NY2d 516, 520 [1985]). The failure to provide a justification for the change requires reversal even if there is substantial evidence to support the agency's determination (see id.).

Here, DHCR did not abandon this principle as its prior determinations in similar cases were not restricted to temporary suspensions. There have been at least several instances where the agency granted an MCI rent increase along with permanent exemptions for particular apartments, rather than issuing temporary suspensions.[1] In one such case, DHCR disagreed with the Rent Administrator's decision to temporarily suspend an MCI increase and instead imposed permanent exemptions.[2] Hence, the

[1] See e.g. Matter of 315 W. 57th St. & 330 W. 58th St., New York New York, & Park Towers S. (DHCR Admin Review Docket No. ED430065-RT et al., at 3); Matter of Clermont Tenants Assn. & Clermont York Assocs. (DHCR Admin Review Docket Nos. UA410049RT & UD410012RO, at 3 [Oct. 8, 2008]; Matter of Sunden (DHCR Admin Review Docket Nos. BF210190-RT & BF230079-RT, at 2); Matter of Tenants of 27 W. 96th St. New York, NY (DHCR Admin Review Docket No. SJ430047RT, at 2 [July 10, 2000]).

[2] See Matter of Tenants of 27 W. 96th St. New York, NY (DHCR Admin Review Docket No. SJ430047RT, at 2 [July 10, 2000]).

underlying premise of Terrace Court's contention is without merit and we reject its attempt to distinguish DHCR precedent recognizing the availability of permanent exemptions.

Nor were temporary suspensions of the MCI increase mandated by Rent Stabilization Code (9 NYCRR) § 2522.4 (a) (13). This regulation provides, in pertinent part, that DHCR should not grant an MCI rent adjustment if the owner "is not maintaining all required services," however, the agency may grant the application "upon condition that such services will be restored within a reasonable time." Although Terrace Court believes that "all required services" encompasses water damage repairs, DHCR interprets the phrase as referencing services that are unrelated to the MCI project. Since an agency's interpretation of its own regulation is entitled to deference (see e.g. Matter of IG Second Generation Partners L.P. v New York State Div. of Hous. & Community Renewal, 10 NY3d 474, 481 [2008]), we cannot say that DHCR's reading of subdivision (a) (13) is irrational. In the overall context of the MCI adjustment process, DHCR is supposed to grant a rent modification if an MCI project inures to the benefit of every tenant in a building (see Rent Stabilization Law [Administrative Code of City of NY] § 26-511 [c] [6]; Rent Stabilization Code [9 NYCRR] § 2522.4 [a] [2] [i] [c]; Matter of Riverside Equities v New York State Div. of Hous. & Community Renewal, 292 AD2d 313, 313-314 [1st Dept 2002]). Subdivision (a) (13) of the regulation, in contrast, envisions situations where

(unlike here) an MCI application satisfies that requirement but the landlord has failed to provide other "required services" unrelated to the MCI project. When that occurs, subdivision (a)(13) permits DHCR to encourage the restoration of those services by making that action a necessary condition of the owner's recoupment of the funds expended on the MCI project. Because it has not been alleged that Terrace Court deprived its tenants of required services unrelated to the MCI work, the regulation has no bearing on this case.

It is therefore apparent that DHCR is not limited to temporarily suspending an MCI rent increase; the agency may permanently exempt an apartment in certain situations. Its choice is deferentially reviewed by the courts to determine whether there is a rational basis for the decision and, if so, DHCR's conclusion must be upheld even if a court would have reached a different result (see e.g. Matter of Peckham v Calogero, 12 NY3d 424, 431 [2009], citing Matter of Pell v Board of Educ. of Union Free School Dist. No. 1 of Towns of Scarsdale & Mamaroneck, Westchester County, 34 NY2d 222, 231 [1974]).

In light of this standard of review, we hold that DHCR acted rationally in this case. It found that, at the time the MCI application was submitted, the five apartments at issue had defective conditions caused by moisture attributable to the MCI project and that those conditions continued in existence when DHCR inspected the apartments approximately 16 months later. On

these facts, it was reasonable for the agency to conclude that those apartments did not benefit from the MCI project since they had been adversely affected by the construction work. As such, there was a sound basis for DHCR to exclude the five apartments from having to contribute to the cost of the MCI project. Consequently, under these circumstances, it was neither arbitrary nor capricious for DHCR to order permanent exemptions from the MCI adjustment rather than temporary suspensions.[3]

DHCR claims that one of the relevant considerations in these situations is whether an owner has demonstrated good faith in diligently addressing the problems caused by an MCI. The agency apparently reasons that an owner who does so is more likely to remedy a defective condition (justifying a temporary suspension of the rent increase), whereas an owner who denies the existence of MCI-related problems or does not undertake repairs within a reasonable amount of time is unlikely to extend the benefits of the project to the affected apartments (thereby justifying a permanent exemption from the MCI adjustment). DHCR maintains that this rationale is relevant here because Terrace Court consistently denied that the MCI project caused the water damage and it did not remedy the defects during the 16-month

[3] The fact that the five apartments did not benefit from the MCI project theoretically would have permitted DHCR to deny Terrace Court's application in its entirety (see Rent Stabilization Code [9 NYCRR] § 2522.4 [a] [2] [i] [c]) and the agency's decision to take less extreme action was not unreasonable as a matter of law.

period when the MCI application was pending. But the agency's order did not cite this as a basis for its decision and we therefore do not consider it (see e.g. Matter of John P. v Whalen, 54 NY2d 89, 97 n 4 [1981]). In future cases where this circumstance is relevant, DHCR should articulate it in the MCI order to allow for adequate review by the courts.

Accordingly, the order of the Appellate Division should be affirmed, with costs.

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SMITH, J.(concurring):

I join the Court's unanimous opinion, but with some misgivings.

There are a number of cases (including Matter of Little & Breslow, DHCR Admin Review Docket No. NC430029RP [August 2,

1999]; Matter of Bourdeau, DHCR Admin Review Docket No. TK230075RT [March 9, 2006]; and Matter of Papamichael Realty, DHCR Admin Review Docket No. UJ130059RO [May 11, 2007]), in which DHCR has ruled that a rent increase based on a major capital improvement should be suspended as to certain apartments until particular problems are fixed. There are also a number of cases (including this one and those cited in footnote 1 of the Court's opinion), in which DHCR has permanently exempted certain apartments from the increase. I accept the idea that both remedies are sometimes appropriate, and that DHCR has discretion to choose between them. What troubles me is that it is not easy to tell from DHCR's decisions on what basis it is making the choice.

In this case, DHCR's opinion is particularly unenlightening. The Commissioner says that the rent increase should be permanent because various unsatisfactory conditions "existed in the apartments when work was completed just prior to the owner's filing of an application for an MCI rent increase." But is it not true in every case involving either a temporary or permanent exemption that a problem existed when the rent increase was applied for?

DHCR has a hard job, and courts should not make it harder by nit-picking. For this reason I join my colleagues in holding that the permanent exemption here was justified by the record. But I hope DHCR will do a better job in the future of

explaining the policies and principles that guide its decisions to make exemptions from rent increases either temporary or permanent.

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Order affirmed, with costs. Opinion by Judge Graffeo. Chief Judge Lippman and Judges Ciparick, Read, Smith, Pigott and Jones concur, Judge Smith in a separate opinion.

Decided February 14, 2012