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

STAHL YORK AVENUE CO., LLC, Plaintiff-Petitioner, vs. THE CITY OF NEW YORK; THE NEW YORK CITY LANDMARKS PRESERVATION COMMISSION; MEENAKSHI SRINIVASAN, in her capacity as Chair of the New York City Landmarks Preservation Commission, Defendants-Respondents.	Index No. 100999-2014 Hon. Michael D. Stallman Motion Sequence No. 1

PLAINTIFF-PETITIONER'S MEMORANDUM OF LAW IN OPPOSITION TO CROSS MOTION TO DISMISS AND REPLY MEMORANDUM OF LAW IN SUPPORT OF THE VERIFIED PETITION AND COMPLAINT

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PRELIMINARY STATEMENT

In 1990, the City of New York blocked Stahl's right to develop 13 of 15 buildings on a city block by designating them as landmarks. In exchange, the City agreed to preserve Stahl's right to develop the other two antiquated tenement-style buildings on the block, which were historically and architecturally distinct from the landmarked buildings. But 16 years later, the LPC[1] reneged on this compromise and re-designated the remaining two buildings as landmarks. This change of heart was not a sincere effort to protect historically or architecturally significant buildings. It was a direct response to community pressure, taken precisely at the moment Stahl began to implement the development plan the City itself had authorized over a decade earlier.

Because Stahl was suddenly left with a commercially unviable property it had been planning to develop for years, it sought relief through an administrative hardship proceeding under the Landmarks Law. That law permits a landowner to demolish and redevelop a landmarked building if it is incapable of earning a reasonable rate of return. Stahl presented overwhelming evidence that it could not earn anything approaching the statutory reasonable return of 6%. The LPC nevertheless denied Stahl's application, through an irrational, inconsistent, and legally erroneous analysis that was jerry-rigged to defeat the application no matter what the evidence showed. The combined effect of the landmark designation and the denial of the hardship application extinguished virtually all of the value of the Subject Buildings, and vitiated Stahl's expectation—reinforced by the City itself—that it could develop the Buildings. Accordingly, Stahl filed this Verified Petition and Complaint challenging the denial of its hardship waiver as arbitrary and capricious, and asserting that the landmark designation of

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[1] All defined terms appearing in this Memorandum retain the definitions set forth in the Verified Petition and Complaint.

the Subject Buildings was an unconstitutional taking of its property without just compensation under the United States and New York Constitutions.

Whether a particular regulation results in a taking of a landowner's property is a highly fact-specific question, and on this motion to dismiss Stahl's takings claim, the Court must assume that the facts alleged in Stahl's pleading are true. Yet in its motion the City seeks dismissal on the basis of issues such as whether the "relevant parcel" for the takings analysis is the entire landmark site, not just the two Buildings, because of Stahl's economic treatment of the Buildings; how much the Subject Buildings lost in value as a result of the 2006 designation; and what Stahl's development expectations were at the time it acquired the Buildings. These are all factual issues that cannot be resolved on a motion to dismiss, and the parties are entitled to develop them in discovery. And to the extent the City purports to raise any genuine legal arguments, it is wrong on the law.

The City's attempt to defend the LPC from Stahl's Article 78 petition is equally toothless. Its opposition is largely an effort to distract the Court from engaging Stahl's principal arguments, which demonstrate that the LPC's jerry-rigged analysis was arbitrary and capricious as a matter of law. The City devotes many pages to a litany of relatively trivial assumptions in Stahl's arguments before the LPC and trumpets the length of the LPC's decision as proof of its rationality. But none of this can salvage the LPC's illegal decision. Most of the assumptions the City tries to debunk are irrelevant to the Petition, as Stahl is not challenging the LPC's rejection of them. Stahl's argument is that the LPC made three critical errors that fatally undermine its analysis, rendering its conclusion arbitrary and capricious and contrary to law. The LPC's lengthy attempt to cover its tracks cannot save its decision from these fatal flaws:

First, the LPC concluded that it could assess Stahl's hardship based on the economics of the entire complex even though the plain language of the Landmarks Law unambiguously requires it to focus on the Buildings' tax lot.

Second, the LPC used the "income approach," rather than the "cost approach," to project assessed value, even though the income approach ignores the significant cost of the substantial renovations that would be necessary for Stahl to earn any return on the Buildings. The use of the income approach set up a sham test that essentially ensures a finding that the property owner can earn a reasonable return post-renovations. In fact, under the income approach, the LPC assumed the post-renovation assessed value of the Buildings was barely half of the cost of the renovations, and would consider a post-renovation rate of return "reasonable," *even if it would take Stahl 32.8 years just to pay for those renovations*. The LPC also failed to explain why it used the cost approach to calculate assessed value in a prior hardship case, but not here.

Third, the City concluded that a significant amount of the renovation costs could be excluded altogether on the ground that they resulted from Stahl's vacancy policies in managing the Buildings while it challenged the designation in court, and thus were a "self-imposed" hardship. But the uncontested facts alleged in the Petition show there was no "self-imposed" hardship: Stahl would have incurred renovation costs regardless of its vacancy policy, and so those costs cannot be considered "self-imposed." Furthermore, the City does not dispute that treating them as a self-imposed hardship effectively penalizes Stahl for exercising its rights to contest the LPC's actions.

As Stahl argued in the Petition and demonstrates further below, once these three errors are corrected, simple math indisputably establishes that there is no way for Stahl to earn a 6% return on the Buildings. And that is true even if one accepts every one of the City's arguments regarding the other aspects of the LPC's analysis. The City now claims the LPC conducted an "alternative" calculation crediting Stahl's arguments, and that the City still wins under that calculation. But the "alternative" calculation failed to do what the LPC said, and it replicated some of the same errors that infected its primary analysis. Whether this was careless or disingenuous, it cannot save the LPC's determination.

Accordingly, Stahl's Article 78 petition should be granted, and the City's motion to dismiss Stahl's takings claim should be denied.

I. THE MOTION TO DISMISS STAHL'S TAKINGS CLAIM SHOULD BE DENIED

The LPC's decision to landmark the Subject Buildings in 2006, coupled with its denial of Stahl's hardship application, was an unconstitutional regulatory taking. This type of regulatory or "partial" taking is governed by the United States Supreme Court's decision in *Penn Central*, which sets forth an "ad hoc, factual inquir[y]" requiring courts to balance several factors, including the severity of the economic impact of the regulation on the property, the extent to which the regulation interfered with distinct investment-backed expectations, and the nature of the governmental action. *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 124 (1978).[2] These factors "do[] not supply mathematically precise variables, but instead provide[] important guideposts that lead to the ultimate determination whether just compensation is required." *Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 326 n.23 (2002) (internal quotation marks omitted). Indeed, the concepts of "justice and fairness" underlying the Takings Clause preclude the use of any "set formula" to determine whether a

[2] Stahl does not dispute that landmarks regulations are a valid exercise of state authority, nor does it challenge the facial constitutionality of the Landmarks Law. Accordingly, the cases the City cites recognizing the government's general authority to landmark property, *see, e.g.*, Mem. at 54-55, provide no support for the City's motion to dismiss.

taking has occurred. *Penn Cent.*, 438 U.S. at 123-24; *see also Tahoe-Sierra*, 535 U.S. at 342 ("[T]he temptation to adopt what amount to *per se* rules in either direction must be resisted." (internal quotation marks omitted)).

Thus, adjudicating a regulatory takings claim "necessarily entails complex factual assessments of the purposes and economic effects of government actions." *Yee v. City of Escondido*, 503 U.S. 519, 523 (1992). This type of ad hoc, factual inquiry plainly cannot be decided on a motion to dismiss the pleadings under CPLR 3211(7), where the "court must accept all of the allegations in the complaint as true, and drawing all inferences from those allegations in the light most favorable to the plaintiff, determine whether a cognizable cause of action can be discerned therein, not whether one has been properly stated." *MatlinPatterson ATA Holdings LLC v. Fed. Express Corp.*, 87 A.D.3d 836, 839 (1st Dep't 2011); *see also EBC I, Inc. v. Goldman, Sachs & Co.*, 5 N.Y.3d 11, 19 (2005) ("Whether a plaintiff can ultimately establish its allegations is not part of the calculus in determining a motion to dismiss.").

In defiance of these standards, the City asks this Court to resolve as a matter of law numerous fact-specific issues, such as how Stahl has managed the Subject Buildings, the amount of the loss in value of the Buildings caused by the landmark designation, and Stahl's development intentions when it acquired the FAE. *See, e.g.*, Mem. 51, 56-57, 61. It is plainly inappropriate for this Court to consider these fact-bound arguments at the motion to dismiss stage. Indeed, none of the cases the City cites authorizes a court to resolve these type of contested factual issues on the pleadings. Because the City's motion is based on factual assertions that Stahl vigorously contests, and because the few legal arguments the City raises are meritless, the motion to dismiss should be denied.[3]

A. Stahl Adequately Alleged That The Relevant Parcel For The Takings Analysis Is The Subject Buildings

The threshold question in any regulatory takings claim is what parcel of land the government has taken. *See Palazzolo v. Rhode Island*, 533 U.S. 606, 631 (2001) (describing this inquiry as the "difficult, persisting question of what is the proper denominator in the takings fraction"). There is no set approach or bright-line rule for determining the relevant parcel; rather, courts follow "a flexible approach, designed to account for *factual nuances*." *Loveladies Harbor, Inc. v. United States*, 28 F.3d 1171, 1181 (Fed Cir. 1994) (emphasis added). The focus of the analysis must be on "the economic expectations of the claimant with regard to the property," *Forest Props., Inc. v. United States*, 177 F.3d 1360, 1365 (Fed Cir. 1999), and the determination will "largely depend upon the facts of the particular case," *Sharp v. United States*, 191 U.S. 341, 354 (1903); *see also 2910 Georgia Ave. LLC v. District of Columbia*, 983 F. Supp. 2d 127, 137 (D.D.C. 2013) ("[T]he relevant 'property' for purposes of this case is a fact-intensive inquiry.").

[3] The City makes a half-hearted argument that to the extent Stahl's takings claim is based on the 2006 designation of the Subject Buildings, it is time-barred. *See* Mem. at 49 n.25. That is wrong. It is black-letter law that takings claims are not ripe without a final order, and accordingly, Stahl was required to seek a certificate of appropriateness prior to bringing a takings claim. *See, e.g.*, *Williamson Cnty. Reg'l Planning Comm'n v. Hamilton Bank of Johnson City*, 473 U.S. 172, 191 (1985); *Church of St. Paul & St. Andrew v. Barwick*, 67 N.Y.2d 510, 522 (1986) (takings claim based on landmark designation was not final until owner sought certificate of appropriateness). Accordingly, the statute of limitations on a takings claim does not accrue until a final decision is rendered. *See, e.g., New Port Largo, Inc. v. Monroe Cnty.*, 985 F.2d 1488, 1493 (11th Cir. 1993); *cf. Save the Pine Bush Inc. v. Zoning Bd. of Appeals of Town of Guilderland*, 220 A.D.2d 90, 94-95 (3d Dep't 1996) (statute of limitations for SEQRA claim alleging a taking triggered by zoning board's decision on variance and special use permit). Stahl's takings claim, then, did not accrue until the LPC's denial of its hardship application.

The City claims it is entitled to dismissal on the "relevant parcel" issue because the existence of some shared expenses and facilities at the FAE supposedly shows that Stahl has managed all of the buildings of the FAE "as a single economic entity." Mem. at 51. But that is a highly contested factual assertion—not a legal argument—and it is not properly before the Court at this stage. Indeed, because of the fact-intensive nature of the relevant parcel inquiry, courts routinely decide that issue *after development of a full factual record*. That is true of every one of the cases the City claims support its "relevant parcel" argument. *See Dist. Intown Props. Ltd. P'ship v. District of Columbia*, 198 F.3d 874, 884 (D.C. Cir. 1999) (affirming grant of summary judgment motion); *Forest Props.*, 177 F.3d at 1367 (affirming trial verdict); *Mt. St. Scholastic v. City of Atchison*, 482 F. Supp. 2d 1281, 1289 (D. Kan. 2007) (motion for summary judgment); *Bevan v. Brandon Township*, 438 Mich. 385, 387-88 (1991) (affirming verdict on stipulated facts). Not one of these cases, or any other case of which Stahl is aware, supports the City's effort to short-circuit Stahl's takings claim at the pleading stage by resolving the fact-intensive relevant parcel issue on a motion to dismiss.

In any event, the mere fact that a landowner treats different buildings similarly for some purposes does not by itself establish as a matter of law that they must be treated as a single parcel for takings purposes. *See Dist. Intown*, 198 F.3d at 889 (Williams, J., concurring) ("Of course there will be some synergy between almost any two neighboring parcels under common ownership, since unified ownership creates options for the sole owner that multiple landowners could achieve only by contracting."). And the Complaint sets forth numerous facts showing that Stahl actually treated the Subject Buildings as a separate economic entity from the remainder of the FAE. For example, the Complaint alleges that ever since the BOE's decision in 1990 to sever the Subject Buildings from the rest of the FAE, Stahl has treated them as a distinct entity for development purposes. Pet. ¶ 69. Most notably, Stahl has crafted a distinct development plan for the Subject Buildings and has operated them accordingly, including by keeping apartments unrented as they came vacant in preparation for the eventual redevelopment of the site. *See* Pet. ¶¶ 37-39; *see also Palm Beach Isles Assocs. v. United States*, 208 F.3d 1374, 1381 (Fed Cir. 2000) (contiguous properties were distinct parcels where owner had not intended to develop both parcels as a single unit). In addition, the Subject Buildings are treated as a discrete parcel for tax purposes, both by the DOF and by Stahl, which files various tax documents for the two Buildings, separate from the remainder of the FAE. *See* Pet. ¶ 71.

Moreover, Stahl's distinct treatment of the Subject Buildings was a direct consequence of the BOE's decision to cleave them from the FAE, with the express purpose of "allow[ing] for [as-of-right] development in the future." Pet. ¶ 34. Indeed, the City itself previously defended the decision to carve the Buildings out of the 1990 Landmark because "the designations were modified to permit as-of-right development at each site." Waters Aff. Ex. B at 9. Moreover, the City induced Stahl not to challenge the 1990 designation of the Other Buildings precisely because it expressly preserved Stahl's rights to develop the Subject Buildings. Pet. ¶¶ 34-35. In such situations, the parcel preserved for development is treated as a separate parcel for takings purposes. *See Loveladies Harbor*, 28 F.3d at 1174, 1181 (where state agency had induced plaintiff to give up development on 38.5 acres of 51 acre tract in exchange for preservation of development rights on the remaining 12.5 acres, proper parcel for takings claim when that agreement was reneged-upon was the 12.5 acre tract, not the total 51 acres). Though the City now suggests the BOE's decision was a "bad backroom deal," *see* Mem. at 46-47, and now opposes development, the City fully supported the decision in the Article 78 challenge to it at the time. *See* Waters Aff., Ex. B at 11 (arguing that BOE's decision had a rational basis). Having done so, it must accept the consequences of its actions on Stahl's development plans for purposes of Stahl's takings claim. *See Twain Harte Assocs. v. Cnty. of Tuolumne*, 217 Cal. App. 3d 71, 85 (Cal. Ct. App. 1990) ("[T]he nature of a particular land use regulation has been recognized as potentially creating separate parcels for 'taking' purposes.").[4]

In sum, Stahl has adequately alleged facts showing that it has operated the Subject Buildings as a distinct parcel from the rest of the FAE, and that the Buildings are therefore the relevant parcel for takings purposes. The City raises, at most, a dispute of fact that cannot be resolved on this motion to dismiss.

B. Stahl Adequately Alleged That The Designation Destroyed Virtually All Of The Value Of The Subject Buildings

The key factor in any partial takings analysis is the severity of the economic impact of the challenged regulation on the property. *See Penn Cent.*, 438 U.S. at 124. Where the loss of economic value of the property is sufficiently severe, it "crosse[s] the line from a noncompensable 'mere diminution' to a compensable 'partial taking.'" *Fla. Rock Indus., Inc. v. United States*, 18 F.3d 1560, 1570 (Fed. Cir. 1994). However, there is no "automatic numerical barrier preventing compensation, as a matter of law, in cases involving a smaller percentage diminution in value." *Cienega Gardens v. United States*, 331 F.3d 1319, 1340 (Fed. Cir. 2003) (internal quotation marks omitted). The economic impact analysis, like the regulatory taking analysis in general, is a fact-intensive inquiry, and thus cannot be resolved on a motion to

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[4] Citing *DGM Partners-Rye v. Bd. of Architectural Review of City of Rye*, 148 A.D.2d 608 (2d Dep't 1989), the City claims that the entire FAE should be considered the relevant parcel because the LPC decided to landmark the entire complex. But *DGM Partners* is not a takings case, and the court there did not purport to address what the relevant parcel was for takings purposes. Rather, that case was an administrative challenge involving the definition of improvement parcel under that particular municipal law. *Id.* at 609. As the City expressly concedes elsewhere in its brief, state law definitions of "improvement parcel" have "no relevance to what the proper denominator should be for purposes of a takings claim." Mem. at 50 n.26.

dismiss. *See id.* at 1341 (observing that "specific findings of fact about the effects of the legislation on the plaintiffs are necessary to complete the analysis of the economic impact factor").

The Complaint alleges that in every year since the designation of the Subject Buildings in 2006, Stahl has lost money by operating the Buildings in their current condition. Pet. ¶ 74. If Stahl improved the Buildings to make them more marketable, the newly renovated Buildings still would not generate enough money to even pay for those renovations, let alone provide a reasonable rate of return. Pet. ¶¶ 75-76, 121. Moreover, the Landmarks Law heavily restricts Stahl's ability—or anyone else's for that matter—to engage in any use of the property other than the current, unprofitable one. *See* Pet. ¶ 53; *see also* N.Y.C. Admin. Code § 25-305(a)(1). In light of the value the Buildings would have without the landmark designation, Stahl has clearly alleged that the designation precludes it from earning a reasonable return and extinguished virtually all of the economic value of the properties. Pet. ¶¶ 73, 121; *cf. Keeler v. Mayor & City Council of Cumberland*, 940 F. Supp. 879, 888 (D. Md. 1996) (granting summary judgment for landowner where costs of either maintaining landmarks buildings or renovating them to address disrepair were so severe that no "economically feasible" use of the buildings was possible; accordingly, refusal to permit demolition was unconstitutional taking).

The City responds largely by raising factual arguments. It claims that the loss in value to Stahl is insufficient, citing several cases that it claims are "similar." *See* Mem. at 54-55. But, "[t]he question of the economic impact of a particular regulatory action is of course fact-specific to the case," *Hendler v. United States*, 175 F.3d 1374, 1385 (Fed. Cir. 1999), and cases involving takings challenges to designations under the Landmarks Law, like all regulatory takings claims, are "ad hoc, factual inquiries." *Penn Cent.*, 438 U.S. at 124. These cases turn on the particular facts involved, and do nothing to bolster the City's flawed argument that a court can resolve the issue of whether the landmark designation, in these factual circumstances, had a sufficiently severe economic impact to constitute a taking of Stahl's property. Not surprisingly, all the cases the City cites finding the economic impact of a regulation inadequate to demonstrate a taking do so after factual development.[5]

The City also asserts that Stahl has not alleged a takings claim because it can continue to operate the Subject Buildings as a "low scale rental property," and is thus merely complaining that it has been deprived of the most lucrative use of the Subject Buildings. *See* Mem. at 54-56 (citing *TIAA v. City of New York*, 185 A.D.2d 207, 208-09 (1st Dep't 1992) (denying takings claim where regulation permitted owner to run current business and owner's sole complaint was that it prohibited more profitable future uses)). That is not Stahl's position. The City ignores the clear allegations in the Complaint, which must be assumed true for purposes of the motion to dismiss, that the landmark designation has destroyed virtually all of the property's economic value. *See* Pet. ¶¶ 73-76.[6]

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[5] *See Palazzolo*, 533 U.S. at 616 (reversing affirmance of bench trial verdict); *Concrete Pipe & Prods. v. Constr. Laborers Pension Trust*, 508 U.S. 602, 614-15 (1993) (addressing confirmation of arbitration award); *Rith Energy, Inc. v. United States*, 270 F.3d 1347, 1348 (Fed. Cir. 2001) (denying petition for rehearing en banc of affirmance of grant of summary judgment); *Gazza v. N.Y. State Dep't of Envtl. Conservation*, 89 N.Y.2d 603, 609-10 (1997) (administrative proceeding under Article 78 and Tidal Wetlands Act, trial court held evidentiary hearing to assess takings claim); *de St. Aubin v. Flacke*, 68 N.Y.2d 66, 70 (1986) ("The taking determination is made on the basis of a full evidentiary hearing . . . ."); *N. Westchester Prof'l Park Assoc. v. Town of Beford*, 60 N.Y.2d 492, 499 (1983) (affirming opinion after bench trial); *Noghrey v. Town of Brookhaven*, 48 A.D.3d 529, 530-31 (2d Dep't 2008) (reversing jury verdict for improper jury instruction); *Briarcliff Assoc. v. Town of Cortlandt*, 272 A.D.2d 488, 490-91 (2d Dep't 2000) (addressing bench trial verdict); *see also Village Bd. of Village of Fayetteville v. Jarrold*, 53 N.Y.2d 254, 258 (1981) (Article 78 action challenging denial of variance, and not involving a takings claim).

[6] Contrary to the City's erroneous claim that "[a] taking occurs . . . only if the property interest is completely destroyed," Mem. at 55, a partial takings claim under *Penn Central* requires that the plaintiff show a "serious financial loss." *Cienega Gardens*, 331 F.3d at 1340 (internal quotation

To the extent the City purports to raise legal arguments, it is wrong on the law. The City suggests that whether Stahl can earn a reasonable return is irrelevant to the economic impact of the landmark designation, and thus irrelevant to the takings analysis, citing *Park Avenue Tower Assoc. v. City of New York*, 746 F.2d 135 (2d Cir. 1984). *See* Mem. at 57-58. *Park Avenue,* however, merely affirmed a grant of summary judgment where the plaintiffs had not established a sufficiently severe reduction in value to demonstrate a taking because it was "factually undisputed that the zoning changes would not prevent either plaintiff from constructing a very substantial building on its property." *See* 746 F.2d at 138, 140. Given that factual record, the Court held that the plaintiffs could not save their claim by "recharacteriz[ing]" it as a loss of "return on investment." *Id.* at 140; *see also William C. Haas & Co. v. City and Cnty. of San Francisco*, 605 F.2d 1117, 1120-21 (9th Cir. 1979) (owner could not "recharacteriz[e] the diminution of the value of its property as an inability to obtain a favorable return on its investment" when "[t]he regulations d[id] not prevent [the owner] from developing the property").

Moreover, the reasonable return inquiry has long been used to measure the economic impact of a regulation, and is a core aspect of the takings analysis. In *Penn Central* itself, the preservation of the landowner's ability to earn a reasonable profit was critical to the finding that there was no taking. *See, e.g.*, 438 U.S. at 136; *accord Rose Acre Farms, Inc. v. United States*,

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marks omitted). Likewise, the "total" takings cases that the City cites, *see* Mem. at 56-57 (citing *Palazzolo* and *Rith Energy*), are irrelevant because this is a partial takings case. Total takings, by definition, require a much higher threshold showing of economic impact than takings claims under *Penn Central*. *See, e.g., Palazzolo*, 533 U.S. at 617 (observing that "a regulation which denies all economically beneficial or productive use of land will require compensation" and that "[w]here a regulation places limitations on land that fall short of eliminating all economically beneficial use, a taking nonetheless may have occurred" under *Penn Central* (internal quotation marks omitted)).

373 F.3d 1177, 1188-89 (Fed. Cir. 2004) (reasonable return analysis is an appropriate measure of economic impact of regulation on a "going business concern"). And in the very cases the City cites, the New York Court of Appeals has repeatedly recognized that a governmental action will constitute a taking where it precludes a landowner from earning a reasonable return. *See, e.g.*, *Gazza*, 89 N.Y.2d at 618 (observing that a "regulation's economic impact" "may be reflected by the economic viability or the 'reasonable return' on the property post-regulation" (citation omitted)); *N. Westchester*, 60 N.Y.2d at 504 ("A zoning classification will be held confiscatory . . . if no reasonable return can be obtained from the property as zoned."); *de St. Aubin*, 68 N.Y.2d at 77 (property owner is required to show that "under no use permitted by the regulation under attack would the properties be capable of producing a reasonable return"). To the extent *Park Avenue* could be read to conclude otherwise, it would be contrary to settled, controlling law.

Finally, the City suggests that Stahl's constitutional claim should be dismissed because the LPC has already found that Stahl can earn a reasonable rate of return. Mem. at 58. This argument is another example of the City's efforts to dispute the allegations in the Complaint. As set forth in the Complaint and for the reasons discussed *infra* in Part II, the LPC's decision was arbitrary and capricious, and Stahl has already demonstrated that it cannot earn a reasonable return in the administrative proceeding. Moreover, the resolution of the Article 78 petition does not control the outcome of the takings claim. The Article 78 petition is resolved solely on the administrative record under a deferential Article 78 standard of review, whereas Stahl is entitled to have its constitutional takings claim resolved *de novo*, after discovery and the presentation of additional evidence to this Court. This Court is obliged to reach its own independent conclusion as to whether Stahl is able to earn a reasonable rate of return. *See Cioffoletti v. Planning and*

Zoning Comm'n of Town of Ridgefield, 209 Conn. 544, 551 (1989) ("[T]rial court should decide the taking issue de novo in light of all the evidence properly presented to it, including, but not limited to, the administrative record."); *Hensler v. City of Glendale*, 8 Cal. 4th 1, 16 (1994) (en banc) (where administrative hearing does not involve judicial protections such as swearing of witnesses and direct and cross-examination, "the administrative record is not an adequate basis on which to determine if the challenged action constitutes a taking"). Indeed, even apart from the reasonable return issue, Stahl's takings claim will necessary implicate additional facts not presented before the LPC—in particular, facts relevant to the reduction in value of the Subject Buildings caused by the designation. *See, e.g.*, *Brotherton v. Dep't of Envtl. Conservation*, 189 A.D.2d 814, 816 (2d Dep't 1993) (denying Article 78 petition on administrative record, but remanding for evidentiary hearing on takings claim).

In short, Stahl has clearly alleged facts demonstrating that it suffered a severe financial loss, sufficient to state a valid claim for a partial taking. Because the City's motion to dismiss is premised on contested factual assertions that cannot be resolved on a motion to dismiss,[7] and makeweight legal arguments that depend on ignoring the allegations of the Petition, the motion should be denied.

C. Stahl Adequately Alleged Interference With Reasonable Investment-Backed Expectations

The *Penn Central* test also requires courts to consider the regulation's interference with the owner's "distinct investment-backed expectations." *Penn Cent.*, 438 U.S. at 124. The

[7] The City also argues that Stahl retains "valuable TDRs" (transferable development rights) and "[t]hus, there has been no taking." Mem. at 55. But the transferability of TDRs is heavily restricted, *see* Pet. ¶ 77, and whether any particular TDRs have value is a fact-specific determination that cannot be resolved on a motion to dismiss. *See Fred F. French Investing Co. v. City of New York*, 39 N.Y.2d 587, 591 (1976) (preservation of TDRs did not preclude finding of taking where market value was "uncertain and contingent").

Complaint alleges that Stahl acquired the FAE—including the Subject Buildings—with the intention of redeveloping the properties, and that its development expectations were cemented by the BOE's decision to leave the Buildings unencumbered by the landmark designation explicitly "to allow for such development in the future." *See* Pet. ¶¶ 34, 79-80; Waters Aff. Ex. B at 9. Since that time, Stahl has taken substantial steps to redevelop the property, including leaving apartments vacant in preparation for future development and retaining professionals to assist in designing the redevelopment plan. Pet. ¶¶ 37-39, 69-70, 81-82.

The City attempts to rebut these allegations on three grounds. First, it argues that at the time of Stahl's acquisition of the FAE, its "expectation that it would one day be able to build a highrise [was not] reasonable." Mem. at 61. However, Stahl has alleged that at the time it acquired the Buildings, it intended to redevelop them, and they were zoned for high-density development. Pet. ¶ 79. Moreover, Stahl had no reason to believe that these unremarkable, outmoded, tenement-style apartment buildings could constitute a potential landmark at some point in the future, and the LPC did nothing to indicate otherwise for 13 years. Pet. ¶¶ 20, 34-35. The City cannot simply declare Stahl's expectations "unreasonable" as a matter of law. *See Cienega Gardens*, 331 F.3d at 1346 (existence of investment-backed expectations "is an objective, but fact-specific inquiry into what, under all the circumstances, the Owners should have anticipated").

Second, the City argues that Stahl could never have reasonably expected to develop the Subject Buildings when it acquired them because it knew the Landmarks Law could eventually restrict their future development. Mem. at 59-60. In so arguing, the City broadly suggests that a landowner's mere knowledge of the existence of the Landmarks Law necessarily defeats a takings claim. *See id.* (noting that Stahl, like "any property owner," was "well aware of the existence of the 1965 Landmarks Law when it acquired" the Buildings). That is absurd. If a landowner could never expect to develop a property because it could one day be subject to the Landmarks Law, then no landmark designation could ever be challenged as a taking. Under the City's logic, if the LPC decided to exercise its historical and aesthetic discretion tomorrow to landmark a cigar shop, a corner bodega, or newspaper kiosk, the owner could not complain because, after all, every property in New York City is at least theoretically subject to a landmark designation. A rule that no property owner who acquires a building should ever expect to redevelop it because of the mere existence of the Landmarks Law would exert a profound chilling effect on all future real estate transactions in New York City.

Perhaps the City means something less sweeping—namely, that Stahl had some reason to believe these particular buildings would be subject to a landmark designation at the time it acquired them. But the City cannot establish this contested fact on a motion to dismiss. The City points to Stahl's "portfolio of other landmark properties," but ignores Stahl's allegation that, unlike those properties, Stahl had no reason to believe these unremarkable tenement-style apartment buildings would one day be deemed worthy of a landmark designation. The City also notes that the Subject Buildings were "highly regulated" at the time, *see id* at 59 n.27, but the regulations it identifies are rent control and stabilization regulations that, unlike a landmark designation, do not restrict development in perpetuity. Moreover, whether or not these buildings constitute a "highly regulated" property is itself a factual question that cannot be resolved on a motion to dismiss. *Cf. Cienega Gardens*, 331 F.3d at 1350-51 (finding trial evidence insufficient to support conclusion that low-income housing was "highly regulated" "field" under *FHA v. Darlington*, 358 U.S. 84 (1958) and its progeny).

In any event, whether Stahl's notice of the possibility that the Subject Buildings might one day be landmarked was sufficient to outweigh its expectations of development is another fact issue incapable of being resolved on a motion to dismiss. Indeed, the United States Supreme Court in *Palazzolo* squarely rejected the principle, implicit in the City's argument, that mere notice of a regulation can be dispositive of the investment-backed expectations inquiry. *See Palazzolo*, 533 U.S. at 628 ("A blanket rule that purchasers with notice have no compensation right . . . is too blunt an instrument to accord with the duty to compensate for what is taken."); *Cienega Gardens*, 331 F.3d at 1350 (notice "is not a blanket rule that disqualifies parties' expectations without inquiry"). Thus, to the extent the City's cases suggest that courts may reject takings claims as a matter of law based solely on the owner's notice of the potential regulation, *see* Mem. at 61-62, these cases pre-date *Palazzolo*, and are no longer good law. Post-*Palazzolo*, notice is but one of many facts to be weighed in the analysis.

Whatever Stahl may have reasonably expected when it acquired the Buildings, the City's subsequent actions independently furthered Stahl's expectation that it was free to develop them. The Complaint alleges that Stahl reasonably understood—based on the BOE's decision, the City's unequivocal support for it in the subsequent Article 78 proceeding, and its affirmance by the New York Supreme Court—that its development rights had been preserved. *See* Pet. ¶¶ 34-35, 80. Indeed, the BOE's decision was a material inducement to Stahl's acquiescence to the original landmark designation of the Other Buildings. *See* Pet. ¶ 35.

The City also claims that the only relevant time for purposes of answering the investment-backed expectations question is the time of acquisition. *See* Mem. at 59. But that argument contravenes the case law. S*ee Laguna Gatuna, Inc. v. United States*, 50 Fed. Cl. 336, 347 (Ct. Cl. 2001) (statements made by EPA to landowner in 1987 regarding right to develop property affected investment-backed expectations in leasehold and right-of-way obtained no later than 1969); *Woodland Manor, III Assocs., L.P. v. Reisma*, No. C.A. PC89-2447, 2003 WL 1224248, at *14 (Sup. Ct. R.I. Feb. 24, 2003) (permit approval obtained after acquisition established landowner's investment-backed expectations).

Finally, the City argues that because the BOE's decision regarding the York Avenue Estates was overturned in the *Kalikow* decision, and because the LPC has the power to amend its designation, Stahl should have expected that the Subject Buildings would eventually be landmarked. *See* Mem. at 60. The City's argument boils down to the untenable position that nothing the government ever does can affect a landowner's reasonable expectations because the government can always change its mind. But the law is clear that the government's actions affect the reasonableness of a property owner's expectations—even if the government later changes its mind. *See, e.g.*, *Woodland Manor*, 2003 WL 1224248, at *14 (owner had reasonable expectation to develop wetlands restricted property where state agency had granted permit to develop part of property, so long as the landowner refrained from developing remainder of property); *see also Laguna Gatuna*, 50 Fed. Cl. at 347 (landowner's investments in its salt water disposal operation were reasonable where it received approval for development from the EPA, which was subsequently rescinded). Moreover, unlike the designation at issue in *Kalikow*, the carve out of the Subject Buildings from the designation of the FAE had a clear rationale consistent with the Landmarks Law, because the Subject Buildings were designed by a different architect, constructed at a different and later time, and were built on a plot of land acquired at a different time and from a different seller than the Other Buildings of the FAE. *See* Pet. ¶¶ 30-31.

The LPC may have had the authority to amend its designation as a matter of administrative law, but after the New York Supreme Court affirmance, it did nothing to suggest it had any intent to reconsider the designation. During this time, Stahl invested considerable time and energy into creating a development plan that the City had invited it to create. It was not until Stahl began to put that plan into motion that the City, plainly responding to improper political and community pressure, decided to change course. Pet. ¶¶ 40, 44-46. The core concepts inherent in the Takings Clause are "fairness and justice." *See, e.g.*, *Tahoe-Sierra*, 535 U.S. at 334. Stahl had every reason to rely on the BOE's decision to preserve its ability to redevelop the Subject Buildings, and should not reasonably have expected that 16 years after the fact, the LPC might attempt to renege on its compromise and block development. At the very least, this question—like all of the questions raised by the City's brief about the reasonableness of Stahl's expectations—is a quintessential fact dispute that cannot be properly resolved on a motion to dismiss.

* * * *

Stahl's Complaint clearly alleges a partial taking under *Penn Central*, and it is entitled to develop a full factual record in support of that claim. Accordingly, the City's motion to dismiss the Complaint must be denied.

II. THE LPC'S CONCLUSION THAT THE BUILDINGS WERE CAPABLE OF EARNING A REASONABLE RETURN WAS ARBITRARY AND CAPRICIOUS

As Stahl's Petition demonstrates, the LPC arbitrarily and capriciously concluded that the Subject Buildings, once renovated, could generate a "reasonable return." The City apparently hopes it can deter the Court from considering the merits of the Petition by falsely suggesting that to do so the Court would have to wade through "24 independent scenarios" and re-do the work the LPC supposedly did in "painstaking" fashion. *See* Mem. at 43. For example, the City devotes a great deal of attention to trying to refute certain assumptions underlying Stahl's submissions that the LPC did not accept: The City challenges Stahl's estimate of rental income likely to be generated under various renovation scenarios, *id*. at 21-23; its use of a 10% as opposed to a 5% vacancy rate, *id.* at 23-26; its exclusion of other opportunities for generating income, such as by operating a laundromat or providing storage space, *id.* at 26-27; its purportedly excessive post-renovation expense figures, *id.* at 27-28; and its inclusion of construction loan interest in depreciation costs, *id.* at 29. The City suggests that, given these purportedly erroneous assumptions, Stahl failed to demonstrate that its rate of return on the renovated Subject Buildings would be less than 6%.

These assumptions are of no consequence to the Petition. The City focuses on the weeds in order to distract this Court from the three core issues that actually affect the outcome of the reasonable rate of return analysis in this case, even if the LPC's other assumptions are accepted: (1) the definition of the relevant "improvement parcel;" (2) whether the cost or income approach is the proper method for determining assessed value; and (3) whether Stahl's renovation costs should be reduced nearly by half because some of those costs were purportedly a "self-imposed hardship." As explained below, those three issues must be resolved in Stahl's favor, and if they are, the only possible conclusion is that Stahl cannot earn a reasonable return on the renovated Subject Buildings, and that the LPC's decision therefore must be vacated.[8]

The City claims that certain of the LPC's "alternative" calculations accepted Stahl's position on these critical issues, and yet still arrived at a rate of return above 6%. That is just not true. The LPC did not conduct an "alternative" calculation that fully and fairly adopted Stahl's position on these important issues. Rather, it employed a hodgepodge analysis that credited

[8] For the reasons described in the Petition and *infra* Part II.E, the LPC's conclusions regarding Stahl's post-renovation operating expenses, vacancy and collection loss, and construction loan interest are also arbitrary and capricious. *See* Pet. ¶¶ 155-61. However, the Court need not even reach those issues for it to conclude that the LPC's decision must be vacated.

Stahl's positions and assumptions haphazardly, with no rhyme or reason for failing to credit them consistently. That is quintessential arbitrary and capricious decision making. The LPC's flawed and manipulated analysis enabled it to reach a pre-ordained, result-oriented conclusion, born of bias against Stahl from the outset, that the hardship application must be rejected. *See* Pet. ¶¶ 63-65; (R-1704; R-2235-36; R-2238; *see also* R-1271; R-2194; R-2206; R-2211). This bias against Stahl's application was laid bare by one Commissioner's statement that the LPC's "job" was "not to be taken in" by Stahl's application. (R-1704). Though the City suggests that the statement merely reflected the LPC's charge "to protect historic buildings," Mem. at 47-48, in fact, the statement reveals an LPC that had decided to reject Stahl's hardship application regardless of what the evidence said. *See* Pet. ¶¶ 63-65, 67. To this end, it manufactured an inconsistent and irrational analysis—jerry-rigged to deny the application—that resulted in a decision that was arbitrary, capricious, and contrary to law.[9]

A. The Relevant Improvement Parcel Under The Landmarks Law Is The Subject Buildings

The hardship provisions of the Landmarks Law require that the LPC determine whether the "improvement parcel" is "capable of earning a reasonable return." N.Y.C. Admin. Code § 25-309(a)(1); Pet. ¶ 55. The relevant improvement parcel is "[t]he unit of real property which (1) includes a physical betterment constituting an improvement and the land embracing the site thereof, and (2) is treated as a *single entity for the purpose of levying real estate taxes*." N.Y.C. Admin. Code § 25-302(j) (emphasis added). The City does not, and cannot, dispute that the

[9] To the extent the City suggests that there is some special deference given to the LPC's decisions on hardship applications, over and above ordinary agency determinations, that assertion is wrong. *See* Mem. at 42. As with any agency determination, the LPC's decision on a hardship application is subject to review under the arbitrary and capricious standard of CPLR 7803(3) and must be vacated when, as here, it is infected by errors of law and irrational conclusions.

Subject Buildings comprise a single tax lot (Lot 22) while the Other Buildings of the FAE comprise three different tax lots (Lots 1, 10, and 30). *See* Answer ¶ 81; (R-2320). It is also undisputed that for tax purposes, the DOF calculates an assessed value for Lot 22 alone, and does not include in that calculation any value for the remainder of the FAE. (*See*, *e.g.*, R-2099; R-2103). Thus, under the plain language of the Landmarks Law, Lot 22 is the relevant improvement parcel for Stahl's hardship application.

The LPC nonetheless concluded that Stahl's rate of return should be calculated based on the entire FAE complex because of the supposed "stylistic[]" and "physical[]" relationship of the Buildings to the entire FAE complex and Stahl's purported common management of the Buildings with the FAE. (R-2321).[10] Even though none of these "specific facts and circumstances" appear within the statutory standard for an improvement parcel, the City argues that this Court must defer to this interpretation of the Landmarks Law. Mem. at 44. But it is black-letter law that a court may not defer to an agency's statutory interpretation unless it "involves specialized knowledge and understanding of underlying operational practices or entails an evaluation of factual data and inferences to be drawn therefrom." *KSLM-Columbus Apts., Inc. v. N.Y. State Div. of Hous. & Cmty. Renewal*, 5 N.Y.3d 303, 312 (2005) (internal quotation

[10] The LPC's speculation that Stahl operated the Other Buildings of the FAE in an effort to support its hardship application was unsupported by any evidence and defies common sense. The City surmises that Stahl artificially increased the vacancy rate in the Other Buildings so it would have open apartments in which to relocate tenants from the Subject Buildings if its application were successful, and claims that this shows that Stahl was managing the entire FAE as one parcel. *See* Mem. at 18. There was no evidence supporting this theory, and in fact, at the time of the hardship application, there were only 93 occupied apartments in the Subject Buildings. At even an 11% vacancy rate in the 13 Other Buildings, there would have been more than enough vacancies to relocate any tenants from the Subject Buildings to comparable apartments in the Other Buildings, even assuming every tenant in the Subject Buildings accepted Stahl's offer. Thus, Stahl would have had no need to leave apartments in the Other Buildings vacant to support its application.

marks omitted). Where, as here, "the question is one of pure statutory interpretation dependent only on accurate apprehension of legislative intent," deference is not appropriate. *Id.* (internal quotation marks omitted). As the Court of Appeals has held, "[w]here . . . the words of the statute are clear and the question simply involves the proper application of the provision there is little basis to rely on any special competence or expertise of the administrative agency and its interpretive regulations, especially when the interpretation . . . directly contravenes the plain words of the statute." *Trump-Equitable Fifth Ave. Co. v. Gliedman*, 57 N.Y.2d 588, 597 (1982) (internal quotation marks omitted). Whether Lot 22 is treated as a single unit for purposes of levying real estate taxes is a straightforward issue that does not call for any discretion or special expertise on the part of the LPC. The relevant question under the statute—whether the property is "treated as a *single entity for the purpose of levying real estate taxes*," § 25-302(j) (emphasis added)—asks only what the relevant tax lot is. Here, the answer is obvious—Lot 22—and this Court should not defer to the LPC.

Moreover, as the City concedes, a Court cannot defer to an agency's interpretation that is "irrational or unreasonable." *See* Mem. at 44. The City's argument that the LPC was authorized to base its decision on non-statutory "specific facts and circumstances," *id.*, directly contravenes the Landmarks Law's unambiguous statutory definition of an improvement parcel. An interpretation that disregards the statutory text in favor of non-statutory factors is plainly irrational or unreasonable. *See* Pet. ¶ 134; *N.Y.C. Campaign Fin. Bd. v. Ortiz,* 38 A.D.3d 75, 84 (1st Dep't 2006) (holding that an agency may not "*expand or add* to the clear and unambiguous language" of a statute, "which must be read and given effect as it was written by the City Council" (emphasis added)). Indeed, the City itself candidly acknowledges that the plain language of the Landmarks Law requires the LPC to assess whether the owner can earn a reasonable return on the "improvement parcel," not the "landmark site." *See* Mem. at 17.

The City's only attempt to link its argument to the text of the statute is its assertion that the LPC could treat the entire block as the relevant tax lot because Stahl has filed consolidated tax filings for the lots on block 1459. *See id.* at 18-19. But the statute refers to the parcel treated as a "single entity for the purpose of *levying* real estate taxes," and it is undisputed that the DOF assesses value—and thus levies real estate taxes—on Lot 22 alone. Moreover, the DOF requires that Stahl file Real Property Income and Expense statements for Lot 22 separate from the remainder of the FAE, which the DOF uses to calculate assessed value. (*See* R-1138-75 (collecting Stahl's filings for 2006-2009 for Lot 22 (or tax block-lot number 1459-22)). In short, the DOF plainly treats Lot 22 as a single entity for the purposes of levying real estate taxes, and the LPC was therefore required by the plain language of the Landmarks Law to calculate the rate of return based on Lot 22 taken alone.

B. The LPC Irrationally Ignored Economic Reality And Rejected The Cost Approach

In order to decide whether the Subject Buildings could generate a reasonable return after undergoing renovations, the LPC was required to determine what their post-renovation assessed value would be. Pet. ¶ 90. That same assessed value figure would in turn be used to calculate applicable real estate taxes and depreciation, both which are defined as percentages of assessed value. *Id.* The parties agreed there are two different ways to calculate assessed post-renovation value—the cost approach, which takes account of the cost of renovations in determining value, and the income approach, which looks solely to the income that will be generated by the renovated building. (*See* R-2336); Mem. at 30.[11] Stahl argued that the cost approach was the

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[11] The cost approach, as used by Stahl and the LPC, refers to the determination of *post-renovation* assessed value by adding a percentage of the cost of those renovations to the original

only approach that, in these circumstances, would adequately take account of the substantial cost of renovations in the various renovation scenarios, and thus the only approach that would accurately calculate the rate of return to be earned on the post-renovation properties. The LPC rejected that argument and instead relied on the income approach. (R-2336-37).

By using the income approach to calculate assessed value, the LPC was able to generate theoretical rates of return far in excess of the 6% minimum. But the use of the income approach was irrational. The LPC effectively created a sham hardship test that ignored the economic reality that renovations required to generate higher returns cost money. That test contravenes the statutory purpose of the hardship provisions of the Landmarks Law and the LPC's prior practice and precedent, and defies common sense.

1. <u>The Income Approach Fails To Consider Renovation Costs</u>

The fundamental flaw with the income approach is that it permitted the LPC to calculate a rate of return based on post-renovation projected income without considering the substantial costs of the renovations necessary to generate that income. That approach artificially understated the amount of income necessary to demonstrate a post-renovation reasonable rate of return, and is divorced from economic reality. Indeed, the LPC's approach created a farce of a test under which virtually any property could generate a reasonable return after substantial renovations—no matter how expensive the renovations were. *See* Pet. ¶¶ 145-47.

For example, one of the renovation scenarios the LPC considered was the "Apartments Only" scenario. (R-2337). The LPC concluded that the cost of renovating the 97 vacant

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pre-renovation assessed value. *See* Pet. ¶ 91. Stahl does not dispute that the pre-renovation assessed value would be calculated by using the income approach. (*See* R-2351 (in LPC's alternative scenario, it calculated assessed value under the cost approach by adding 45% of renovation costs to 2009 assessed value)).

apartments under that scenario would be $8,066,811.05. (R-2351). Under the income approach, the assessed value of the Buildings after those renovations would be barely half of what the renovations cost—(at most) $4,099,149. (R-2349). According to the Landmarks Law, then, Stahl would suffer no hardship as long as it could earn at least 6% of that assessed value, or (approximately) $245,949 each year. (*Id.*).[12] In other words, under the income approach, an annual return of $245,949 would be reasonable, even though it would, at that rate, take Stahl 32.8 years to pay for those renovations—and in fact, conservatively, would take twice as long when the time value of money is considered.[13] But no property owner in New York City would consider a rate of return "reasonable" if it took almost 33 years to turn a profit. Similarly, for every renovation scenario, the resulting market value of the property as calculated under the income approach would increase by less than the cost Stahl would incur to renovate the building. Why would a reasonable landowner ever renovate property if that were true? There would be no way to earn any return.

Moreover, it bears emphasis that the hardship analysis significantly underestimates the rate of return to begin with, because it calculates the return based on assessed value rather than market value. For properties like the Subject Buildings, assessed value is merely 45% of the

[12] This amount, of course, would be well below the reasonable return as calculated under the cost approach for this scenario, which the LPC calculated as $369,814. (R-2351).

[13] $8,066,811.05 in renovation costs divided by an annual return of $245,949 equals approximately 32.799 years. The City's argument would similarly support even more egregious rates of return. The LPC also calculated assessed value for the "Apartments Only" scenario under a lower income per square foot level. (*See* R-2349). Using this figure, the income approach would find reasonable a rate of return that would take 38 years for Stahl to break even. (*See id.* ($8,066,811.05 in renovation costs divided by an annual return of 6% of the assessed value of $3,537,863 equals approximately 38 years)); *see also* Pet. ¶ 146, (R-883, R-890, R-2083) (explaining, as an illustration, that using the income approach for a gut renovation costing $16,697,332 would generate an assessed value of $4,046,400 according to the DOF, and thus find reasonable a rate of return requiring approximately 68.77 years for Stahl to break even).

property's market value. In other words, the true minimum rate of return is not actually 6%, but rather 2.7%,[14] a very low bar compared to the return a commercially reasonable property owner would expect to earn on any investment. Given that the hardship provisions place the landowner at an immediate disadvantage by ignoring the property's true economic value, the LPC must be required to analyze the rate of return in a fair and economically realistic fashion.

But instead, the LPC's use of the income approach compounded that unfairness. It permitted the LPC to conclude that virtually any property could generate a reasonable return after renovations because the true cost of those renovations were not reflected in the analysis. That is plainly not what the legislature intended when it enacted the hardship provision. Its entire purpose is to provide relief to owners who cannot earn a reasonable economic return on landmarked properties. *See* Pet. ¶¶ 145-47. The City feebly argues that the purpose of the provision is also "to protect landmark buildings from demolition, where the property can generate a reasonable economic return." Mem. at 44-45. But since the LPC's approach essentially ensures that a post-renovation rate of return could always be "reasonable," then all landmarked buildings will be protected from demolition, and no owner will ever be able to demonstrate otherwise. The City has no answer to this fundamental shortcoming.

2. <u>The DOF Often Uses The Cost Approach</u>

Ignoring economic reality, the City says it was proper to use the income approach because a statement by DOF Assistant Commissioner Sheares indicated that the DOF always uses the income approach to assess value for residential rental multiple dwellings. Mem. at 30.

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[14] Since assessed value equals 45% of market value, taking 6% of that amount is equal to 2.7% of market value (*i.e.*, 6% multiplied by 45% is 2.7%). Of course, because the renovations and the leasing of the newly renovated apartments would not occur overnight, even this 2.7% return could be achieved only years down the road.

As Stahl has explained, that statement is belied by numerous examples in which the DOF regularly adjusts assessed value of properties because of physical improvements. *See* Pet. ¶¶ 94-96, 141; (R-2050-54; R-2057-66; R-2095-97). The City now claims that adjusting assessed value based on physical improvements is not the same thing as "utilization of the cost approach," and that any "reference to an increase in assessment based on physical changes is for the purpose of explaining why some increases in assessment are phased in (transitional) and others are not (physical)." Mem. at 30. Whatever this delphic comment means, it cannot explain away the fact that the DOF increased the assessed value of *these particular buildings* for the 2009 test year based on "[c]ost information" submitted to the Department of Buildings related to "structural changes" to the property. (R-2095-96; R-2100-01; R-2105). In other words, at the very time Stahl's hardship application was filed, the DOF was increasing the assessed value of the Subject Buildings on the basis of renovation costs—exactly what the Sheares statement falsely claimed the DOF does not do.

In addition, the DOF uses cost information to adjust taxes through the J-51 program, which makes a property owner who engages in alterations or improvements to a property eligible for a tax abatement of a percentage of the *cost of those alterations or improvements*. *See* N.Y.C. Admin. Code § 11-243(c)(1). The City says this is "irrelevant" to the validity of the LPC's use of the income approach to evaluate a hardship application. *See* Mem. at 33 n.20. But the City cannot have it both ways. Having defended the LPC's use of the income approach on the ground that the DOF routinely uses it for some non-landmark related purposes, the City cannot run away from the DOF's use of the cost approach for other non-landmarks related purposes. Indeed, the existence of the J-51 program flatly contradicts the Sheares statement, and fatally undercuts the LPC's reliance on it.

3. The LPC Departed From KISKA Without An Adequate Explanation

Stahl also demonstrated that the LPC's decision to reject the cost approach here is inconsistent with the LPC's use of the cost approach in KISKA, and that the LPC failed to justify its change in position. That renders its decision arbitrary and capricious. *See In re Field Delivery Serv., Inc.*, 66 N.Y.2d 516, 520 (1985) (absent "valid reasons," an agency's "failure to conform to agency precedent will . . . require reversal on the law as arbitrary, even though there is in the record substantial evidence to support the determination made"); Pet. ¶ 143.

The City says there is no inconsistency to explain because KISKA used the cost approach to calculate rate of return only for "sale" scenarios, and that, just like here, it used the income approach when calculating rate of return for "rental" scenarios. *See* Mem. at 31-33. This is specious because all of the scenarios in KISKA used the owner's purchase price—not the assessed value of the property—as the starting point for calculating the rate of return (*i.e.*, the denominator).[15] So the LPC's decision in KISKA to exclude renovation costs from the *purchase price* under the rental scenarios tells one nothing about the proper approach for treating renovation costs when calculating *assessed value*. And in fact, as the City and LPC acknowledge, when the LPC in KISKA determined the assessed value for purposes of calculating real estate taxes and subtracting depreciation costs, it used the cost approach and factored in the costs of renovation under every scenario. Answer ¶ 120 (conceding that the LPC used the cost approach in KISKA to determine assessed value for calculating real estate taxes); (R-2333 (acknowledging that renovation costs were included in KISKA to determine assessed

[15] The LPC is permitted to use the purchase price as a substitute for assessed value where, unlike here, the owner recently purchased the property. *See* § 25-302(v)(2)(b).

value for the depreciation calculation)).[16] *These calculations are the only instances in which the LPC calculated assessed value in KISKA.* *See* Pet. ¶ 99. Thus, the City's claim that the LPC did not use the cost approach to determine assessed value in KISKA is demonstrably false.

Because the LPC used the cost approach in KISKA, it was bound to do so here absent a persuasive justification for changing course. *See Klein v. Levin*, 305 A.D.2d 316, 320 (1st Dep't 2003) (rationale for distinguishing precedent must be "adequate"); *see also Huff v. Dep't of Corrections*, 52 A.D.3d 1003, 1005 (3d Dep't 2008) (agency's failure to follow precedent required vacating decision where reasons proffered by agency did not adequately distinguish precedent). The LPC offered no such justification. As explained, it principally denied that KISKA used the cost approach in rental scenarios—an assertion refuted by a plain reading of KISKA itself. And though the LPC was forced to concede a departure from KISKA in the determination of assessed value for real estate taxes, *see* Mem. at 31 n.19; (R-2185 (admitting that "this varies from the approach in KISKA")), the City meekly argues that the LPC was entitled to "follow[] the approach it used in KISKA in some instances [but not] in other instances" because it "specifically explained" why it was doing so. *See* Mem. at 45. But the LPC never explained, specifically or otherwise, why it made sense to use the cost approach to

[16] For example, in Tables B and L of the KISKA decision, which determined real estate taxes for rental and sales scenario respectively, the LPC added a percentage of "Total Renovation Costs" to a "Current Assessed Value" figure in order to determine the tax base of the property. (R-2291-92, R-2305-06; *see also* R-2293-94 (tax base for real estate taxes in rental scenario include "Total Renovation Costs")). Similarly, in Tables F and J, which reflect reasonable return calculations for rental and sales scenarios respectively, the LPC added a percentage of "Reno Costs" to the "Assessed Value of Bldg." in order to determine depreciation. (R-2298, R-2302; *see also* R-2297 (depreciation in rental scenario includes "Reno. Costs"); R-2298 (same); R-2301 (depreciation in sales scenario includes "Reno. Costs"); R-2302 (same); R-2307-08 (same)).

calculate real estate taxes in KISKA, but not here. Pet. ¶ 143 (collecting cases for proposition that agency explanation must be rational).

Indeed, because the LPC granted the hardship application in KISKA, the only apparent explanation for the agency's change in position on calculating real estate taxes here is that the LPC will use whatever approach leads to the result it wants to achieve. Where the LPC wants to allow demolition of a landmark, as in KISKA, it will allow the landowner to demonstrate an insufficient rate of return by using the higher cost approach for assessing value in the calculation of real estate taxes; and where it wants to prevent demolition, it will insist on the lower assessed value generated by the income approach.[17] That kind of result-oriented reasoning is precisely what the *Field* doctrine is designed to prevent. *See Field*, 66 N.Y.2d at 519 (the policies behind the requirement of consistency in agency reasoning are "to provide guidance for those governed by the determination made; to deal impartially with litigants; promote stability in the law; . . . and to maintain the appearance of justice" (citation omitted)).

4. The LPC's Application Of The Income Approach Was Arbitrary And Capricious Because It Was Internally Inconsistent

Finally, Stahl demonstrated that the LPC's use of the income approach was internally inconsistent because it factored the cost of renovations into assessed value for some purposes, but excluded them for others, without any explanation for the different treatment. The LPC essentially created an equation in which assessed value for depreciation was calculated using the

[17] The LPC's approach to calculating real estate taxes in KISKA also shows how spurious is the City's claim that the LPC used the income approach because taxpayers prefer that approach when the City calculates real estate taxes. *See* Mem. at 31. In other words, despite using the cost approach in KISKA, the City now claims that since taxpayers want the lower real estate taxes produced by the income approach, they should be obliged to accept the income approach for purposes of a hardship application. Of course, the question is not what most taxpayers want when the City calculates real estate taxes; the question is which methodology makes sense when calculating a post-renovation rate of return for purposes of a hardship application.

cost approach, while assessed value for the denominator of the equation and real estate taxes was calculated using the income approach. (*Compare* R-2337 ("The Commission finds that the income approach is the most reasonable and likely method that would be used to determine the post-renovation assessed value . . . ."), *with* R-2335 ("[T]he Commission finds that . . . the costs of renovating 53 apartments vacant at the time of designation . . . should be included in calculating depreciation, plus 15% contingency and 22% soft costs.")). In other words, in a single calculation, assessed value meant one thing in one place, and something else in another place. Now faced with this obvious internal inconsistency, the City declares that the LPC was only being "both fair and reasonable." Mem. at 32, 44. But the City cannot save a fundamentally incoherent and, by definition, illogical approach just by saying it is "fair."

Indeed, the City's explanation for using the cost approach for calculating assessed value for depreciation underscores the illogic of the LPC's overall methodology. The City claims that even though it chose not to use the cost approach when calculating real estate taxes and the denominator of the rate of return equation, the LPC included renovation costs in the depreciation expense because "it recognized that the owner would have to incur expenses in renovating apartments." Mem. at 32-33. But this exact same observation—*i.e.*, that Stahl would have to incur significant renovation costs—compels the use of the cost approach when calculating real estate taxes and the denominator of the rate of return calculation. If renovation costs must be considered in the equation in order to rationally calculate the rate of return—as the City concedes—they must be included in each component of the equation that uses assessed value, not just those components that help support the LPC's predetermined conclusion. Assessed value cannot logically mean two different things in the same calculation.

C. The LPC's "Self-Imposed Hardship" Finding Unfairly Punished Stahl For Exercising Its Legal Rights

Beginning at least as early as 2000, Stahl began leaving apartments in the Subject Buildings unrented as they became vacant, in order to prepare for the eventual redevelopment of the property. *See* Pet. ¶ 38; Answer ¶ 37; (R-1090-91).[18] As of the 2009 test year, 97 apartments were vacant. *See* Pet. ¶ 103. Every single one of these apartments had to be substantially renovated in order to generate any income. Pet. ¶ 26; (*E.g.*, R-178-79; R-1917-18). And all of the renovation scenarios that the LPC used to calculate Stahl's rate of return factored in the projected income Stahl would earn from all 97 of the renovated apartments. (R-2344-47; R-2352-55). The LPC concluded, however, that it could ignore renovation costs of 44 of these apartments in the depreciation calculation—the only place where the LPC did not ignore renovation costs—because they became vacant after the 2006 designation of the Subject Buildings. The LPC concluded that those vacancies were a "self-imposed hardship" and thus could be excluded from the rate of return calculation as a punishment for "a voluntary assumption of risk." (R-2322).

The LPC's decision to exclude some renovation costs on the ground of "self-imposed hardship," like its use of the income approach, defies economic reality. The rate of return calculation is, as the City concedes, a mathematical formula designed to show how much income a renovated property might produce under various renovation scenarios. Mem. at 10-11. Since the LPC factored in the income that would be generated from all 97 apartments, it makes no sense to pretend that those renovations, or some portion of them, are somehow cost-free. The

[18] Despite the suggestion of proposed Amicus The New York Landmarks Conservancy that Stahl "neglect[ed] . . . the buildings," Amicus Br. at 4, it is undisputed that throughout this time, Stahl complied with its legal duties to adequately maintain the Subject Buildings. *See* Pet. ¶ 39; (R-1106).

reasonable return formula does not mandate practices that owners of landmarked properties must follow, and it does not empower the LPC to dole out punishment to owners who fail to do so. Nor does it give the LPC the license to assess a hardship application based on tort-like concepts such as "assumption of the risk." Absent the particular renovations contemplated in each renovation scenario, Stahl would not earn the projected income associated with those renovations. To include the income but exclude the costs concededly necessary to generate that income is, by definition, an irrational way to calculate the rate of return.

Moreover, the LPC's "self-imposed hardship" analysis rests on the erroneous assumption that, but for Stahl's policy of leaving apartments unrented as they became vacant, the apartments in question would not have required any renovations. But as Stahl alleged in the Petition, and the LPC nowhere disputed, all of the vacant apartments would have required substantial renovations before they could be re-rented anyway. Pet. ¶ 26. Thus, it was not Stahl's policy of leaving apartments unrented that created a need for renovations. And because the only fact the LPC identified to support its self-imposed hardship analysis was Stahl's policy of leaving vacant apartments unrented, that self-imposed hardship analysis necessarily falls apart. The renovation costs contemplated by the various renovation scenarios were not "self-imposed;" they were a necessary expense for generating additional rental income for all 97 apartments, and would have been incurred at some point, even at the time the apartments became vacant.[19]

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[19] The City implies that Stahl's decision to leave apartments vacant contributed to their disrepair, and thus presumably increased the cost of the renovations that are now necessary. *See* Mem. at 34-35. If the LPC's theory is that Stahl's policy of leaving vacant apartments unrented *increased* the renovation costs necessary to produce additional income from those apartments, that theory would support, at most, a "self-imposed hardship" reduction corresponding to those incremental renovations costs. But the LPC made no finding about such incremental renovation costs. Instead, the LPC took a wholesale "self-imposed hardship" reduction for the *entire* renovation costs of all 44 apartments. As explained, that wholesale reduction cannot rationally be supported as a "self-imposed" hardship.

In fact, the LPC's approach penalizes Stahl for exercising its rights to challenge the landmark designation and prepare for the redevelopment of the Subject Buildings if its challenge was successful. Stahl's Article 78 challenge to the designation was still pending when its hardship application was filed. *See* Pet. ¶¶ 50-52, 105. Under the LPC's logic, in order for Stahl to succeed on its hardship application, it had to renovate vacant apartments—incurring considerable renovation costs and future relocation expenses for any rent regulated tenants—that it had every intention of demolishing pursuant to its development plan, even though its legal challenge to the underlying designation was still pending. *See* Pet. ¶¶ 105-06, 152. It cannot be that, in order to preserve the possibility of a successful hardship application, the Landmarks Law requires a property owner to make unnecessary renovations for a building it intends to obtain permission to demolish.

Ignoring the obvious inequities that would result from such a requirement, the City now claims that Stahl should not "benefit" from its decision to keep apartments vacant because it should not have expected its challenge to be successful. Mem. at 20 (asserting that Stahl's decision to leave the apartments vacant was a "conscious business decision and a voluntary assumption of risk"). This argument again falsely assumes that the "risk" was incurring future renovation costs that otherwise would have been unnecessary. But as explained, those costs had to be incurred in order for the apartments to generate additional income, even if Stahl intended to re-rent the apartments when they became vacant. The only "risk" of Stahl's business decision to leave the apartments vacant while it pursued its legal challenge was the loss of rental income from any vacant apartments that might have been rented in the interim. But Stahl is not trying to enhance its hardship application based on any lost interim rental income, which it voluntarily assumed; it seeks only to account for the renovation costs that, regardless of the outcome of its legal challenge, were required to turn these apartments into income-producing assets.

Contrary to the City's argument, Stahl is not asking for a "benefit," but rather for a faithful application of the hardship provisions of the Landmarks Law. The purpose of the provision is to protect landowners aggrieved by a landmark designation, if those landowners can show they are incapable of earning a reasonable return. Refusing to consider the full costs of renovating all of the apartments Stahl was required to renovate permits the LPC to, yet again, ignore substantial costs Stahl would incur, further divorcing the hardship test from economic reality. If the LPC is free to include income generated from newly-renovated apartments without even considering the costs to renovate those apartments, the hardship test becomes a farce.

D. A Proper Application of the Cost Approach To The Relevant Parcel Mandates The Conclusion That Stahl Cannot Earn A Reasonable Return

As explained above, the LPC was required to calculate Stahl's rate of return by (1) focusing only on the Subject Buildings as the relevant parcel; (2) applying the cost approach; and (3) including the full cost of renovating all 97 apartments without any made-up "self-imposed" hardship reduction. Its failure to do so was arbitrary, capricious, and contrary to law. Critically, had the LPC not made these three basic errors, it necessarily would have concluded that Stahl cannot earn a reasonable return of 6% of assessed value under any of the renovation scenarios. This is true even adopting the LPC's conclusions on every single other point—including the projected rental income figure, vacancy rates and collection loss, additional income,[20] post-

[20] The City suggests in passing that Stahl has not adequately proved the value of any TDRs. *See* Mem. at 46; *see also id.* at 34. But the hardship provisions define reasonable return in terms of the "net annual return," which itself is tied to the income generated from the ongoing operation of the property. *See* § 25-302(v)(3)(a) (defining net annual return in terms of "earned income" from "the improvement parcel"). This provision does not envision the use of a one-off sale of developmental rights to determine whether a particular property is capable of earning a

renovation operating expenses, and construction loan interest. *See* Stern Aff. Ex. 1.[21] Put another way, even if this Court were to agree with the vast majority of the City's arguments and calculations, the record is clear that a proper application of the cost approach to the relevant parcel would necessarily have shown that Stahl cannot earn a reasonable return.

Ordinarily, this would end the analysis; because the LPC's conclusion that Stahl could earn a reasonable return depended on these legal errors, its denial of Stahl's hardship application must be vacated. However, presumably acknowledging that its analysis was suspect, the LPC included an "alternative" scenario, in which it purported to evaluate Stahl's hardship application using the proper improvement parcel (Tax Lot 22), adopting the cost approach, and considering the renovation costs for all 97 vacant apartments. *See* Mem. at 35-37. Because the LPC concluded that Stahl could earn a reasonable return under this scenario, the City says the LPC's denial of the application was valid even accepting Stahl's position on the critical issues. *Id.*

But as Stahl made clear in the Petition, even though this alternative scenario purported to fix the errors in the LPC's analysis, it did not in fact do so. Most notably, the LPC used real estate taxes calculated using the income approach, not the cost approach. *See* Ex. 1; (*compare, e.g.*, R-2344 (including real estate taxes of $542,768 for "Apartments Only" scenario), *and* R-

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reasonable return. In any event, the City concedes that the LPC "did not assign [the TDRs] any specific value in its hardship analysis." Mem. at 26-27. This Court may not uphold an agency action on a ground not relied upon by the agency. *See* Pet. ¶ 130; *Scherbyn v. Wayne-Finger Lakes Bd. of Coop. Educ. Servs.*, 77 N.Y.2d 753, 758 (1991) ("[A] reviewing court . . . must judge the propriety of [an agency] action solely by the grounds invoked by the agency. If those grounds are inadequate or improper, the court is powerless to affirm the administrative action by substituting what it considers to be a more adequate or proper basis." (internal quotation marks omitted)). The existence of any TDRs, therefore, cannot save the LPC's flawed analysis.

[21] Exhibits 1 and 2 to the Stern Affidavit are compiled from numbers used by the LPC in the appendices to its final decision. (*See* R-2344-59). Accordingly, this information was before the LPC at the time of its decision, and constitutes part of the administrative record the LPC considered in denying Stahl's hardship application.

2349 (calculating real estate taxes of $542,768 for "Apartments Only" scenario under the income approach), *with* R-2351(calculating real estate taxes of $816,118 for "Apartments Only" scenario under the cost approach)). The LPC made this exact same error for every renovation scenario. (*Compare* R-2344-47, *and* R-2349, *with* R-2351; *compare* R-2352-55, *and* R-2357, *with* R-2359). Similarly, contrary to the City's claims, the LPC never calculated depreciation including the full cost of renovating all 97 vacant apartments. (*See* R-2348 (projecting depreciation as based on renovations to 53 apartments); R-2356 (same)). The LPC's cherry-picking produced an obviously irrational alternative calculation where: (1) in the denominator, assessed value was determined through the cost approach using renovation costs for 97 apartments; (2) for depreciation, assessed value was determined through the cost approach using renovation costs for 53 apartments; and (3) for real estate taxes, assessed value was determined through the income approach. Had the LPC's alternative scenario in fact done what the LPC said it would do—namely, used the cost approach consistently, including renovation costs for all 97 vacant apartments—the LPC necessarily would have concluded that under any renovation scenario, Stahl would earn below 6% of the Subject Buildings' assessed value. *See* Stern Aff. Ex. 1.[22]

E. The LPC's Refusal To Include Construction Loan Interest Was Based On An Erroneous Interpretation Of The Landmarks Law

In addition to the errors detailed above, the LPC also arbitrarily reduced the soft costs in all renovation scenarios based on an erroneous and indefensible interpretation of the Landmarks

[22] The City does not dispute that Stahl seeks in good faith to demolish the Subject Buildings and construct a new income-producing building if its application were granted. *See, e.g.*, Mem. at 2 (noting Stahl's "desire to demolish the Subject Buildings and construct a new high-rise building on the site"). However, it now asserts for the first time that Stahl failed to submit a proposed construction plan along with its hardship application, which it claims Stahl "was required to do." *Id.* at 48. But the Landmarks Law only requires that the applicant seek in good faith to construct a new building, not that the applicant include a construction plan when it files its application. *See* § 25-309(b)(1). Accordingly, Stahl has satisfied both requirements of the hardship test.

Law. Though the Court need not reach this issue in order to vacate the LPC's denial of Stahl's hardship application, the LPC's erroneous exclusion of construction loan interest from soft costs further demonstrates the LPC's arbitrary and misguided approach to Stahl's application.

The Landmarks Law requires the LPC to calculate the rate of return as "the amount by which the earned income yielded by the improvement during a test year exceeds the operating expenses of such parcel during such year, *excluding mortgage interest and amortization*." § 25-302(v)(3)(a) (emphasis added). The statute does not mention construction loan interest as a cost to be excluded from the calculation, and thus the exclusion of construction loan interest was contrary to law. *See* Pet. ¶¶ 109-10, 156. The City argues that the Court must defer to the LPC's interpretation because the Landmarks Law is somehow "silent" as to whether construction loan interest is included in the calculation. Mem. at 45-46. But simply because the statute does not explicitly mention construction loan interest does not mean it is "silent." *See, e.g.*, *UMG Recordings, Inc. v. Escape Media Grp., Inc.*, 107 A.D.3d 51, 58-59 (1st Dep't 2013) (statutory interpretation "maxim" of *expressio unius est exclusio alterius* "dictates that the specific mention of one thing implies the exclusion of others"). By listing "mortgage insurance" and "amortization" as expenses excluded from the rate of return formula, the statute necessarily implies that construction loan interest is included. Furthermore, whether construction loan interest is carved out of the statute is a pure question of statutory interpretation, and thus the LPC's interpretation is not entitled to deference. *See, e.g.*, *KSLM-Columbus Apts.*, 5 N.Y.3d at 312; Pet. ¶¶ 157-59; *supra* at pp. 22-23. And finally, while mortgage interest is an operating expense, construction loan interest is treated as a capitalized expense under GAAP and the Internal Revenue Code. *See* Pet. ¶ 156; 26 U.S.C. § 263A(f) (treating loan interest for development of real property as capitalized expense). It therefore makes no sense to treat construction loan interest the way mortgage interest is treated.

Notwithstanding this error, the LPC did consider an alternative scenario in which construction loan interest was properly included. (*See* R-2338). For the same reasons discussed above, that scenario itself was irrational and does not save the LPC's arbitrary denial of Stahl's hardship application. *See* Stern Aff. Ex. 2.

CONCLUSION

For the reasons set forth above, the City's motion to dismiss Stahl's takings claim should be denied, and the Article 78 petition to vacate the LPC's denial of Stahl's hardship application should be granted.

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Respectfully submitted,

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