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Part I: How To Overcome Tenant Resistance To An MCI Application

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I. General Overview

Major Capital Improvement Increases (MCI's) are a concept that parties can contract for if they are not subject to rent regulation. However, generally speaking, unregulated residential tenants rarely do contract for them. They are therefore, in a practical sense, uniquely belonging to the world of rent regulation and are a means whereby landlords can profit from the installation of new or replacement systems in the building complex.

In regulated housing, a landlord may only obtain an MCI upon application to the New York State Division of Housing and Community Renewal (DHCR).

While the Rent Stabilization Code (RSC) lists the most common of the systems eligible for MCI treatment, any building system can qualify, provided that it is:

(a) deemed depreciable under the Internal Revenue Code, other than for ordinary repairs; and

(b) is for the operation, preservation and maintenance of the structure; and

(c) is an improvement to the building or to the building complex which inures directly or indirectly to the benefit of all tenants, and which includes the same work performed in all similar components of the building or building complex, unless the owner can satisfactorily demonstrate to the DHCR that certain of such similar components did not require improvement

If the system is not on the RSC list, there is a procedure the landlord can employ for qualifying it as well. However, it is very rare that off-list systems are installed and therefore unnecessary to discuss them here.

MCI's are written into the rent stabilization system as a means of incentivizing the landlord to upgrade the building as a whole as well as its individual apartments. The incentive is that most basic to capitalism – profit.

Therefore, while some tenant advocate organizations in New York City seek to eliminate MCI's as another means of landlord profit, it is so strongly part of the entire system one can assume

that so long as there is rent stabilization, there will be MCI's.

The profit, crudely on its face appears from the fact that an improvement appears to become 100% reimbursed to the landlord seven years after it is made. Actually, that is an over-simplification. The granting or denial of the application can take years before the DHCR and usually does. It therefore leaves inflation unaccounted for. On the other hand, once the rent increase is put through, it becomes part of the base rent and a means towards the landlord's goal of achieving high rent deregulation when the legal rent exceeds $2,000 per month. Since it is part of the base rent, it is also subject to the annual or biennial rent increases as well as vacancy increases. Therefore, the recovery can be much faster than the seven years after approval of the application.

Buildings converted to cooperatives and condominiums present special issues. While the no longer rent-stabilized units are part of the arithmetic for computing the increase, they do not themselves generate increased revenue to the landlord from an MCI.

Therefore, the system is really designed for an MCI increase in a cooperative or condominium converted building to be just one more tool for the landlord to drive the rent regulated tenants out of the building prior to selling the apartments.

However, that does not mean tenants are without their weapons in such matters. The bulk of this article will explore that arsenal and how a landlord can fire back or avoid the assault in the first place.

II. MCI's A Highly Technical Application

Only a very foolish landlord would undertake an MCI application in a large building with a vigorous tenant organization without having all its ducks lined up, including, most importantly, well experienced and competent legal counsel. However, accidents and mistakes do happen and sometimes facts uncomfortable for the landlord are simply papered over. All of these create vulnerabilities for the tenant advocates to use to their advantage. It is the tenant advocate's job to find these flaws. It is the Landlord's Attorney's job to question the client closely to uncover these flaws before they can hurt the landlord, to present the facts in as convincing a manner as possible, and, where possible, to guide the landlord in producing as bullet proof an application as possible.

Look for Part II of How to Overcome Tenant Resistance to an MCI Application in next month's issue. . .

Part II: How To Overcome Tenant Resistance To An MCI Application

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Last month in Part I: How To Overcome Tenant Resistance To An MCI Application we discussed the general overview of the application as well as the technical aspects. In Part II, we continue with the complex

requirements of the MCI application.

III. The Requirements of MCI

a. The work must affect all residential units in the building.

In order to qualify for an MCI, the improvement must affect all residential units in the building. It need not have any effect on the commercial units at all.

However, "all" does not really mean "all." If a building has, for example, 1000 windows, the replacement of 900 windows would not qualify for MCI treatment. However, the replacement of 997 windows would. These numbers are only given as examples. They are not fixed percentages, but merely an indication that the DHCR has the discretion to construe "almost all" to be "all" for the building. If, to use this same example, only 997 windows are replaced, the landlord must have readily on hand, compelling explanations as to why the three windows were left out of the project. That the tenant refused access is not a sufficient reason. The landlord will have to have been proactive about gaining access – including, where appropriate, having brought court proceedings.

Windows are only given as one example of the many kinds of building systems that could be replaced. However, they are a very special system because: they are easy to count and they normally affect all units in the building.

Other examples of building systems that come down to a question of whether all of the apartments are affected would be the rewiring of the building. While there would not normally be a valid reason to skip a particular apartment for rewiring, there could be a valid reason for skipping replacement of a particular window where, for example, a window identical to the new ones going into the building had to be replaced a year before the MCI window replacement program started.

A well instructed tenants' association will count the building systems that were actually replaced, obtaining a precise count. If too few systems were replaced, the application for MCI treatment must be denied. Therefore, the Landlord must be absolutely meticulous to anticipate this count with a verifiable one of its own which shows that the entirety of the system was, in fact, replaced except as to those units validly exceptable.

b. The things being replaced must be too old to be within their "useful life" as defined by the RSC.

The RSC sets forth a list of what is a "useful life" for any particular building system and in some cases distinguishes amongst various kinds of particular systems. The Tenant's Lawyers can guide the Tenants' Association to the particular RSC provisions to ascertain which useful life (or lives) apply to the particular building systems for which the landlord is laying claim.

A well informed tenants' association will ascertain both the specific type and the age of the

systems that were replaced. If the application for MCI overstates the age of the building system or misrepresents the type that was replaced, the application could be defeated. Therefore, the Landlord must be absolutely certain to have used the correct useful life for the particular project for which MCI treatment is sought.

c. The increase must be 1/84th of the actual cost.

d. The leases must authorize the charge.

MCIs are only authorized with respect to a particular apartment if that apartment is held by the tenant pursuant to a lease that actually includes a lease clause authorizing MCI increases. It is possible that the leases do not contain such clauses. It is also possible that neither the landlord nor the tenant is actually in possession of any lease.

e. The application must have been filed within two years after the completion of the installation of the windows.

f. The improvements cannot have been funded out of a cooperative's or condominium's cash reserves.

The landlord can borrow from a cooperative or condominium, but it cannot directly use cooperative or condominium funds for the payment of the improvement.

IV. Concluding Observations

There is nothing automatic about the granting of an MCI application. A strong showing on behalf of the tenants that the application should be denied has historically resulted in the denial of many of these applications. This makes it essential, therefore, that the landlord get it right directly from the start instead of trying to play catch-up after the attack comes.