

Economic Infeasibility: A Rare and Complicated Defense

By Adam Leitman Bailey and Dov Treiman

In what is commonly known as an HP action, tenants can bring a court proceeding against a building owner asking the court to order the owner to make necessary repairs and correct code violations. However, in some circumstances, forcing an owner to make the ordered repairs could cause the owner severe economic distress. In such circumstances, the owner may attempt to defend itself by raising the so-called “economic infeasibility” defense, in essence stating that the cost of correcting the violations will exceed the value of the building after making the repairs. It is a rare defense because is difficult to establish, and it requires total disclosure of an owner’s finances. It is, however, in many cases, the only available defense against making the repairs.

Because the lower courts are hostile to the defense and it is expensive to establish, the Department of Housing Preservation and Development (HPD) will often find it easy to circumvent, unless the owner is thoroughly committed to this lengthy and costly process. Given the lower courts’ hostility, an owner raising an economic infeasibility defense should not expect victory at the trial court level, an appeal will likely be necessary.

The idea behind the economic infeasibility defense is that the Fifth Amendment of the U.S. Constitution prohibits the government from taking private property without just compensation, meaning that the government cannot require someone to stay in a losing business. While the courts have had some trouble in deciding how to evaluate a building’s costs and revenues when determining “economic infeasibility,” it appears that if the repairs ordered will cost more than the estimated value a sale of the building would produce after the required repairs are effected, the court cannot order the repairs. The owner does not necessarily have to show that it is seeking to sell the building. The owner just has to demonstrate what the honest arm’s length price of the building if fully repaired would be, and then compare that amount to the cost of the repairs.

That said, the courts require a full economic analysis of the building. While it would seem that the only factors the court should consider would be the fair market value of the building on the open market and the cost of the repairs, the court will want to see the computation of the fair market value, which will require a full cash flow-analysis, including the rent roll, profit and loss statements, and a thorough engineering analysis. That level of analysis can be enormously expensive, and the owner will want to evaluate whether freeing the building from the court ordered repairs will quickly enough amortize the upfront expense of assembling the proof.

Defense Applies to Repairs, Not Tenant’s Right to Stay

Economic infeasibility operates to exempt the owner only from a court’s Order to Correct, not to exempt the owner from a rent-

regulated tenant’s right to remain in the apartment. The owner remains liable for whatever damages the tenant may claim and, of course, an abatement of the rent. However, these claims are typically tiny compared to the other things that could be happening with the building. So, while the owner may not be ordered to repair the building, that does not automatically mean that the owner can remove the remaining tenants. Usually, that removal will require an application to the Division of Housing and Community Renewal for permission to demolish the building.

The defense will not be heard by a court where the economic woe of the building is self-inflicted. As one court stated in *Eyedent v. Vickers Management and HPD*, 150 AD2d 202 (First Department 1989), “[i]n view of the [owners’] business acumen in this field, we find that the alleged economic hardship the [owners] now face in making the repairs required by the trial court order was self-inflicted, since the facts adduced at the trial indicate that the need to make such repairs could have been anticipated.” Unless it is indisputable that the economic difficulties of the building came from an outside source, such as a fire that spread to the building from a neighboring building, an owner should expect HPD to claim that the defense is invalid because the owner created the problem for itself. As another court wrote in *Rodriguez v. Cziment*, 20 HCR 222A, NYLJ 4/22/92, 25:5 (Civ Kings), “[s]ome portion of the economic hardship respondent now faces was self-inflicted. . . . The fact that respondent’s neglect of the premises contributes to the substantial expenditure necessary to repair the property should not inure to his benefit.” Substantially less clear is whether any insurance proceeds the owner collects will count against the owner when doing the economic infeasibility arithmetic, but the better view of the law is that since the question is the building’s economic viability rather than its owner’s, insurance should not be a factor.

For the defense, the court will consider only costs associated with removing the violations. Cosmetic work or enhancement of the premises is not part of the calculation.

Proof Includes Documentation and Expert Testimony

In order to establish the defense, the owner will have to prove:

- (1) The current value of the building;
- (2) The cost of the repairs that would be ordered, including materials and labor, or of restoring the building;
- (3) The assessed value of the building;
- (4) Any current offers for the property;
- (5) The buildings financial condition, shown by its operating statement of the premises, including the rent roll;

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- (6) The total economic viability of the building;
- (7) The income tax consequences of the repairs;
- (8) That the alleged economic hardship the owner now faces in making the needed repairs was not self-inflicted by its failure to properly maintain the building over the years; and
- (9) That the owner did not violate its legal obligations or withhold services illegally to force residents to leave.

To establish these proofs, the courts require documentation and testimony from accountants and other experts who must state the bases of their conclusions.

HPD is entitled to “discovery” when an owner advances an economic infeasibility defense. Few owners would welcome the kind of delving analysis by government accountants that this could entail, but if the owner is unwilling to turn over the necessary records, the right to assert this defense vanishes.

In the right circumstances, economic infeasibility is a viable defense to HP proceedings, but an owner must be willing to present thorough and convincing economic data, full accounts of business operations, and expert witnesses. And that is only the first step. The owner also must understand that victory is not likely until an appeals court hears the case, adding to the cost of an already expensive process that should be expected to take years. ♦

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