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New York's new rent regulation law continues tenant protections for certain categories of apartments. However, the "reforms" generally favor sitting tenants and landlords at the expense of the younger generation and peripatetic and lower-income tenants.

The private housing market in New York City is a complex mixture of the regulated and the unregulated. The regulated category includes apartments in buildings constructed prior to 1974, cooperative and condominium units that continue to be occupied by qualified tenants who resided in those apartments before their conversion to the cooperative or condominium form of ownership, and apartments in post-1974 buildings constructed under certain real estate tax-exemption programs.

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The unregulated market includes housing accommodations in buildings completed or substantially rehabilitated as family units on or after January 1, 1974, cooperatives and condominium apartments whose occupants have vacated or are no longer entitled to remain in occupancy pursuant to the offering plans, and luxury and vacancy decontrolled apartments. Luxury decontrol and a limited form of vacancy decontrol were first instituted in 1993 and apply to apartments renting for \$2,000 or more per month. Wealthy tenants residing in such apartments are required to pay market rent or vacate. Wealthy tenants residing in apartments renting for less than \$2,000 per month are not so affected.

The present laws are directly descended from federal wartime legislation, the Emergency Price Control Act of 1942, and superseding local law, the Housing and Rent Act of 1947. They were enacted in response to chronic housing shortages and designed to institutionalize rent

and eviction protections to classes of tenants. The "emergency" must be declared at an end once the vacancy rate exceeds 5 percent. The present vacancy rate hovers at approximately 4 percent. According to the latest survey, there are presently 1.1 million private apartments under some form of rent regulation.

The official title of the newly enacted rent law in New York is the Rent Regulation Reform Act of 1997 (the Reform Act). It amends the Emergency Tenant Protection Act of 1974, as amended (the ETPL). Governor George E. Pataki signed the Reform Act into law on June 19, 1997, four days after sunset of the law it was amending. By the terms of the Reform Act, no tenant is prejudiced by the four-day gap. The new law extends the rent regulations to June 15, 2003.

In this article, the authors will review the Reform Act, compare its salient provisions with prior law, and comment on the interests that the rent laws ostensibly seek to foster. The authors then briefly describe another program used by government to affect housing availability in New York City, a real estate tax-exemption program, and assess its role in the regulatory scheme. The tax-exemption program in question operates on a creative strategy designed to encourage the construction of affordable housing. It accomplishes this result in part by issuing negotiable certificates, comparable in some respects to those used in the energy business to comply with environmental laws.

The Rent Laws and What They Regulate

There is obvious tension between the interests of landlords and tenants, and it is only heightened where the demand for affordable housing is greater than the supply. The ETPL, as further amended by the Reform Act, officially recognizes the shortage, and states in part that its intention is to prevent "exaction of unjust, unreasonable and oppressive rents and rental agreements" and "uncertainty, hardship, and dislocation." The apparent bias in favor of tenants notwithstanding, the various statutes in effect from time to time attempt more subtle balancing of parties' rights and remedies.

New York City actually has two tiers of rent laws—rent control and rent stabilization. Together, they account for approximately 50 percent of all private rental apartments in New York City. Rent control is essentially local in jurisdiction. It

expired in 1969, but continues to protect sitting tenants and their legal successors in approximately 100,000 apartments in New York City.

Rent stabilization is governed by state law. It was introduced by the ETPL, following a brief and turbulent period in which government, unsatisfactorily, experimented with full vacancy decontrol. There are approximately 1 million apartments under rent stabilization. As rent-controlled apartments are vacated, they become rent stabilized, and pursuant to the stabilization law and regulations the landlord is entitled to charge market rent to the first tenant. When stabilized apartments become vacant, landlords are limited to stabilization increases in the amounts discussed subsequently.

At one time, it could be said that rent-controlled tenants enjoyed an advantage over their stabilized neighbors, because their longevity in occupancy put them in possession of large apartments at regulated rents. However, the advantages have largely been erased by time. In addition, key provisions in the laws are consistent, so that if eventual phaseout is assured for one, it will as assuredly mean the same for the other.

One distinction without any particular consequence is the manner in which rent increases are set annually. Rent for controlled apartments are increased annually at an amount not exceeding 7½ percent. Increases for stabilized apartments depend on whether tenants opt for a one- or two-year lease renewal. For a one-year renewal lease commencing on or after October 1, 1996, and expiring on or before September 30, 1997, the landlord was permitted an increase of 5 percent; for a two-year lease, the permitted increase was 7 percent. The 1997–1998 increases will be 2 percent and 4 percent, respectively.

Bona fide tenants in both classes of apartments are protected from eviction, unless they are not paying rent or are violating a substantial obligation of their tenancies. The right to occupy regulated apartments is reserved to those tenants who maintain the units as their primary residence.

Rent Regulation Reform Act of 1997

Landlord Perspective. It is telling that a 1994 survey of more than 300 landlords conducted by the New York City Rent Guidelines Board indicated that, among possible initiatives designed to improve building ownership profitability, increased rent

ranked third. They most favored lower property taxes and water and sewer charges (40 percent); next, a more efficient housing court (30 percent); and, third, higher rents (25 percent).

The Reform Act addresses the second and third items, but not the first, which is essentially outside the scope of the rent regulations and, ultimately, driven by considerations of local politics and more manipulable for being out of the public eye.

Tenant Perspective. While the authors are unaware of any similar survey conducted among tenants regarding proposed legislative reforms, it is fair to say that the issues of paramount concern among tenants are (1) calculation of permissible rent increases; (2) rights of continued occupancy; and (3) protection from unwarranted eviction actions and harassment. For tenants, the problem with an unregulated market in the context of a chronic housing shortage is evident: Without a right of renewal or succession, a tenant can be evicted without explanation when his or her lease expires; without rent regulations whose purpose is to prevent "speculative, unwarranted and abnormal" rent increases, tenants would face periodic burdensome increases that effectively preclude their continuing occupancy in their present apartments. For these reasons, statutory tenant protections with respect to renewal and succession rights as well as rent adjustments have been viewed as necessary to foster a more equitable bargaining position.

The Reform Act addresses all of these tenant concerns, but not necessarily in a manner that strengthens the position of tenants existing prior to the enactment of the Reform Act.

National and Local Debate. It should be noted that the comprehensive rent and eviction regulations in effect in New York are the exception around the country, although in the 1970s and into the 1980s there was a growing trend in favor of such laws. This trend has reversed course. Some local communities continue to impose some form of regulation, but the laws either have been or are being phased out. Massachusetts, in 1994, and California, in 1995, have enacted statewide laws that preempt localities from imposing rent control.

As in the other states, so in New York. Rent regulations have been under attack. During the months leading up to the enactment of the Reform Act, the debate regarding what reforms

were advisable and necessary was generally depicted in the daily newspapers and other media in terms of two extremes. Property owners were depicted as either well-intentioned business persons deprived of their right to own and operate their properties at an acceptable profit margin due to antiquated and one-sided tenant protection laws, or as single-minded profiteers determined to drive less powerful tenants out of their homes in order to rent only to those who could afford to pay the highest rents.

In contrast, tenants were depicted either as nothing better than freeloaders who enjoyed significantly below-market rents and virtually unlimited renewal rights at the expense of their landlords, or as a disparate group of persons with little individual or collective economic clout who enjoyed few, if any, viable housing options other than their present apartments.

Tenant advocates and their allies regard rent regulations as a necessary mechanism for ensuring affordable housing and for protecting renters against rent gouging, diminution of services, and illegal and retaliatory acts. They deplore the decontrolling initiatives of other jurisdictions because advocates foresee them as the ultimate wedge for undermining the city's rent and eviction regulations. Owners and landlords argue that the regulations are a species of subsidization and regard the laws as a taking (a constitutional issue that has never been successfully propounded in New York). To emphasize their point, landlord groups focus intensely on "wealthy" tenants said to be living in luxury apartments for a pittance, as though that condemned the protections altogether.

The issue is obviously more complicated than depicted. In reality, the rent laws attempt to ensure a balancing of interests, as well as protection of communal values and neighborhood stability. The law denies landlords all the control they demand, but ensures them a reasonable return on their investment and sufficient income to maintain their properties.

Major Provisions in the Reform Act. As already indicated, the Reform Act introduces a variety of changes; some favoring landlords, others, tenants. An expansion of New York's limited form of vacancy decontrol is obviously the most valuable right won by landlords. But they also won higher vacancy allowances, "bonuses" as they are described by Governor Pataki, more rigorous succession requirements, and stiffer procedural measures in summary proceedings.

Tenants essentially won a continuation of the regulatory program. The authority and obligation of the Rent Guidelines Board to determine on an annual basis the authorized amount of permissible rent increases for one- and two-year renewal leases remains intact. However, the Reform Act's recognition of tenant lease succession rights came with a price for tenants. Besides the more rigorous succession requirements noted previously, limitations were imposed on how frequently successions can occur before leases "inherited" by a successor are treated—for rent computation purposes—as if they are a "vacancy leases." It is difficult at this time to gauge the effect of other tenant-oriented provisions of the Reform Act, such as the classification of certain kinds of tenant harassment as a felony and the increase in civil penalties for such behavior by landlords.

Luxury and Vacancy Decontrol. The Reform Act expanded decontrol for high-income and high-rent apartments in both rent control and rent stabilization.

- *High-income decontrol.* The 1993 amendment to the New York City Administrative Code introduced high-income decontrol. The Reform Act expands the class of tenants who will be subject to this so-called "luxury decontrol." Under the ETPL, a tenant of an apartment who paid at least \$2,000 in monthly rent and whose adjusted gross income (or combined incomes, if more than one tenant resides in the apartment) for two consecutive years was \$250,000 or more would not be entitled to receive a renewal lease at a rental computed in accordance with the Rent Guidelines Board renewal increases. Under the Reform Act, the annual income threshold has been lowered to \$175,000, while the \$2,000 minimum monthly rental remains unchanged. For tenants in apartments at the threshold rent, landlords may require them to disclose their adjusted gross income on an income certification form prepared by the Division of Housing and Community Renewal. The amounts certified may be subject to verification by the New York State Department of Taxation and Finance. If the apartment is decontrolled, the landlord is required to grant tenants a "right of first refusal" to lease the apartment at a "market rent."

- *High-rent decontrol.* Under the Reform Act, apartments renting for \$2,000 or more per month (after taking into account permissible adjustments authorized under prior law and the Reform Act) that become vacant after June 15, 1997 are immediately eligible for decontrol. The change is slight, but significant in favor of landlords. Under prior law, the rent charged under the *expiring* lease had to be equal to or greater than \$2,000 for eligibility. The change permits landlords to reach the \$2,000 threshold more quickly. Landlords have an additional benefit in that the law makes no provision for raising the rent threshold to account for inflation. Either the political leaders did not consider the eroding value of the dollar, or they did, and discounted it, to the benefit of landlords.

- *Tenants affected by expansion of decontrol.* The Center for Real Estate and Urban Policy at New York University Law School finds that there are approximately 2,700 regulated tenants in New York City who both pay more than \$2,000 a month and have incomes of \$175,000 or more. Virtually all such tenants reside in Manhattan. In addition, there are approximately 8,900 additional rent-stabilized tenants in New York City who earn at least \$175,000 per year and who pay less than \$2,000 per month, approximately one-half of whom pay less than \$1,000 in monthly rent.

As noted previously, the Reform Act facilitates the elimination of rent regulations on higher rental apartments and expands the class of persons who will be required to file income disclosure forms with their landlords. It is unclear how these provisions will change the demographics of New York City's population, but there appears to be at least a potential for some combination of (1) an exodus of middle-class and upper-class residents and (2) an influx of such residents into the cooperative and condominium sales market.

Vacancy Increases. The Reform Act recognizes a number of opportunities justifying rent increases upon vacancy. When a stabilized apartment is vacated, the landlord is eligible for a "vacancy bonus allowance" based on whether the new tenant requests a one-year or two-year lease. If the new tenant requests a two-year lease, the "bonus" is equal to 20 percent of the previous legal regulated rent for a two-year lease; if

a one-year lease is requested, the bonus equals the percentage obtained by subtracting from 20 percent the difference between the two-year and one-year renewal lease percentage increases established by the Rent Guidelines Board.

The 20 percent vacancy "bonus" allowance is *in addition* to the 9 percent vacancy allowance previously set by the Rent Guidelines Board for the fiscal period October 1, 1996 through September 30, 1997. Thus, for the brief period between the Reform Act's June 19 effective date and September 30, 1997, landlords owning vacant apartments achieved a significant victory. However, the New York City Rent Guidelines Board has since indicated that, at least for the 1997-1998 fiscal period, it will not authorize a vacancy allowance in addition to those permitted under the Reform Act.

In cases where the prior tenant resided in the apartment for eight or more years, the owner is eligible for an additional 0.6 percent allowance for each year of the tenant's occupancy. Apartments renting for between \$300 and \$500 receive either the percentage bonus or \$100, whichever is greater.

These vacancy allowances are in addition to other increases authorized under existing law, not dependent on an apartment becoming vacant. These other increases may result from a landlord's making certain building-wide capital improvements or substantial modifications to individual apartments, or furnishing additional services, equipment, or improvements.

When coupled with the increases authorized under prior law, the Reform Act vacancy increases provide a strong incentive for landlords to undertake improvements and renovations, especially to mid-priced and higher-priced rental units and the buildings in which they are located. Such an investment by landlords would increase the inventory of high rent, unregulated apartments and decrease the number of units with rents in the more moderate range. If so, the impact of such a change is most likely to be felt by those moderately high-income tenants whose annual gross income falls below the \$175,000 threshold. If a large enough number of apartments close to the high-rent range shift to the \$2,000 or more "luxury" category, these tenants—who do not qualify as "wealthy" tenants under the rent laws—will have to forgo stabilization rights to which they would otherwise be entitled in order to lease such apartments.

This potential increase in the number of "luxury" apartments highlights the direction in which the New York City rental housing market is moving: toward the creation of two separate classes of housing stock—the regulated and the unregulated. In this regard, the Reform Act acknowledges, if only implicitly, an independent emerging segment of the higher-income housing market: investor-owned condominium units. In recent years, these units have accounted for an increasing share of the rental housing market. During the real estate recession of the late 1980s and early 1990s, the number of purchasers for newly constructed or newly renovated condominium units declined sharply. As a result, the owners of these units began to lease them. This strategy served two purposes: The rentals obtained during this period enabled the owners to meet their financial obligations with respect to these condominium units while maintaining an inventory of apartments that could be sold, vacant, when the sales market had reversed itself. All of these units were free from rent regulations.

One effect of the luxury and high-rent decontrol provisions of the Reform Act is to put deregulated rental units on a more equal footing with investor-owned condominium units. Presumably, owners in both categories will be competing for tenants whose incomes or willingness to pay high rentals have disqualified them from the class of tenants entitled to the protection of New York's rent laws.

Continuity of Occupancy. The Reform Act continues the policy of permitting "family" members to inherit occupancy rights, but modifies it in an attempt to prevent the kinds of abuse decried by landlords. For landlords, each approved successor is likely to delay the day when an apartment becomes entitled to vacancy increases. For tenants, the ability to remain in possession of an apartment prevents potentially dramatic increases in housing costs and ensures continuity of neighborhoods.

To qualify for the privilege of succession, a person must be a "family member." The Reform Act's definition of the term contains several key features. First, it expressly excludes uncles, aunts, nieces, and nephews who were automatically eligible for consideration under the ETPL. However, the new law is sensitive (or lawmakers are sensitized) to alternative living arrangements and is careful not to exclude non-blood and "non-legal" relations as "family."

Rather, the Reform Act's definition seeks to take into account a number of factors, previously articulated in a 1989 decision of New York's highest court, the Court of Appeals. These factors include (1) the exclusivity and longevity of the relationship; (2) the level of emotional and financial commitment; (3) the manner in which the parties have conducted their everyday lives and held themselves out to society; and (4) the reliance placed on one another for daily family services. If the would-be successor can meet the definition burden, he or she must then show that he or she resided (1) with the prior tenant (2) in the apartment (3) as his or her primary residence (4) for not less than two years immediately prior to the permanent vacating of the apartment by the prior tenant of record, or from the inception of the prior tenancy or commencement of the familial relationship, if either is for less than two years. (Where the prior tenant of record meets the Reform Act's definition of a "senior citizen" or "disabled person," the two-year time period requirement described above is shortened to one year.)

In computing the proposed successor's length of occupancy, the Reform Act provides that certain temporary absences—for such reasons as engaging in active military duty, enrollment as a full-time student, hospitalization, temporary employment relocation, or for other grounds as the State Commissioner of Housing and Community Renewal deems reasonable—will not be deemed to have interrupted the family member's occupancy of the apartment.

When a family member succeeds to a tenant of record, the new rent is *not* established on the basis of any of the vacancy "bonuses" described above. However, if, after a family member succeeds the prior tenant of record, another family member thereafter wishes to succeed to such successor as a new tenant, these vacancy increases will be imposed with respect to the new lease issued to the successor and for each *second* subsequent succession.

Housing Court Reforms. The general perception is that New York City housing courts traditionally favor tenants over landlords. Landlords maintain that, even for good cause, it has become all but impossible to obtain a meaningful judgment in their favor in an expeditious and cost-effective manner.

Given the shortage of affordable housing and the greater number of resources at a landlord's disposal—especially in connection with disputes with tenants in lower-income brackets—it is understandable that judges have been reluctant to evict tenants from their homes. However, this practice has resulted in an unresponsive and inefficient court system that creates as many, if not more, problems than it was intended to solve.

The Reform Act changes the rules in Housing Court, in an attempt to redress landlord complaints of tenant bias. Although prior law provided that the court "shall direct that the tenant post all sums as they become due for future rent and use and occupancy," the practice was otherwise. In their discretion to waive the deposit requirement "for good cause shown," most judges refused to impose this burden on tenants.

Coming on top of backlogs and other inefficiencies inherent in the landlord-tenant court system, this practice enabled a tenant to remain in possession of an apartment on a rent-free basis for many months, and even, in extreme cases, years. By the time a judgment was entered in a landlord's favor, it was likely that there would not be any viable source for the collection of accrued rents.

The option for a judge to waive the requirement that a tenant pay rent into escrow "for good cause shown" is now deleted from the enabling statute governing landlord and tenant disputes. Retained is the directive that the court "shall" require a tenant to pay rent into escrow; to be excused, the tenant must establish statutory defenses that essentially go to the issue of jurisdiction, not to the merits.

The overall effect of these technical changes is to withdraw from the court discretionary power on matters that, when previously exercised, invariably worked in favor of tenants. As presently mandated, the consequences of a tenant's failure to comply with a court's order to pay accruing rent into escrow or directly to the landlord is that, upon the landlord's request, the court must dismiss, without prejudice, all defenses and counterclaims, except the defense of payment, if the tenant can prove payment. These changes are far more likely to adversely affect lower-income tenants than the more affluent. If a tenant is financially unable to pay rent on a current basis and might otherwise have valid defenses or counterclaims (e.g., breach of warranty of habitabil-

ity), then he or she will be faced with the formidable financial challenge of commencing a separate action to assert his or her claims. Needless to say, if the tenant cannot pay rent on a timely basis, it is not likely that he or she can fund the prosecution of a new lawsuit.

If a landlord succeeds in its summary proceeding, the Reform Act eliminates any discretion a judge would otherwise have in postponing the actual eviction of the former tenant, unless the tenant can establish to the court's satisfaction that he or she has paid the amount of the judgment within the statutory time frame.

Additional Tenant Remedies. To protect tenants against a potential onslaught of unscrupulous eviction efforts by landlords seeking to take advantage of the vacancy "bonuses," the legislature included two provisions intended to discourage such conduct: Harassment of a tenant by a landlord has been made a felony; and civil penalties for harassment, as determined by the New York State Division of Housing and Community Renewal, have been increased from \$1,000 to not less than \$5,000 for each offense.

How effective these protections prove to be will depend on the willingness of the various District Attorney offices to prosecute alleged instances of harassment that meet the criteria set forth in the Penal Law, and on the ability and resolve of tenants and tenant organizations to initiate and participate in hearings before the Division of Housing and Community Renewal.

Twilight of Rent Regulations?

In his Executive Memorandum to the Reform Act, Governor Pataki stated that during the life of the bill, the reforms he was signing into law would ensure that the rent levels of three out of every four stabilized apartments would achieve market levels. He is silent with respect to rent-controlled apartments, although, at the present rate of increases, they will not be far behind.

Outside the Reform Act, but consistent with the Governor's legislative program, the governor announced that the "Division of Housing and Community Renewal will contractually agree not to regulate newly developed housing for a 50-year period in exchange for a developer's voluntary commitment to build new housing in areas of the State found to be suffering from a housing emergency." Aside from this statement in his Executive Memorandum, the

governor has given no indication as to how such a program is to be implemented. Until specific laws and rules for such a program are proposed, there is no guidance for developers (and their lenders) interested in participating in such a program and no assurance that, without regulations or oversight, the program can work.

The question is, how does the state ensure or seek to encourage the replenishment of low-priced to medium-priced apartments to offset the losses from luxury and vacancy decontrol? It does this primarily through real estate tax-exemption programs. In exchange for these benefits, developers voluntarily accept the constraints imposed by the rent regulations.

New York State and New York City offer several different kinds of real estate tax-exemption programs. Here, we will mention only that program known as Section 421-a, after the statute of that number in the New York State Real Property Tax Law. Since the institution of this program in 1971, approximately 110,000 apartments have been constructed in New York City. Under the Section 421-a program, a developer's real estate taxes are initially "frozen" at a designated level computed on the basis of the property's value *prior to* commencement of the construction of the new housing; thereafter, increases in the property's value, and corresponding increases in the property's real estate taxes, are gradually phased in during the life of the benefits period.

If a developer wishes to construct housing in the Manhattan "Exclusion Area" (a district located south of 96th Street and north of a boundary line located approximately at 14th Street) and to receive Section 421-a tax-exemption benefits, it has two alternatives. The first is to agree to set aside at least 20 percent of the apartments in the project for affordable housing units reserved for low-income and moderate-income families. For higher-priced buildings—the kind most likely to be constructed in the Exclusion Area—this is not an attractive option to the developer.

The developer's second alternative is to purchase Section 421-a tax-exemption certificates from other developers that have constructed low-priced to medium-priced apartments anywhere in New York City. These developers of low-priced to medium-priced housing receive five negotiable tax-exemption certificates for each unit they build and are permitted to sell these certificates to the developers of higher-priced apartments located in the Manhattan Exclusion Area. Under the existing Section 421-a law and regu-

lations, these certificates enable a developer that purchases them to obtain tax-exemption benefits for its Manhattan Exclusion Area apartments, provided that construction of such units begins before January 1, 1999 and is completed on or before December 31, 2000.

The 1992 and 1993 amendments to the Section 421-a program "deepened" the benefits for those residential buildings constructed in Manhattan neighborhoods located south of 110th Street that contain the 20 percent low-income and moderate-income housing units "on-site." The 10-year exemption for such buildings in the Manhattan Exclusion Area was increased to 20 years, while the 15-year exemption for neighborhoods between 96th and 110th Streets in Manhattan was also increased to 20 years.

Regardless of how a developer qualifies for the benefits of the Section 421-a program—by on-site construction of low-income and moderate-income housing units, or by purchasing Section 421-a negotiable certificates—the housing units receiving these benefits will be subject to the restrictions of rent stabilization, but only for the duration of their real estate tax benefits.

Conclusion

The modifications introduced by the Reform Act are both procedural and substantive. Protections continue for regulated housing, but

landlords have been given greater control over their inventory. According to the governor's Executive Memorandum, rent protections continue for "99 percent of current tenants, and their family members." Landlords won increases designed, again according to the governor, to bring the rent levels to market. Tenants won "tough new criminal and civil penalties for owners who unlawfully harass [them]."

If the governor is correct in his prediction that rents will be raised to market levels, then rent regulation is on its way out. Apartments in the luxury class will graduate to market rent and those below will inexorably rise to the luxury level and become, upon vacancy, decontrolled. Rising behind them are the low-priced apartments ready to graduate to the medium-priced level.

There will then remain in the private market a single source for "affordable" housing, the tax-exemption programs referred to above, but they will produce only relatively short-term (up to 20 years) protection. If the goal is to drive all apartments to market rent, then it is on the horizon of achievement, even as chronic shortages remain. If, on the other hand, the goal is to create a pool of private housing "affordable" to the middle class, then state leaders will have to rethink the balances between landlords and tenants. The laws appear to protect the present generation, but not the next, and it is the next whom the policymakers should be considering. ■

Gerald M. Levine -- List of publications

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