SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK
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STAHL YORK AVENUE CO., LLC,

INDEX NO. 100999-2014

Plaintiff-Petitioner,

-against-

Justice Stallman

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.

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TABLE OF CONTENTS

INTRODUCTION

Petitioner, Stahl York Avenue Co., LLC, seeks to exempt itself from commonplace historic preservation legislation on the ground that its not-uncommon circumstances subject it to financial hardship in the form of loss of economic value of its property. Unmentioned by Petitioner is that it is totally unrealistic to think that a buyer of property can reasonably expect that the zoning, historic preservation status, building codes, and all manner of other property regulation affecting the property will remain unchanged over decades to come, or that, with change of rules, there might not be some loss of economic value of the property.

Such losses, if they occur, are costs of living and doing business in a civil society and rarely reach the level of a "taking" entitling the owner to exemption from regulation or, alternatively, to compensation.

The Landmarks Preservation Commission denied Petitioner's application for hardship relief, finding that Petitioner had failed to carry its statutory burden of proving that the property was incapable of earning a reasonable return.

The question here is whether there is something unique to this case that entitles Petitioner to special treatment. Amici submit that there is not.

There are two key issues on which Amici will focus:

1) Does the designation of Petitioner's property as a landmark so frustrate its reasonable investment-backed expectations or totally eliminate the economic value of its property as to constitute a taking? Answer: It does not. Petitioner had no "reasonable investment-backed expectation" to be free of landmark

designation, and has not demonstrated the requisite *total* loss of economic value of its property under the alternative *per se* test.

2) Did the Commission act arbitrarily or capriciously in concluding that the property is capable of earning a reasonable return so that it is not qualified either for special tax exemption or other amelioration of the financial consequences of designation, or to issuance of a permit to demolish on the basis of hardship? Answer: No. The Commission acted within its statutory authority and appropriately.

Petitioner's position threatens to weaken the Landmarks Preservation Law by allowing demolition of landmarks under watered down tests that would turn the takings clauses of the Federal and State Constitutions (Fifth and Fourteenth Amendments; Article I § 7 of the State Constitution) and the statutory hardship safety valve of the Landmarks Preservation Law into insurance policies against poor management and disappointed speculative dreams.

<u>Background and purpose of the Landmarks Preservation Law</u>.

The Landmarks Law (Admin. Code §§ 25-301 ff.) was adopted in 1965 in response to extensive and longstanding grassroots and political advocacy, as well as the catalyzing impact of the demolition of Penn Station.

In adopting the Landmarks Law, the City Council expressly recognized that "many improvements . . . having a special character or a special historical or aesthetic interest or value . . . have been uprooted, notwithstanding the feasibility of preserving and continuing the use of such improvements . . . and without adequate consideration of the irreplaceable loss to the people of the city of the aesthetic, cultural and historic values represented by such improvements." Admin. Code § 25-301(a). The City Council "declared as a matter of public policy that the protection, enhancement, perpetuation and use of [such] improvements . . . is a public necessity and is required in the interest of the health, prosperity, safety and welfare of the people." It established the Landmarks Preservation Commission to "effect and accomplish the protection, enhancement and perpetuation of such improvements. . . and of districts which represent or reflect elements of the city's cultural, social, economic, political and architectural history. . . ." Admin. Code § 25-301(b).

INTEREST OF AMICI

Amici are civic groups concerned with historic preservation issues, and elected officials representing the political districts in which the property at issue is located. The civic organizations represent various constituencies, ranging from the leading State preservation organization to community groups within the City.

Amici have in common a belief that the greatness of a city most often depends upon its respect for its past and its recognition that preservation of selected buildings and communities embodying the city's history provide comfort to its residents and reason for visitors to come and enjoy those elements of the city that distinguish it from other urban communities.

Amici recognize the importance of the City's Landmarks Preservation Commission and the extraordinary work it has done to identify, designate and protect worthy examples of the City's past.

Amici support the position of the Commission in its efforts to save the integrity of the City and Suburban Homes First Avenue Estate, an important example of an enlightened workers' housing movement active in the late 19th and early 20th centuries. The project consists of 15 six-story apartment buildings covering the entire block from First to York Avenues, and from East 64th to East 65th Streets. It is the product of wealthy and public spirited residents of the City who set out to build quality housing with reasonable rents with a view to earning a limited financial return. An important feature of the buildings is the use of large central light courts to provide natural light and air to all rooms and to the public stair wells, a marked deviation from the then-common cheek-by-jowl tenements lacking windows in many rooms. The sponsors meant to provide an example to be imitated by others.

It seems especially fitting today – as the City seeks new and vast expansion of the stock of low-cost housing – that we also preserve examples of historical efforts of a like nature to provide quality housing at reasonable prices.

1. Elected Officials: The following Amici represent political districts in which the First Avenue Estate is located.

Carolyn B. Maloney, Member of Congress, representing the 12th Congressional District of New York

Liz Krueger, New York State Senator, 28th District

Rebecca Seawright, New York State Assemblymember, 76th District

Ben Kallos, New York City Council Member

Gale A. Brewer is the President of the Borough of Manhattan, an elective office. As such, she has a significant interest in historic preservation of buildings within the Borough of Manhattan, including the City and Suburban Homes First Avenue Estate. Under the City's Charter, the Borough President is responsible for making "recommendations to the mayor and to other city officials in the interests of the people of the borough . . ." and establishing and maintaining "a planning office for the Borough to assist the borough president in planning for the growth, improvement and development of the borough; [and] reviewing and making recommendations regarding applications and proposals for the use, development or improvement of land located within the borough. . . ."

2. Civic Organizations:

Friends of the Upper East Side Historic Districts ("Friends"), founded in 1982, is an independent, not-for-profit membership organization dedicated to preserving the architectural legacy, livability, and sense of place of the Upper East Side. Friends regularly monitors, attends and testifies before the Landmarks Preservation Commission, Community Board, Design Commission and City Council in its effort to strike a balance between preservation and development on Manhattan's Upper East Side.

Friends led the effort to reassemble this full-block landmark site and testified in favor of designation of the Subject Buildings before the LPC on November 14, 2006. Friends was amicus curiae on the December 14, 2009 brief submitted to the New York State Supreme Court Appellate Division. Friends testified three times before the LPC, urging the denial of the hardship application on January 24, 2012, June 11, 2013, and November 12, 2013. Friends contracted and submitted two supportive economic feasibility studies from HR&A Advisors, an industry-leading real estate, economic development and energy efficient consulting firm.

The National Trust for Historic Preservation is a privately funded nonprofit organization, chartered by Congress in 1949, to further the historic preservation policies of the United States, and to "facilitate public participation" in the preservation of our nation's heritage. 16 U.S.C. § 468. With the strong support of almost 200,000 members and supporters nationwide, including over 14,000 members in New York, the National Trust works to protect significant historic sites and to advocate for historic preservation as a fundamental value in programs and policies at all levels of government. This includes challenges to local administrative decisions that have the effect of undermining or circumventing the integrity of local ordinances nationwide. In carrying out its mission, the National Trust has participated as a party or amicus curiae in more than 200 cases in federal and state courts since 1970.

The Preservation League of NYS is New York's statewide historic preservation advocacy organization. Founded as a not-for-profit membership organization in 1974, the Preservation League invests in people and projects that champion the essential role of historic preservation in community revitalization, sustainable economic growth, and the protection of New York's historic buildings and landscapes. Based in Albany, the League leads advocacy, economic development, and education programs all across the state in support of these goals. The Preservation League has frequently been involved as an amicus party in legal cases that challenge local administrative actions that undermine or circumvent the integrity of local preservation laws (e.g., revoking landmark designation, misapplication of exemption standards such as hardship or special merit, and significant procedural violations).

All of the organizations listed below testified before the Commission concerning its application for hardship relief under review here.

The Historic Districts Council is the advocate for all of New York City's historic neighborhoods. HDC works to ensure the preservation of significant historic neighborhoods, buildings and public spaces in New York City, uphold the integrity of New York City's Landmarks Law and further the preservation ethic. This mission is pursued through ongoing programs offering hands-on assistance to more than 500 community and neighborhood-based groups and through direct advocacy, public-policy initiatives, publications, educational outreach and sponsorship of community events.

Greenwich Village Society for Historic Preservation was founded in 1980 to preserve the architectural heritage and cultural history of Greenwich Village, the East Village, and NoHo. GVSHP is a leader in protecting the sense of place and human scale that define the Village's unique community. GSHP testified at each of the hardship hearings concerning the Subject Properties.

Landmark West! has worked to achieve landmark status for individual buildings and historic districts on the Upper West Side and to protect them from insensitive change and demolition.

Friends of First Avenue Estate is a neighborhood association that has been involved with the current matter since the First Avenue Estate was first designated in 1990. Members of the Friends of First Avenue challenged the Board of Estimate's modifications to the landmark site in 1990 but were unable to appeal the Supreme Court's decision upholding the BOE's modifications due to insufficient resources.

ARGUMENT

The case is cast by Petitioner as directly concerning two buildings at the eastern end of the First Avenue Estate complex which Petitioner has sought, and been denied, administrative permission to demolish. They are referred to herein as the "Subject Buildings." The 13 other buildings in the complex, also owned by Petitioner, are referred to here as the "Other Buildings." Amici endorse the Commission's position that the entire Estate should be treated as a unit and hardship should be based on the whole, not just a part.

POINT I

PETITIONER FAILS TO DEMONSTRATE THAT LANDMARK DESIGNATION RESULTS IN A TAKING IN THIS CASE

Petitioner offers two theories for its claim that the designation effects a taking of its property, for which Petitioner seeks an award of just compensation:

> First, that the designation has deprived the property of "virtually" all of its value.
>
> Second, that the designation has deprived Petitioner of its investment-backed expectation of being able to develop the property to its fullest potential.

As to the first theory, only a total deprivation of all economic value suffices to invoke the *per se* test under which a taking occurs because of impact on value, standing alone without other factors. Alleging loss of "virtually" all of the property's value falls short of the requisite standard.

As to the second theory, the investment-backed expectations test depends, among other things, on the owner's expectations being reasonable. Petitioner's own allegations confirm that they are not. Petitioner spent close to 40 years "expecting" that the subject properties would not be designated as landmarks (though the Landmarks Preservation Commission had clearly expressed its belief that they are eligible for designation), would not be down-zoned, and would not be otherwise adversely affected in the course of conventional land-use regulation. The investment-backed expectations test then requires that the owner have relied, with related investment, on that expectation. But Petitioner does not allege having done much in that regard.

It did nothing for the first 23 years of its ownership, other than continuing to make do with what it considered to be an unproductive investment. Then, for the next 15 years, Petitioner languidly waited for tenants to depart, avoided finding new tenants for the vacated apartments, and avoided spending on renovations which would increase the rental value.

Petitioner did not suffer because landmark designation interfered with a reasonable investment-backed expectation that it would be free of landmark designation. Rather, Petitioner made a business judgment that it could gamble that there would be no landmark designation, and that it could tear down these historically significant buildings – and lost.

A. Current state of regulatory takings law.

As stated by the United States Supreme Court, there are "two relatively narrow categories" of "*per se* takings for Fifth Amendment purposes. First, where government requires an owner to suffer a permanent physical invasion of her property – however minor — it must provide just compensation. See Loretto v. Teleprompter Manhattan CATV Corp., 485 U.S. 419 (1982) (state law requiring landlords to permit cable companies to install cable facilities in apartment buildings effected a taking). A second categorical rule applies to regulations that completely deprive an owner of '*all* economically beneficial us[e]' of her property. Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992) (emphasis in original). [The Supreme Court] held in Lucas that government must pay just compensation for such 'total regulatory takings,' except to the extent that 'background principles of nuisance and property law' independently restrict the owner's intended use of the property. *Id.*, at 1026-1082." Lingle v. Chevron U.S.A. Inc., 544 U.S. 528, 538 (2005).

The Lingle opinion further explains that, in all other cases (except the "special context of land-use exactions"),[1] "regulatory takings challenges are governed by the standards set forth in Penn Central Transp. Co. v. New York City, 438 U.S. 104 (1978)." (544 U.S. at 538). "[T]hese three inquiries (reflected in Loretto, Lucas, and Penn Central)," the Court says, "share a common touchstone. Each aims to identify regulatory actions that are functionally equivalent to the classic taking in which government directly appropriates private property or ousts the owner from his domain. * * * A permanent physical invasion, however minimal the economic cost it entails, eviscerates the owner's right to exclude others from entering and using her property – perhaps the most fundamental of all property interests. [Citing Loretto and other cases]. In the Lucas context, of course, the complete elimination of a property's value is the determinative factor. See Lucas, 505 U.S. at 1017 (positing that 'total deprivation of beneficial use is, from the landowner's point of view, the equivalent of a physical appropriation'). And the Penn Central inquiry turns in large part, albeit not exclusively, upon the magnitude of a regulation's economic impact and the degree to which it interferes with legitimate property interests." (544 U.S. at 539-540).

New York courts employ much the same analysis, determining whether a regulation goes "too far" by considering the factors identified in Penn Central. Consumers Union of U.S., Inc. v. State, 5 N.Y.3d 327, 357 (2005).

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[1] This refers to such cases as Nollan v. California Coastal Commission, 483 U.S. 825 (1987), Dolan v. City of Tigard, 512 U.S. 374 (1994), and Koontz v. St. John's River Water Management District, 133 S.Ct. 2586 (U.S. 2013), which find a taking where government conditions issuance of a permit on the applicant providing some benefit in exchange.

B. Petitioner has not shown a *per se* taking based on total deprivation of economic value.

Petitioner alleges that the designation has "destroyed virtually all economic value in the properties."

"Virtually" does not suffice. Lucas and Lingle require that regulation reduce the value of the property to absolutely zero before the *per se* rule can come into play. The New York Court of Appeals has approvingly quoted Lucas on this point. Consumers Union, supra, 5 N.Y.3d at 387; Gazza v. New York State Dep't of Environmental Conservation, 89 N.Y.2d 603, 616 (1997). The older formulation of Spears v. Berle, 48 N.Y.2d 254, 262 (1979) (a taking might be found solely on the basis that the regulation destroys "all but a bare residue of its value"), should be deemed to have been laid to rest by Consumers Union and Gazza. The uncertainty as to what exactly triggers application of a *per se* rule turns a precisely aimed tool into a dangerous weapon.

Where Spears v. Berle, 48 N.Y.2d 254, 262 (1979), remains valid is in its requirement that valuation for the purpose of showing loss of value in a takings case must be proven through dollars and cents evidence.

Petitioner's evidence on the subject is conclusory. In addition, it is strongly rebutted by the City's evidence (to be discussed in Point II) that, far from being reduced to zero, there is value based on a significant return that could be realized with proper management.

C. Petitioner has not shown that the designation interferes with its investment-backed expectations.

The absence of a *per se* taking requires consideration whether a taking has occurred under the Penn Central standards. Penn Central holds that whether a taking has occurred is a fact-intensive issue in which many factors may play a role. One of those is whether the regulation has dashed the owner's investment-backed expectations, and that is the single factor invoked by Petitioner. This is not a test in the sense that, if stated criteria are satisfied, the automatic result follows that a taking has occurred. Disappointed investment-backed expectations are simply a factor in weighing whether the regulation unfairly imposes on a single owner economic burdens which ought, in fairness and justice, to be borne by the public as a whole. See Penn Central Transp. Co. v. New York City, 438 U.S. 104, 124 (1978). That is the ultimate test.

Notably, Petitioner does not mention that the investment-backed expectations factor necessarily presupposes reasonable reliance. Petitioner uses the phrase, "investment-backed expectations," as if the most far-fetched dream, if fervently believed in, protects the dreamer against a rude awakening. So Petitioner argues that its property should not be subject to landmark designation in 2007 because, there was no designation 30 years earlier in 1977 when Petitioner took title with the vague idea that, some decades later, it might redevelop the site. Petitioner further argues that, without any further investment, it "relied," in 1990, on the Board of Estimate's carve- out of the Subject Buildings from the Landmarks Preservation Commission's designation in that year of the entire block. Petitioner no doubt knew this as soon as it happened. Petitioner was no doubt also aware that the First Department shortly thereafter held exactly such a carve-out, on precisely the same facts, to be illegal and void. Petitioner of course also knew that the Commission redesignated the Subject Buildings in 2006, and that the First Department soon after ruled that the Commission's redesignation of the formerly carved-out buildings is valid.[2] There was no basis in any of these events for having a realistic expectation that Petitioner could demolish the Subject Buildings and rebuild.

Seemingly, Petitioner assumes that the absence of the word "reasonable" in Penn Central's formulation of the "investment backed expectations" factor turns "expectation" into something akin to a pipedream earnestly believed in. But, in a real world, there can be no legitimate "expectation" other than one based on facts, experience and reason, at least none cognizable in a legal system that depends upon uniform application of justice rather than each person's subjective interpretation of the law.[3] Petitioner cannot justifiably pretend that it may

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[2] At the time of designation in 1990, the Commission recited why the property was worthy of designation, and designated the entire block as a single landmark with a single "landmark site" (also the entire block). (See Designation Report, Waters Affirmation, 12-12-14, pg. 25). The Appellate Division ruled, as to the simultaneous designation of the City and Suburban York Avenue Estate, located further uptown, and similar in nature to the First Avenue Estate designation, that the Board of Estimate's carve-out from the integral designated landmark and landmark site, of a few buildings in the York Avenue Estate was illegal. (See decision in Matter of 400 East 64/65th Street Block Association, et al. v. City of New York, 183 A.D.2nd 531 (1st Dep't 1992), appended to Waters Affirmation as Exhibit C). Although the First Avenue Estate was not a party to the appeal, the Court's rationale ("The position that a part of the complex should be considered worthy of designation as a landmark for its historical, architectural, cultural and aesthetic value and part should not is inherently inconsistent") clearly applied to the First Avenue Estate, as well as the York Avenue Estate. The same Court confirmed precisely that after the redesignation of the Subject Buildings, holding that the rationale of the earlier decision applied and that the Landmarks Commission, like any other governmental agency, is always free to correct prior error or change prior decisions for other good reason. It based that ruling on Matter of Charles A. Field Delivery Serv. (Roberts), 66 N.Y.2d 516 (1985), a decision obviously available to Petitioner since its promulgation in 1985. (See Matter of Stahl York Avenue Co. LLC v. City of New York, 76 A.D.3d 290 (1st Dep't 2010), reproduced as Waters Affirmation, Exhibit F).

[3] Even if some subjectivity could be tolerated, Petitioner is hardly in a position to exploit such toleration. Petitioner (through its parent or other affiliated entities) was familiar with the

hold property for close to 40 years in the "expectation" that it will never be down-zoned, it will never be subject to landmark designation,[4] the building code will never become more stringent, or that countless other environmental and land-use laws and regulations will never adversely affect its property. Penn Central dismissed just such thinking as "quite simply untenable." (444 U.S. at 130) (referring to the railroad's claim that designation denied it the ability to exploit a property interest that it had "believed" was available for development)

Only a year after the Penn Central decision, the Court, in Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979), quietly restated Penn Central's "investment-backed expectations," as "reasonable investment backed expectations." That phrase has remained quite constant ever since. See Lucas, 505 U.S. at 1034 (Kennedy, J. concurring); Palazzolo v. Rhode Island, 533 U.S. 606, 617, 619, 626 (2001), and at page 655 (Breyer, J. dissenting).

Kaiser Aetna solidly demonstrates by its facts and holding that "reasonable investment backed expectations" must be based, not on a dream, but on (a) unquestionable fact or law, and (b) reliance in the form of significant actual investment directly related to the premise that that fact or law has not changed at the time of investment. In Kaiser Aetna, the plaintiff acted on immutability of Hawaii's property law recognizing a certain tidal pond as private property – immutable in the sense that lifting it would almost certainly constitute a taking as a direct conversion of private property for public use. It acted on the reasonable expectation that creating a marina-oriented community on the pond, connected to the ocean by a newly dredged inlet, would not change its title and rights in the property. Subsequently, the Federal

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Landmarks Law, as a result of owning other landmark properties, and was a sophisticated real estate operator. (See City Memorandum of Law pg. 59).

[4] Petitioner acquired the property in 1977. The Landmarks Preservation Law was adopted in 1965.

Government asserted that Kaiser Aetna's acts had turned the premises into navigable waters and thereby conferred on the Federal Government a navigational servitude allowing the public to enter the pond and use it. The Court held that the Government could not, on the basis of these facts, convert what was private property into public property by eliminating the right to exclude, one of the most fundamental attributes of private property.

Petitioner cannot legitimately claim that it acted on the basis of reasonable investment-backed expectations in the sense the factor is phrased in Penn Central, and as its application is illustrated by Kaiser Aetna.

D. Petitioner has not shown that any loss of value caused by designation establishes a taking under Penn Central.

Even though Petitioner appears to rely on the per se standard for taking by "virtually" total deprivation of value, we will comment briefly on the possibility that a taking claim is asserted under Penn Central on the ground that designation's economic impact is so extensive as to amount to a taking.

The Penn Central opinion does not favor such a claim. It particularly notes that diminution in value caused by regulation, standing alone, does not constitute a taking, even where the diminution is very substantial, citing cases where regulation reduced value by as much as 75% or 87.5%. (438 U.S. at 131). Government may even require total destruction of severable property, as in the case of cedar trees subject to disease that could infest nearby apple orchards (438 U.S. at 125-126, citing Miller v. Schoene, 27 U.S. 272 (1928)). As discussed above, Lucas and Lingle confirm that the Penn Central factor analysis applies only where the Lucas *per se* test does not apply because there is not a "complete" loss of economic value. Otherwise, the courts must look to whether other factors, either independently, or in combination with reduction of economic value, have the kind of impact that renders a regulatory action directly equivalent to a physical taking. Penn Central specifically identifies as such other factors (a) interference with investment-backed expectations, and (b) the character of the government interference, such as regulation of private property in order to serve uniquely governmental functions, as opposed to adjustment of private interests of individuals as among themselves.[5]

The Court in Penn Central is rather specific about partial loss of value as a result of landmark designation (the subject of Penn Central) not constituting a taking. It takes as its fundamental premise that the purpose of applying the factors it lists as indicia of possible regulatory taking is to determine whether the governmental action does not force "some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." (438 U.S. at 123-124, citing Armstrong v. United States, 364 U.S. 40, 49 (1960)).

But the Court also observes that the nature of historic preservation legislation is not to shift a public function to private parties. "The consensus is that widespread public ownership of historic properties in urban settings is neither feasible nor wise. Public ownership reduces the tax base, burdens the public budget with costs of acquisitions and maintenance, and results in the preservation of public buildings as museums and similar facilities, rather than as economically productive features of the urban scene. See Wilson & Winkler, The Response of

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[5] As Penn Central puts it, "A 'taking' may more readily be found when the interference with property can be characterized as a physical invasion by government, see, e. g., United States v. Causby, 328 U.S. 256 (1946) (airspace used by government planes for landing at airport), than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good." (438 U.S. at 124). It cites Hadacheck v. Sebastian, 239 U.S. 394 (1915) (upholding law prohibiting owner from conducting otherwise lawful brickyard operation where such use was inconsistent with neighboring uses) as an example of a regulatory non-taking.

State Legislation to Historic Preservation, 36 Law & Contemp. Prob. 329, 330-331, 339-340 (1971)." (438 U.S. at 109).

The Court adds that, "While the [New York City] law does place special restrictions on landmark properties as a necessary feature to the attainment of its larger objectives, the major theme of the law is to ensure the owners of any such properties both a 'reasonable return' on their investments and maximum latitude to use their parcels for purposes not inconsistent with the preservation goals." (438 U.S. at 110).

We do not propose to quibble over the possibility that there might be some state of facts under which severe regulatory impact on value, coupled with some other compelling factor, might, under Penn Central's ad hoc factors-oriented approach, so uniquely impose public burdens on private shoulders as to cross the takings divide. The present case is hardly that exemplar. Not only is this a typical designation whose appropriateness has been judicially acknowledged,[6] but, as in Penn Central, it closely conforms to the pattern of regulation among private uses to protect the general public welfare, as opposed to regulation to facilitate a uniquely public function. Moreover, the circumstances demonstrate that there are ample alternative explanations for the owner's perceived economic hardships including intentional warehousing of vacated units in the Subject Buildings since at least as early as 2000, (Petition Pars. 26, 38, 53, 80, 105; Answer Par. 252); the need to remove rent-protected tenants for whom substitute housing must be found (Petition Par. 62); an intentional program of deferred maintenance inevitably leading to reduced market attractiveness in the near term and higher costs when the

[6] See Stahl York Avenue Company LLC v. City of New York, Slip Opinion, Waters Affirmation Exhibit E; and affirmance on appeal, 76 A.D.3rd 290 (1st Dep't 2010), Waters Affirmation Exhibit F.

owner must renovate in the future to correct the consequences of deferred maintenance (Petition Pars. 39, 53); and intentional destruction of exterior architectural detail of the buildings while the re-designation process was pending, a factor that would also likely cause market depreciation (Answer Pars. 160, 162).[7] It is hard to avoid the inference that Petitioner is largely responsible for whatever loss of value it may have suffered.

POINT II

THE LANDMARKS PRESERVATION COMMISSION HAS FOLLOWED APPROPRIATE PROCEDURES IN DETERMINING THAT THE PROPERTY IS CAPABLE OF EARNING A REASONABLE RETURN; ITS DECISION IS NOT ARBITRARY OR CAPRICIOUS

Petitioner poses an array of objections to the Commission's methodology in passing on Petitioner's application for a certificate of appropriateness to demolish pursuant to Admin. Code § 25-309 on the ground of inability of the property to earn a reasonable return as a result of the designation. It appears to us that the Commission has amply and satisfactorily explained its reasoning, and we see no reason to repeat its arguments. What may be helpful to the Court is a discussion of what latitude the Landmarks Law allows the Commission for application of appraisal methodology other than that specifically set forth in the Law. Such latitude is extensive.

[7] As to the removal of architectural detail, see Matter of Stahl York Avenue, supra, 76 A.D.3d at 295.

A. <u>The applicable provisions of the Landmarks Law</u>.

Section 25-309 authorizes the hardship exemption procedure. To the extent relevant here, it requires that "the applicant establish[...] to the satisfaction of the commission that (a) the improvement parcel (or parcels) which includes [the subject] improvement, as existing at the time of filing of [the owner's request for a permit to demolish], is not capable of earning a reasonable return."

The details of methodology are, at least partially, left to definitions set forth in a general definitions section of the law, Section 25-302.

Under subdivision c of that Section, "capable of earning a reasonable return" means "Having the capacity, under reasonably efficient and prudent management, of earning a reasonable return. For the purposes of this chapter, the net annual return, as defined in subparagraph (a) of paragraph three of subdivision v of this section, yielded by an improvement parcel during the test year, as defined in subparagraph (b) of such paragraph, shall be presumed to be the earning capacity of such improvement parcel, in the absence of substantial grounds for a contrary determination by the commission."

The subject "improvement parcel" is "The 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 . . . ." (§ 25-302(j)).

The "test year" is "(1) the most recent full calendar year, or (2) the owner's most recent fiscal year, or (3) any twelve consecutive months ending not more than ninety days prior to the filing . . . of the request for a certificate. . . ." (§ 25-302(v)(3)(b)).

"Reasonable return" means, in its simplest terms, "a net annual return of six per centum of the valuation of an improvement parcel." (§ 25-302(v)(1)).

Subdivision v goes on to provide that "(2) Such valuation [of the improvement parcel] shall be the current assessed valuation established by the city, which is in effect at the time of the filing of the request for a certificate of appropriateness," subject to an exception which we do not understand to have been invoked here for situations where there has been a sale of the affected property.

Finally, "Net annual return shall be the amount by which the earned income yielded by the improvement parcel during a test year exceeds the operating expenses of such parcel during such year, excluding mortgage interest and amortization, and excluding allowances for obsolescence and reserves, but including an allowance for depreciation of two per centum of the assessed value of the improvement, exclusive of the land, or the amount shown for depreciation of the improvement in the latest required federal income tax return, whichever is lower; provided, however, that no allowance for depreciation of the improvement shall be included where the improvement has been fully depreciated for federal income tax purposes or on the books of the owner." (§ 25-302(v)(3)(a)).

Upon making a determination of "hardship" under Section 25-309, the Commission then must make an effort to relieve the hardship by tax or other relief. This obligation, of course, did not come into play as the Commission ruled that there was no "hardship."

B. Construction of the "reasonable return" provisions.

One could, as Petitioner does, at least when convenient, construe the foregoing formula for determining "reasonable return" as a strict Diktat from which there may be no deviation. Thus, Petitioner insists that the formula must be applied not to the entire block but to the single tax lot on which the subject improvement is located (see subdivision j, and Paragraphs 132-138 of the Petition); and that construction interest incurred in projected renovations must be included in expenses because it is not "mortgage interest" (see subdivision v(3)(a); Petition Pars. 107-112); and that the Commission relied on the operating expenses of the Other Buildings rather than the Subject Buildings alone, thereby, in Petitioners' opinion, understating the operating expenses used in the calculation (Petition Par. 160).

On the other hand, going beyond a literal construction of the specifically stated tests in the statute, Petitioner includes in the denominator the assessed value of the improvements, not as actually used in the test year, but as it would be revised to reflect the improvements which are being included for purposes calculating projected rents. And, Petitioner is not content to use the method used by the Department of Finance to adjust the assessed value for improvements (increased rental income), but insists that the adjustment must be based on the cost incurred for the improvements. (See Petition Pars. 90-101, 139-149).

Alternatively, one could, as the Commission evidently made every effort to do, construe and supplement the statutory formula to achieve a rational and accurate estimate of projected reasonable return under circumstances that are really not contemplated by the statutory formula. More specifically, the statutory formula, most narrowly construed, relates to a simple situation where the facts are static: there is an improvement with a known tax assessment; it has known income and expenses; and no changes are contemplated. That, obviously, is not the present situation.

Literal construction is clearly not intended by the statutory reasonable return provisions. At least two factors support this conclusion:

First, "capable of earning a reasonable return" means "Having the capacity, *under reasonably efficient and prudent management*, of earning a reasonable return." (§ 25-302(c), emphasis added). Unless the Commission is satisfied that management during the test year (or as earlier management may have affected the results of the test year) has been "reasonably efficient and prudent," it will be necessary to adjust figures to take into account what the results would have been with reasonably efficient and prudent management. The statute does not prescribe how this is to be done, perhaps for the obvious reason that the method will depend upon the nature and specific impacts of the particular inefficiency and imprudence.

Second, the net annual return yielded by an improvement parcel is "presumed to be the earning capacity of such improvement parcel, *in the absence of substantial grounds for a contrary determination by the commission*." (§ 25-302(c), emphasis added). In other words, the statutory scheme is expressly subject to the qualification that the Commission may find it inappropriate in a particular situation.

The Commission was, therefore, fully justified in adjusting the particulars of the test to accomplish the test's purpose in a situation far more complex than is addressed by a rigidly narrow reading of the statutory formula. To begin with, it sought to treat the entire block as the parcel for which reasonable return must be determined. The two Subject Buildings are part of a group of 15 similar buildings that are all operated in great measure as a business unit.

A single heating system serves the entire block; laundry services are offered to tenants of the Subject Buildings at locations in Other Buildings; management and renting services are handled on a coordinated basis through a single office; and a high vacancy rate is maintained in the Other Buildings for the evident purpose of warehousing enough apartments to accommodate remaining tenants in the Subject Buildings just before demolition when Petitioner would be legally obligated to provide housing for them. Reflecting these coordinated and joint operations, Petitioner files property tax information with the City's Department of Finance on a composite basis for all the Buildings. (See Answer Par. 253). Such evidence suggests that it would be difficult to compute a rate of return using only figures from the Subject Buildings, and would likely produce inaccurate results. Yet, Petitioner would not cooperate in presenting its claim on the basis of a single operation covering all 15 buildings comprising the First Avenue Estate. The Commission declared that it determined the entire block to be the applicable "improvement parcel," and that Petitioner had failed to adduce sufficient information to support a finding of lack of reasonable return for the entire block. The Commission, therefore, properly denied the application. (Decision May 20, 2014 pg. 14). The Decision, nevertheless, proceeded to make an analysis of the available information concerning the Subject Buildings. It determined that, in each instance, the estimated net return under various scenarios posited by the Petitioner, would exceed 6% of the assessed value, adjusted to take into account appropriate renovation expenses that the Department of Finance would apply to recompute the assessed value. The Commission, therefore, also denied the application on this second ground.

Moreover, the statute requires adjustment to take into account anything short of "efficient and prudent" management. Here, for many years, management appears to have been "efficient and prudent" only in the sense of answering to the interest of the owner in vacating the

Subject Buildings, allowing them to deteriorate, and demolishing them and building something more profitable. Under the circumstances, a simplistic application of the limited statutory formula would have been utterly irresponsible.

The allegations of the Petition do not convince us that more substantive judgments of the Commission were arbitrary or capricious. For example,

The Commission preferred to compute the rate of return by considering the Subject Buildings together with the Other Buildings. (It also covered the possible risk by computing the return of the Subject Buildings alone, and determined that the Subject Buildings are capable of earning a reasonable return, though possibly at a lower rate than is achievable in combination with the Other Buildings.) Section 25-309 offers flexibility in selection of the applicable "improvement parcel(s)." The alternative singular or plural formulation seems to take into account the possibility not only that the improvements at issue might cover more than one tax lot, but that the improvements at issue might be operated, as in the present case, together with other improvements on other tax lots in such a manner that a reasonably accurate picture of earning capacity will not result from a calculation of the subject improvement independently. Granted, the definition of "improvement parcel" in Section 25-302(j) seems to require that the subject "improvement parcel" be "treated as a single entity for the purpose of levying real estate taxes," and that may conflict with the Section 25-309, the result is not that Section 25-309 should be ignored, but that the two should be harmonized, for example by construing Section 25-302(j) as implicitly acknowledging that it is subordinate to the purposes of Section 25-309 and, therefore, qualified by any inconsistent provision of that section. It should be noted that, under Federal law applicable to computing loss of value in a takings situation, the owner is prohibited from manipulating the result by picking the most favorable possible definition of the scope of property affected. The definition of the affected property must fairly reflect the realities of operation and interdependence.[8] So, one cannot obtain relief from a moratorium on developing real property simply by claiming that one segment of the property – the temporal interest consisting of the moratorium period – has been taken. Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency, 535 U.S. 302, 331 (2002). As the Court stated in Penn Central: "Takings jurisprudence does not divide a single parcel into discrete segments and attempt to determine whether rights in a particular segment have been entirely abrogated." 438 U.S. at 130-31. . This may be relatively simple to apply when the "parcel" and the entire related series of buildings comprise a single tax lot. Where that is not the case, as here, the agency first, and then the Court, should consider whether assessment of the effect of regulation on the tax lot alone provides a true picture of the impact. The New York Court of Appeals in its evaluation of Penn Central's case took such an approach when it observed that assessment of the impact of landmark designation on the Terminal building itself must take into account the railroad's ownership of hotels and office buildings in the immediate area that benefit from the Terminal operation. Penn Central Transp. Co. v. City of New York, 42 N.Y.2d 324, 333, 336 (1977). That reaches far beyond what the Commission did here which is simply to treat a series of buildings that were built by a single owner, with a single purpose, and have been operated as a single unit, is if they are what they appear to be, a single parcel.

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[8] A number of factors that may be considered in establishing what constitutes the proper "parcel" for which to determine adverse impact of regulation are presented in District Intown Properties Limited Partnership v. District of Columbia, 198 F.3rd 874, 880-883 (D.C. Cir. 1999), cert. denied, 531 U.S. 312 (2000), and see decision below, 23 F. Supp. 2d 30, 35-36 (D.C. Dist. 1998). Significantly for present purposes, these Courts hold that denial of permission to build on eight lots, though it may render those eight lots valueless in themselves, is not a *per se* taking because the historical common ownership and association of those lots with a ninth lot containing a large apartment building, and the design and operation of the eight lots as a broad lawn benefiting the ninth lot, required that the financial impact of regulation be judged as to the entirety of all nine lots.

Because, among other factors, the Subject Buildings have been operated jointly with the Other Buildings, they share management, the heating equipment for the entire tract is located in the Other Buildings, and rental (or vacating) of units is coordinated, by a single rental office, in order to reduce occupancy in the Subject Buildings to prepare for demolition, while also reducing occupancy in the Other Buildings to make vacancies available to accommodate remaining tenants in the Subject Buildings whom the Petitioner has statutory responsibility to house, the Commission had good reason to treat the entire group as one. (See Answer Pars. 249-252). The designation of the entire group as a single landmark on a single landmark site also supports the Commission's legal position. (See original designation, Waters Affirmation Exhibit A pg. 25; amendment to restore designation of subject buildings, Waters Affirmation Exhibit D pg. 5).

Petitioner complains that the Commission used projected income from the buildings as they would be renovated to determine what the new assessed value would be, but should, in Petitioner's opinion, have used the cost of renovation. The Commission's response that it inquired of the Department of Finance what method DOF uses, and applied that method, seems at least presumptively legitimate, and Petitioner does not adduce sufficient arguments to prove otherwise.

Petitioner complains that the Commission used neighborhood vacancy rates to downwardly adjust the total theoretical revenue if the renovated buildings were fully rented, and that the neighborhood vacancy rates did not reflect conditions at the Subject Buildings or Other Buildings. (Petition Par. 161). But, if, as the Commission found, the vacancy rates at the Subject Buildings and Other Buildings were artificially high because Petitioner chose not to rerent vacated apartments in the Subject Buildings in view of its intent to demolish, and chose not to rerent vacated apartments in the Other Buildings in order to bank vacant apartments to receive remaining tenants from the Subject Buildings whom Petitioner would have to provide housing for upon evicting them, Petitioner surely had a heavy burden of proving that its preference for choice of vacancy rate would be more accurate than the Commission's choice of a neighborhood rate.

Finally, Petitioner complains that the Commission evidenced prejudice because some Commissioners made individual comments at the hearings that reflected concern for preserving buildings that have been duly landmarked, and whose landmark designation has been sustained by the Council and the courts. (Petition Pars. 45, 64-65). Such criticism is misplaced. Some leeway in debate must be tolerated simply in order to assure rigorous consideration by the Commission as a whole. What ultimately counts is whether the decision on which a vote is taken is, within its four corners, well-considered and fair, or is arbitrary and capricious. At least equally important is that the Commission clearly has a fundamental duty, stated in strong terms in the Landmarks Law (Section 25-301), to promote the preservation of landmark quality structures for the benefit of the general public and the welfare of the City, and zealously to protect the integrity of designated landmarks and historic districts. Its additional duty to permit demolition in the unfortunate event that a landmark is determined to be incapable of earning a reasonable return, plus the inability of the Commission to develop and effectuate a plan to avoid demolition by, for example, reducing taxes on the affected improvement or arranging its sale, must be exercised in utmost good faith. But the latter duty by no means eliminates the former, nor the appropriateness of expressing concern for the general duty of preserving.

CONCLUSION

Petitioner has not met the standards to obtain relief in the form of either permission to demolish or entitlement to just compensation for a regulatory taking.

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Respectfully submitted,

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