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MITCHELL-LAMA BUYOUTS: POLICY ISSUES AND ALTERNATIVES

David J. Sweet & John D. Hack*

I. Introduction

The Mitchell-Lama law, Article II of New York State's Private Housing Finance Law,1 is one of the nation's pioneering programs for the development of middle-income housing.2 Originally enacted in 1955,3 the program offers state and municipal assistance to private developers in the form of long-term, low-interest mortgages4 and real

1. N.Y. PRIV. Hous. FIN. LAW §§ 10-37 (McKinney 1976 & Supp. 1989). Enacted by 1961 N.Y. LAWS chs. 803-04, the Private Housing Finance Law collects various programs relating to state and local assistance for housing developed by non-governmental entities which were previously contained in the Public Housing Law or had been enacted as separate, unconsolidated laws. The principal sponsors of Mitchell-Lama were Senator MacNeil Mitchell and Assemblyman Alfred A. Lama. Walsh, Mitchell-Lama Dissolution: A Conflict of Law and Politics, 16 N.Y. ST. B.A. REAL PROP. L. SEC. NEWSL. 11, 15 n.3 (No. 3, July 1988) [hereinafter Walsh].

2. At one time, the Mitchell-Lama law served as a source of large-scale housing production. It produced a broad range of housing: massive developments such as Co-op City in the Bronx and Starrett City in Brooklyn, projects ranging from single buildings to large superblocks on numerous urban renewal sites, as well as privately-owned land, and such notable later developments as the Roosevelt Island housing. See infra note 15.


4. The statute authorizes a maximum loan term of 50 years. See N.Y. PRIV. Hous. FIN. LAW § 26(2) (McKinney 1976). These loans were initially made directly by the state or municipality. Id. § 22(2) (state loans); id. § 23 (municipal loans). Later, the legislature created public agencies to do the job: the New York State Housing Finance Agency in 1960 (1960 N.Y. Laws 671 (codified as amended at N.Y. PRIV. Hous. FIN. LAW §§ 40-61 (McKinney 1976 & Supp. 1989)), and the New York City Housing Development Corporation in 1971 (1971 N.Y. Laws 551 (codified as amended at N.Y. PRIV. Hous. FIN. LAW §§ 650-70 (McKinney 1976 & Supp. 1989)). The New York State Urban Development Corporation (see 1968 N.Y. Laws 174, §§ 1, 5(17)) and the Battery Park City Authority (see N.Y. PUB. AUTH. LAW § 1974(14) (McKinney 1976)) are also authorized to make loans to housing companies incorporated under the Mitchell-Lama program. These agencies were created to get around obstacles that limited the use of direct government loans. At the state level, virtually all direct debt must be approved in a voter referendum. N.Y. CONST. art. VII, § 11. At the local level, competition for such money by other agencies pressed cities' debt limits.

In each case, the owner of the project pays debt service essentially equal to the agency's cost of funds plus the provision of any necessary reserves. N.Y. PRIV. Hous. FIN. LAW § 26(2) (McKinney 1976) provides for repayment of principal "in annual installments equal to the amount payable by the state on the moneys borrowed for the project . . .
estate tax exemptions.5 In return for such governmental assistance, the owners of rental projects must limit their profit and rent levels.6 Similar assistance is available to cooperative projects, conditioned on the regulation of the apartments' purchase price and monthly carrying charges.7 In either case, the projects are owned by special statutory corporations known as limited profit housing companies.8 The apartments are available to renters or co-op owners whose income does not exceed specified levels, based on a multiple of the rent or maintenance costs.9

[plus interest at] the same rate of interest paid or to be paid by the state for the definitive housing bonds issued on account of such loan.” Id. Thus, the benefits of both the credit rating of the government and the tax-exempt status of the public bonds issued to raise mortgage money are passed through to the project. These benefits significantly reduce monthly maintenance charges and rents. This is so particularly because these projects were built, even more so than housing generally, with borrowed funds. The law authorizes 95% financing in most cases, with loans up to the full project cost permitted to certain forms of non-profit sponsors. Id. §§ 22(2), 23(1).

5. Real estate tax exemptions are granted on a local option basis. In practice, if a locality does not grant an exemption, the builder does not go through with building a project. The current state authorizing legislation permits real estate taxes to be reduced to a level equal to 10% of shelter rent—defined as the rent, excluding any portion attributable to gas, electricity or other utility costs. N.Y. PRIV. HOUS. FIN. LAW § 33(1)(a) (McKinney 1976 & Supp. 1989). Until 1989, the law authorized tax exemptions for the period of the project mortgage, but in no event for longer than 30 years. Id. In the case of projects refinanced in response to the fiscal crisis of the mid-1970s, with federal mortgage insurance, the tax exemption lasts for the life of the refinanced loan. Id. § 33(1)(d). The statute was amended in 1989 to remove the 30 year limit and permit tax exemptions for the term, not only of the original government loans, but also of any future refinancing “approved by the [c]ommissioner or the supervising agency.” 1989 N.Y. Laws 229, amending PRIV. HOUS. FIN. LAW §§ 33(1)(a), (1)(c), (4). This would appear to authorize the indefinite continuation of tax benefits, so long as any mortgage is outstanding.

Although the ultimate classification of a project as “state” or “municipal” depends on the source of the mortgage, the real estate tax exemption is granted by the locality. Thus, if a project withdraws and surrenders its subsidies, it is the locality which will take in greater taxes, not the state.

6. In most cases, the owners of a Mitchell-Lama project are limited to a 6% annual return on their equity. Id. § 28(1). The rents that may be charged are set by the New York State Division of Housing and Community Renewal (DHCR) or by a municipal agency. Essentially, the rent is to be set at a level so as to cover expenses, reserves, and the statutory return on equity. Id. §§ 31, 2. Projects financed by state agencies are supervised by the DHCR. See id. § 2(6). Municipal projects are regulated by the applicable municipal agency. In New York City, for example, the Department of Housing Preservation and Development (HPD)—under general supervision of the DHCR—is the supervisory agency. Id. § 2(15). If a project receives neither a state nor a municipal Mitchell-Lama loan, but only a property tax exemption, it is classified as “municipally assisted.” Id. § 2(17).

7. N.Y. PRIV. HOUS. FIN. LAW § 31 (McKinney 1976 & Supp. 1989) (carrying charges calculated by same formula as for rentals); Id. § 31-a (limits on resale prices of apartments).

8. Id. § 11.

9. The basic income limits are seven times the annual rent, rising to eight times the
The Mitchell-Lama statute also allows Mitchell-Lama project owners to withdraw from the program by prepaying or "buying out" the government mortgage that financed the project. Specifically, the statute permits project owners to pay off their mortgages prior to the maturity date, after the project has been occupied for twenty years. Upon such prepayment, the owner must also give up the tax exemption; however, the project then ceases to be subject to the Mitchell-Lama limitation on rents and profits. Consequently, the project is subject only to whatever general rent regulations, if any, exist in the local community, and a rental project may be converted to a cooperative or condominium under the same requirements as other local rental housing. Depending on a project's condition and location, Mitchell-Lama owners could make a substantial profit if they exercised the statute's buyout right.

In fact, a number of development owners have already withdrawn from the program and others are in the process of doing so. Tens of thousands of apartments are eligible for families with three or more dependents. N.Y. PRIV. HOUS. FIN. LAW § 31(2)(a) (McKinney 1976). Various exclusions from income permitted under the statute and regulations make this formula—already more liberal than the rent/income ratio provisions in most housing programs—even less restrictive. Furthermore, tenants whose incomes are up to 25% above the formula are still eligible, provided they pay additional rent based on the rent surcharge formulas applicable to tenants whose incomes rise above the limits after admission. Id. § 31(2)(d). See also N.Y. Times, Mar. 13, 1989, at A19, col. 2.

10. N.Y. PRIV. HOUS. FIN. LAW § 35(2) (McKinney 1976). Because most of the construction occurred in the early years of the program, a large portion of the Mitchell-Lama stock is now at or near the 20-year point at which buyouts are permitted. See infra note 15. A few projects have already exercised the right to withdraw from the program, or are in the process of doing so. Tens of thousands of additional units will reach this point in the next few years. See infra note 13 and accompanying text.

11. N.Y. PRIV. HOUS. FIN. LAW § 35(3) (McKinney 1976).

12. The impact of the right to invoke the buyout provision will vary greatly based on a project's location. In many areas, where the housing market may not yield great returns from a deregulated project, the owner will want to keep the subsidy and accept the governmental regulation. In other areas, giving up governmental aid would be a small price to pay compared with the profits to be made by converting a rental project into a cooperative or condominium.

13. As of early 1989, 5,328 units in Mitchell-Lama projects had been lost to the program because of owner buyouts. Another 2,988 units in New York City were in the process of buying out. MEMORANDUM, GOVERNOR'S PROGRAM BILL No. 30. See also CITIZEN'S HOUSING AND PLANNING COMMISSION, 48 COMMITTEE ON PUBLIC POLICY MEMORANDUM 1-2 (Jan. 1989) [hereinafter CHPC MEMORANDUM] (citing slightly lower figures). The majority of projects which have either bought out or have filed notice of intent to buy out are rental projects. Id. at 5-10. These are statewide figures. Approximately 135,000 of the state's 165,000 units are within New York City. N.Y. Times, July 6, 1988, at B3, col. 1. See infra note 15 for a summary of the status of those projects.

14. Under the city and state regulations, a fairly lengthy procedure is required before a project may actually become deregulated. For a discussion of these regulations, see...
ble to join them or will become eligible over the next few years. Exercise of the buyout privilege can produce two related results, both of which raise controversial public policy questions. First, a Mitchell-Lama owner can reap a potentially great profit from what was intended to be a government program for middle-income housing. Second, middle-income tenants who live in buildings which

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15. Statistics compiled by the Citizen's Housing and Planning Council (CHPC) from city and state records show that projects containing a total of approximately 76,000 apartments had passed the 20-year point as of the end of 1988 and accordingly were eligible for buyouts. The number of eligible apartments will increase to over 91,000 by the end of 1992. CHPC MEMORANDUM, supra note 13, at 5.

The CHPC statistics indicate the number of state-regulated and city-regulated developments that become eligible for buyouts annually. These statistics show how the growth of the buyout issue in the last few years tracks the history of the program—an initial spurt in project completions in the mid-1960s, followed by a slight lull, followed by a second round of extensive development in the early 1970s. For a chronological summary of Mitchell-Lama activity, project by project, in both the city and the state programs, see id. at 5-10.

The sharp growth in the number of apartments (as distinguished from the number of projects) theoretically available for buyouts is accounted for in part by a few very large cooperatives, chiefly developed by the United Housing Foundation and other non-profit housing groups in the 1960s. More than 15,000 apartments in Co-op City in the Bronx joined the buyout-eligible list in 1988, accounting for most of that year’s jump in the cumulative total. Other major developments in this category include Rochdale Village in Queens, with nearly 6,000 apartments, and Warbasse Houses in Brooklyn, with approximately 2,600 apartments. These projects, located chiefly in outlying areas and frequently developed and tenanted by groups with strong ties to labor unions, are not likely candidates for Mitchell-Lama buyouts.

The true test of the present buyout formula, as it applies to cooperatives, will come with Southbridge Towers, which will reach its 20th anniversary at the end of 1990. This 1,651-unit project is located just south of the Manhattan approaches to the Brooklyn Bridge, adjacent to both the City Hall area and New York City’s financial district. At the time of construction, this project’s site was essentially a non-residential area. However, nearby downtown areas now form a luxury housing market, characterized by the Battery Park City development and various luxury loft conversions. The Southbridge apartments would command high prices in today’s housing market.

16. This is the latest, and perhaps most fundamental, of a series of controversies that have arisen over the history of the program. They have included disputes over the displacement of tenants that resulted from project development, the treatment of project tenants whose income exceeded that of the program’s target group, the inability of some projects to make required payments on their government mortgage loans, and the racial composition of certain projects. Recently, a sharp controversy developed over the occupancy of apartments by only one or two persons. The New York City administration has sought to encourage and, as a last resort, compel tenants of these “under-occupied” units to move to smaller apartments, thus making available the family-sized apartments. The mandatory aspects of the program were sharply criticized. The Koch administration, faced with proposed city council legislation to outlaw mandatory transfers, abandoned the effort. For a statement of the Koch administration’s position, see N.Y. Times, March 13, 1989, at A19, col. 2.

have been "bought out" may be forced to move out because of increased rent or maintenance costs.\textsuperscript{18} Even if present tenants are protected, apartments which become vacant will no longer be set aside for middle-income tenants, further aggravating the shortage of affordable housing in many urban communities.\textsuperscript{19} Because of these controversies, the New York legislature has been considering proposals to revoke or substantially limit an owner's buyout right.\textsuperscript{20} Such amendments, however, raise significant issues of constitutional law and public policy.\textsuperscript{21}

Because Mitchell-Lama housing consists of both rental projects and cooperatives, the buyout issue involves at least three different private interest groups: rental project owners, rental tenants, and cooperative apartment owners. Furthermore, because Mitchell-Lama is a government program intended to provide affordable housing, the buyout issue also involves the interests of the general public.

If the buyouts proceed as present law permits, the owners of rental projects may be able to charge higher rents than they otherwise could have under the Mitchell-Lama regulations,\textsuperscript{22} or to make substantial profits on a cooperative conversion of the property. Mitchell-Lama rental tenants, however, will face uncertain housing prospects and possible rent increases.

In Mitchell-Lama cooperatives, this clash of interests has a further twist. As in any cooperative, the project tenants are also the owners. Because of governmental assistance, the initial purchase price for such apartments was substantially lower than the market price for equivalent apartments. Mitchell-Lama's resale price regulations, however, essentially prohibit a departing tenant-shareholder from making a profit, thus forcing the tenant-shareholder to pass on the benefit of the low purchase price to the next owner.\textsuperscript{23} In some neighborhoods, cooperative units not regulated by Mitchell-Lama would command extremely high prices in today's market. Thus, although some cooperative residents may be content to continue receiving the Mitchell-Lama benefit of low monthly maintenance charges, others may desire

\textsuperscript{18} See Walsh, supra note 1, at 15 n.6.
\textsuperscript{19} See id. See also CHPC Memorandum, supra note 13, at 1.
\textsuperscript{20} See infra notes 199-200 and accompanying text.
\textsuperscript{21} Id. See also infra notes 119-86 and accompanying text.
\textsuperscript{22} Subsequent rent levels will depend on whether there exist more specific statutes pertaining to a particular geographical area. See infra notes 74-101 and accompanying text.
\textsuperscript{23} N.Y. Priv. Hous. Fin. Law § 31-a (McKinney 1967 & Supp. 1989) essentially provides that a seller may recover only what he initially paid for the cooperative apartment plus that part of maintenance that was used for amortization of the building's mortgage plus any money paid for capital improvements.
the prospect of far greater benefits from deregulation. In the context of cooperatives, therefore, the Mitchell-Lama buyout issue may pit shareholder against shareholder—in other words, neighbor against neighbor.24

Government officials view the affordable housing provided by Mitchell-Lama projects as a scarce resource that should be preserved.25 If the buyout provision is not amended, New York State (and especially New York City) faces the loss of a portion of the housing stock set aside for middle-income tenants. Such a loss would come at a time when the costs of creating new units have escalated dramatically and federal housing assistance has been sharply curtailed.26 As a means of postponing a depletion of New York's middle income housing units, the administrations of Governor Cuomo and Mayor Koch favor an extension of the twenty-year buyout waiting period to thirty-five years.27

Part II of this Article discusses the history of the buyout provision and its effect on Mitchell-Lama rental and cooperative projects. Part III analyzes the constitutional issues raised by potential legislative modification of the buyout provision. Part IV discusses the policy issues involved in allowing Mitchell-Lama buyouts. Part V draws on these policy considerations and outlines the various factors which should govern the development of a solution to the buyout dilemma. This Article concludes with recommendations for legislative action—including provisions for appropriate incentives for keeping projects within the program—to protect the interests of project owners, ten-
ants, and those concerned with the preservation of the affordable housing stock.

II. The Mitchell-Lama Program and the Buyout Provision

A. History of the Buyout Provision

1. Pre-1959 Law

As first enacted, the Mitchell-Lama law made mortgage prepayment difficult, if not impossible. A Mitchell-Lama housing company could be dissolved and removed from regulation only if the following three conditions were met: (1) the consent of the state or municipal regulatory agency involved, (2) expiration of thirty-five years from the occupancy date,28 and (3) repayment to the municipality of a sum equal to the total of all tax benefits which the project had received.29 Thus, dissolution was an involved and potentially profitless endeavor.

If project owners met these three conditions, a project could be transferred from the Mitchell-Lama company to the company's owners30 or sold to new owners.31 Alternatively, the Mitchell-Lama company itself could be "reconstituted pursuant to appropriate laws relating to the formation and conduct of corporations . . . ," i.e., its certificate of incorporation could be amended so as to convert it into an ordinary unregulated business corporation.32 These provisions were added to the original Mitchell-Lama law one year after its enactment33 and still apply to pre-1959 Mitchell-Lama projects.34

28. The occupancy date is
the date defined in the contract between a company and a municipality or the state, as the case may be, as the date upon which the project is to be deemed ready for occupancy, or if such term is not defined in such contract, the date of issuance of the temporary certificate of occupancy.
N.Y. PRIV. HOUS. FIN. LAW § 12(3) (McKinney 1976).
29. Id. § 35(1).
30. Id. § 35(3).
31. Id. § 36(1). With respect to a sale to a different owner under this section, rather than "voluntary dissolution" under § 35, the law (1) prohibited such sale prior to 35 years from the occupancy date except to another Mitchell-Lama company, (2) provided that upon such sale both the benefits and the burdens of the Mitchell-Lama program would follow the project, and (3) permitted the selling company (now an empty shell) to be dissolved with governmental consent. Id. Upon dissolution, "the stockholders of the dissolving company shall in no event receive more than the par value of their stock with accrued and unpaid dividends upon such stock." Id. at § 36(2).
32. Id. § 35(3).

In 1959, after the original Mitchell-Lama law failed to produce a significant number of middle-income housing projects, the New York legislature added the initial buyout provision. This provision gave the owner of a Mitchell-Lama project the option of dissolving the housing company on or after the fifteenth anniversary of the occupancy date. Consent of the regulatory agency was not required for such dissolution, but the new provision continued to require the owner to pay off the government mortgage and surrender the project's future tax exemptions. Unlike the original law, however, the 1959 amendment did not require the owner to repay the tax benefits previously received.

The 1959 buyout provision was part of then Governor Nelson A. Rockefeller's bill to encourage private-sector participation in the creation of middle-income housing. To that end, the bill also included provisions which both broadened the right of investors to participate jointly and made Mitchell-Lama projects lawful investments for certain fiduciaries.

The buyout provision was amended in 1960 to increase the minimum period before which an owner could withdraw a project from fifteen to twenty years. The 1960 amendment also extended the buyout privilege to municipally-assisted as well as to state-assisted projects.

3. Legislative History of the Buyout Provision

The legislative history of the 1959 and 1960 amendments contains little discussion of the buyout provision. In a memorandum approving the 1959 bill, however, Governor Rockefeller noted that the bill carried out his proposals for "an all-out program of collaboration among [s]tate government, local government and private enterprise" to develop middle-income housing. Among several changes

35. By May 1, 1959, project owners had begun work on only nine cooperative and four rental projects. See Walsh, supra note 1, at 15 n.6.
37. Id.
38. Id.
39. See Walsh, supra note 1, at 13.
40. 1959 N.Y. Laws 675, §§ 1, 2, 5.
42. Id.
43. See N.Y. PRIV. Hous. FIN. LAW § 35(2) (McKinney 1976).
44. Message of the Governor, Middle Income Housing Loans, 1959 N.Y. Laws at 1764.
"designed to make this collaboration possible," the memorandum referred to the "opportunity for the transfer of new housing to private ownership after fifteen years."45

The only mention of the buyout provision in the Governor's bill jacket46 appeared in a letter from one of New York City's leading civic groups in the housing field, the Citizens Housing and Planning Council (CHPC).47 The CHPC letter sharply attacked the buyout provision as giving an unjustified possibility of extra profit to developers, who would already be receiving significant subsidies under the program.48 Further, CHPC alleged, because this extra profit would be available only upon leaving the program, the buyout provision created an incentive to withdraw housing from the Mitchell-Lama program.49 The CHPC letter argued that this change was unnecessary to draw private capital into the program.50

The legislative history of the 1960 amendment is even less illuminating. This amendment appeared in a bill principally devoted to making the existing Mitchell-Lama law reflect the creation of the New York State Housing Finance Agency (HFA).51 This bill was part of the Division of Housing and Community Renewal's (DHCR) legislative program.52 That agency's memorandum in the Governor's bill jacket mentioned the buyout provision only in passing; specifically, it noted that a fifteen-year prepayment period could result in raising the costs of the state borrowing used to finance the Mitchell-Lama loan, while a twenty-year term would reduce this potential problem.53

45. Id.
46. A "bill jacket" is the executive chamber's file on a bill sent to it by the legislature. The bill jacket includes both the documents setting out the legislative actions and all comments received by the governor's office on whether the bill should be signed or not. The governor's office routinely solicits comments on pending bills from a wide variety of organizations.
48. Id.
49. Id.
50. Id.
52. See Walsh, supra note 1, at 11-13.
53. The extension to 20 years "will serve to lessen the increased interest rate and premium [on the debt used to finance the state or HFA loans to the housing company] resulting from the 15-year privilege." Memorandum of State Division of Housing and Community Renewal at 17 (Apr. 8, 1960) (in bill jacket for 1960 N.Y. Laws 669).
B. Procedures for Withdrawal from Mitchell-Lama

In 1987, faced with the initial group of Mitchell-Lama buyouts,\(^5\) New York State and New York City issued regulations\(^5\) governing withdrawal from the program. These regulations provide for notice and review of a proposed buyout before it takes effect.\(^5\) The DHCR regulations are intended to "assure full disclosure in advance to all residents and to the public . . . to effect a smooth transition . . . and to assure that all required actions to be taken on the part of the housing company have been complied with prior to the dissolution thereof."\(^5\)

Thus, although the agency did not assert any right to prevent a buyout which meets the statutory criteria, it established a fairly elaborate procedure for withdrawal.

At least 180 days before the proposed reorganization, a project owner must submit a "notice of intent" to the DHCR, accompanied by detailed information regarding the present and proposed future status of the project.\(^5\) When the agency has received all of the required documentation, it then authorizes the owner to proceed to the next step, a public information meeting. Notice of this meeting must be given not only to tenants, but also to various public officials, including the state legislators within whose district the project is located.\(^5\)

Other regulations ensure transition of Mitchell-Lama rental tenants to rent stabilization at the last rent under Mitchell-Lama,\(^6\) notice to the local taxing jurisdictions to assure termination of the tax exemption upon reorganization, and payment of various fees owing under the program.\(^6\)

The process ends with the issuance of a certificate by the DHCR to the Secretary of State (with whom any corporate dissolution papers would have to be filed) that all legal prerequisites have been met and that the DHCR "has no objection" to dissolution. This language, however, does not purport to confer power on the DHCR to reject an application which meets the statutory criteria. Indeed, the regulations specifically state that the DHCR "shall" issue the certificate if

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\(^6\) Id. § 1750.15.
all of the prescribed steps are completed.\textsuperscript{62}

The basic provisions of the Mitchell-Lama buyout regulations apply to both rental and cooperative projects. There are, however, special requirements for cooperative buyouts. These additional requirements include: (1) advance approval by the shareholders of the expense of carrying out the preliminary steps toward dissolution; (2) the Attorney General’s acceptance of an offering plan before final DHCR approval; and (3) approval of the dissolution by a two-thirds shareholder vote.\textsuperscript{63}

The state and city procedural regulations have been the subject of at least two reported court decisions. In \textit{Winthrop Gardens v. Eimick} [sic],\textsuperscript{64} the owners of Mitchell-Lama rental projects unsuccessfully challenged the right of DHCR to promulgate these regulations.\textsuperscript{65} The court upheld the regulations, stating that they did not interfere with the absolute right to withdraw from the program, because they “do not permit the DHCR to disapprove a prepayment plan or prevent a dissolution on public interest grounds.”\textsuperscript{66} Consequently, although in some cases dissolution may be delayed, the regulations did not exceed the Commissioner’s powers.\textsuperscript{67}

More recently, in \textit{2250 Olinville Avenue, Inc. v. Crotty},\textsuperscript{68} the court

\textsuperscript{62.} \textit{Id.} \textsection 1750.14. Project owners must pay a “buyout fee” of between $2,500 and $5,000, depending on the number of apartments in the project. \textit{Id.} \textsection 1750.13. Specific provisions make it clear that the owners must absorb all of the costs of the transaction, including this fee, and cannot pass them on to the tenants or to any project fund. \textit{Id.} \textsection 1750.13(d).

\textsuperscript{63.} \textit{Id.} \textsection 1750.7-.13(d).

\textsuperscript{64.} No. 1185, slip op. (Sup. Ct., Albany County, Feb. 22, 1988).

\textsuperscript{65.} \textit{Id.} at 55-57. The presiding judge, Justice Vincent G. Bradley, upheld the regulations in all respects, pointing to the detailed regulatory authority of DHCR over Mitchell-Lama housing.

\textsuperscript{66.} \textit{Id.} at 56. The owners argued that the Mitchell-Lama law grants them an absolute right to withdraw from the program after 20 years without regulatory approval. \textit{Id.} at 52. Justice Bradley responded that the regulations “do not interfere with this right [because they] do not permit the DHCR to disapprove a prepayment plan or prevent a dissolution on public interest grounds,” but merely impose procedural requirements. \textit{Id.} at 56. The court further observed “that in all but a few cases, dissolution will not even be delayed.” \textit{Id.}

\textsuperscript{67.} \textit{See id.} The owners affected filed a notice of appeal from Justice Bradley’s decision to the Appellate Division. Before the appeal could be heard, however, the owner achieved a buyout under the challenged regulations, rendering the case moot. Since the regulations simply make the buyouts slower and more complex, but ultimately do not prevent them, appellate-level decisions may not be forthcoming in future challenges. \textit{Cf.} Orrego v. United States, 701 F. Supp. 1384 (N.D. Ill. 1988), dealing with similar temporary hurdles to withdrawal from certain federal housing programs. These burdens were imposed by an act of Congress rather than an administrative regulation. \textit{See infra} notes 201-03 and accompanying text.

\textsuperscript{68.} 141 Misc. 2d 238, 532 N.Y.S.2d 996 (Sup. Ct. 1988).
ruled against the attempt of the New York City Department of Housing Preservation and Development (HPD) to apply its buyout regulations retroactively to Mitchell-Lama projects whose owners had applied to prepay their government loans prior to the effective date of the regulations. HPD argued that it had delayed processing these applications because new regulations were about to be issued. The court ruled that the regulations could not be applied retroactively and that therefore the Mitchell-Lama owners whose applications were already pending had the right to proceed with an action alleging violation of the contract contained in their loan documents.

C. Effect of the Buyout Provision on Rental and Cooperative Projects

Under the Mitchell-Lama law, a project owner, upon compliance with the conditions of the statute, has an absolute right to remove the project from the program. While the loan documents entered into by the housing company vary in their treatment of the owner's right, the statute requires the agency supervising the loans to approve buyout applications that meet the statutory criteria. Beyond this

69. Id.

70. 2250 Olinville Ave., Inc. v. Crotty, 141 Misc. 2d 238, 532 N.Y.S.2d 996 (Sup. Ct. 1988). The validity of the regulations was not at issue in Olinville. Justice Saxe suggested that he probably would uphold the regulations, but found that, in any event, they could not be applied retroactively:

[w]hile this contractual right to repay the mortgage may be procedurally altered by municipal regulation . . . there was no such alteration in effect when the respondents refused to accept prepayment . . . The notes therefore constituted binding and valid contracts with the city, the terms of which were in no way abrogated by regulation when plaintiffs applied to prepay their mortgages.

Id. at 240, 532 N.Y.S.2d at 997.

It should be noted that Justice Saxe found the "contract" solely in the loan documents themselves, and found no occasion to analyze, or even mention, the question of whether the statutory right to prepay was itself a contract between the government and the developer. For a discussion of the constitutional contract clause issue, see infra notes 122-52 and accompanying text.

71. N.Y. PRIV. HOUS. FIN. LAW § 35(2) (McKinney 1976). See also supra notes 27-43 and accompanying text.

72. For example, HFA loan documents prohibit prepayment before 20 years but do not grant or deny the right to prepay the mortgage thereafter. Urban Development Corporation (UDC) regulatory agreements generally provide for continued regulation of the project for a period of 20 years or as long as the UDC mortgage is outstanding, whichever is longer; the mortgages themselves prohibit prepayment without consent of the UDC. The loan documents for municipally-aided projects similarly prohibit prepayment unless the regulatory agency consents.

73. Since the mortgages and regulatory agreements are contracts, one might argue that the Mitchell-Lama owner, by signing an agreement not to prepay without the mortgagor's consent, has provided the state or city with an independent legal basis for keeping a project in the program. But this contention is contrary to the plain meaning of the
threshold question, however, the effect of the Mitchell-Lama withdrawal provisions on rental as opposed to cooperative projects differs so dramatically that the two must be treated separately, even though this segment of the statute does not draw such a distinction.

I. Rental Projects

a. Rent Stabilization

i. Application of Rent Stabilization

Upon removal from the Mitchell-Lama program, a rental project located in New York City immediately becomes subject to rent stabilization. Although this conclusion has been challenged by the real estate industry and may eventually have to be resolved by the courts, it follows directly from the language of the Emergency Tenant Protec-
tion Act (ETPA). The ETPA regulates all housing not explicitly exempted by the statute, and Mitchell-Lama projects are among the classes of housing explicitly exempted. The specific exemption applies to housing "in which rentals are fixed by or subject to the supervision of" another government agency. Once a Mitchell-Lama project is removed from the program through a buyout, it falls outside of the exempted category and consequently is subject to ETPA regulations.

Any contrary argument which concludes that upon removal from the Mitchell-Lama program, a New York City rental project does not become subject to rent stabilization, requires reading the ETPA exemption to exclude housing whose rents not only "are" but were at any time in the past supervised by a public agency. In other words, exemption status would be determined once and for all as of the time the ETPA took effect (when the municipality made its "declaration of emergency") and would then be unaffected by any later changes. However, any such reading of the ETPA is inconsistent with the purpose of the provisions relating to the exemption of housing subject to regulation by other government entities, as well as with the well-

76. The ETPA rent stabilization exemptions are set out in the New York City Administrative Code § 26-504 (a) and the Emergency Tenant Protection Act, N.Y. UNCONSOL. LAW § 8625(a) (McKinney 1987). The introductory clause of the latter provision includes "all or any class or classes of housing accommodations in a municipality," but excepts certain other classes.

77. The rent stabilization exemption that applies to Mitchell-Lama housing is for housing "in which rentals are fixed by or subject to the supervision of the [S]tate [D]ivision of [H]ousing and [C]ommunity [R]enewal under other provisions of law or the New York [C]ity [D]epartment of [H]ousing [P]reservation and [D]evelopment or the New York [S]tate [U]rban [D]evelopment [C]orporation." N.Y. UNCONSOL. LAW § 8625(a)(3) (McKinney 1987). This provision covers Mitchell-Lama companies as well as several other forms of regulated housing. The original Rent Stabilization Law contained a similar exclusion for housing "owned or leased by, or financed by loans from, a public agency or public benefit corporation." NEW YORK, N.Y. ADMIN. CODE § 26-504(a)(1)(a) (1986). This exclusion was somewhat more limited, since it applied only to publicly-funded housing and not to the somewhat broader class of publicly-regulated housing. Thus the original provision, standing alone, would not exclude from rent stabilization a project which received assistance only in the form of real estate tax benefits. N.Y. UNCONSOL. LAW § 8625(a)(3) (McKinney 1987).

78. By its nature, the question will only arise at the point at which withdrawal from the Mitchell-Lama regulation has been accomplished, the precise point at which, applying the statutory language quoted supra note 77, the rents are no longer "fixed by or subject to the supervision of the DHCR or HPD." N.Y. UNCONSOL. LAW § 8625(a)(3) (McKinney 1987).

79. Under the ETPA, a municipality may declare an emergency and afford rent regulation to all buildings not already subject to rent stabilization. See N.Y. UNCONSOL. LAW § 8621 (McKinney 1987).

80. See infra notes 82-86 and accompanying text.
established interpretation of analogous clauses relating to rent-controlled apartments and publicly owned buildings.

Unlike certain other exemptions under the ETPA, the exemption of Mitchell-Lama projects from rent stabilization is not intended to encourage or deter certain landlord actions; rather, it is in the statute only because the Mitchell-Lama rents are already regulated, and additional rent regulation is not needed and would prove unworkable. Therefore, if a Mitchell-Lama project is no longer subject to the Mitchell-Lama law, the only reason for the exemption from rent stabilization no longer exists.

The provisions of the ETPA pertaining to rent controlled apartments are analogous to those pertaining to Mitchell-Lama housing. The relevant provisions state that "housing accommodations subject to" the rent control laws are not covered by the ETPA. Here again, coverage is not required because such units are already regulated. Rent controlled apartments become rent stabilized when vacant, since at that point the exemption is no longer in operation, i.e., the apartment is no longer "subject to" rent control. This result has never been the subject of dispute, and thus, the legislature did not consider it necessary to state in the statute that the exemption ended upon such change in status. Applying the same reading to a precisely similar clause of the ETPA, a Mitchell-Lama project's exemption from rent regulation will end after that project loses its Mitchell-Lama status.

Another example of a clause analogous to the Mitchell-Lama statute is the exemption for publicly-owned buildings. This provision contains no language explicitly stating that the exemption ends if the

81. Certain ETPA exemptions must be read as fixing a building's status under the law once and for all, in order to prevent the operation of the provision from undermining established housing policy. For example, buildings with fewer than six units are exempt from rent stabilization. N.Y. Unconsol. Law § 8625(a)(4)(a) (1987); New York, N.Y. Admin. Code § 26-504(a) (1986). But alterations adding a sixth apartment to a 5-unit building do not end the building's exemption. See 126 East 56th St. Corp. v. Harrison, 122 Misc. 2d 799, 473 N.Y.S.2d 910 (Sup. Ct. 1984). A contrary result would penalize an owner for creating new housing units. Similarly, reducing the apartment count below six by combining units does not lead to deregulation. This would reward elimination of an apartment, as well as penalize the tenants in occupancy.


83. Establishment of this system was perhaps the most significant feature of and motive for enacting the ETPA. In New York City this provision recaptured units that had been removed from rent control prior to 1974 and moved units still subject to control to stabilization as they become vacant. Notably, however, the ETPA in its list of exemptions did not explicitly provide that the exemption for rent-controlled apartments ceased upon vacancy. The exemption was acknowledged by all parties as operating only while the apartment remained rent controlled. If this had not been the universal understanding of the language, a specific provision to this effect would have been deemed necessary.

84. N.Y. Unconsol. Law § 8625(a)(2) (McKinney 1987).
building goes into private hands. Yet there has never been any doubt that a city-owned residential property sold to a private owner is subject to rent stabilization. The exemption has always been understood to operate only so long as its conditions are met. Likewise, there is no reason to read the ETPA as extending the exemption for Mitchell-Lama housing once the conditions of the exemption are no longer met.

ii. Initial Rent Level

Assuming that a deregulated Mitchell-Lama rental project is subject to rent stabilization, an appropriate rent level must be set. Rent stabilization sets an "initial legal regulated rent," which is generally the rent level set in the prior lease. Thus, in the case of a project withdrawing from the Mitchell-Lama program, the immediately preceding rent (i.e., the last Mitchell-Lama rent) becomes the "initial legal regulated rent." Subsequent adjustments are available only in certain circumstances specifically noted in the rent stabilization law.

Any other formulation of the initial stabilized rent would require an independent statutory basis. For example, in the case of apartments moving from rent control to rent stabilization, the law allows "the rent agreed to by the landlord and the [new] tenant" to be the basis for the stabilized rent. This right of the owner is subject to the tenant's right to seek a rollback to an administratively determined "comparable" rent.

85. Id.
86. Indeed, the only question has been what the initial stabilized rent would be. This issue was dealt with by local legislation, which preserved the rent schedules which had been "restructured" by the city while it owned the building. As a result rents would not revert to the level (often far lower) charged before the city took over the building. NEW YORK, N.Y. ADMIN. CODE § 26-507 (1986) (as added by Local Law No. 14 of 1979).

In the course of the debate over this rent restructuring issue, there was never any doubt on the part of any party that the apartments became regulated under the ETPA upon sale to a private owner.

87. N.Y. UNCONSOL. LAW § 8626(a); NEW YORK, N.Y. ADMIN. CODE § 26-512(b).
88. N.Y. UNCONSOL. LAW § 8626(b)(2). The statute provides that the initial stabilized rent is "the rent reserved in the last effective lease." Id. See also NEW YORK, N.Y. ADMIN. CODE § 26-512(b)(3).
89. Id. See also Walsh, supra note 1, at 12.
90. N.Y. UNCONSOL. LAW § 8626(d). For example, a change in services provided to the tenant would be grounds for a rent adjustment. Id. § 8626(d)(1).
91. For example, another formulation might consist of allowing the owner to set an open market rent for the first new lease, or permitting the regulatory agency to fix some intermediate point between the old rent under Mitchell-Lama and a market rent.
92. N.Y. UNCONSOL. LAW § 8626(b)(1); NEW YORK, N.Y. ADMIN. CODE § 26-512(b)(2).
93. N.Y. UNCONSOL. LAW § 8629(b); NEW YORK, N.Y. ADMIN. CODE § 26-513.
The statute governing rent stabilization explicitly states, however, that for apartments "other than those described," i.e., other than those which are specifically permitted a new rent level, the rent from the last effective lease forms the basis for the new rent.94 Thus, there is no legal basis for restructuring rents upon transfer of a Mitchell-Lama project to stabilized status.95 In its Rent Stabilization Code, the DHCR has explicitly incorporated this result.96

iii. Treatment of Surcharges

The Mitchell-Lama law requires that tenants whose income exceeds the limit for a particular project must pay surcharges, above the normal rent set for the project.97 The rent laws make no provision for the treatment of such "extra" rent.98 The legislature's silence, however, is hardly surprising, because surcharges based on income are peculiar to government-assisted programs for persons of prescribed income levels. It is unlikely that such surcharges were within the contemplation of legislators drafting a rent law for private-sector housing.

If the rent under the last effective lease prior to the buyout is the basis for the stabilized rent, these surcharges should be included in the

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94. See NEW YORK, N.Y. ADMIN. CODE § 26-512(b)(3). See also N.Y. UNCONSOL. LAW § 8626(b)(2) ("all other housing accommodations").

95. The statute does provide for adjustment of the initial rent on application of either tenant or owner "upon a finding that the presence of unique or peculiar circumstances materially affecting the initial legal regulated rent has resulted in a rent which is substantially different from the rents generally prevailing in the same area for substantially similar housing accommodations." N.Y. UNCONSOL. LAW § 8629(a); NEW YORK, N.Y. ADMIN. CODE § 26-513(a). This provision, however, addresses situations in which the normal rent formulas do not make sense when applied to an individual apartment. For example, an apartment previously occupied by a relative of the owner or by a building employee might be totally or nearly rent-free. Basing all future adjustments on this "rent" would be irrational.

The Mitchell-Lama situation, however "unique or peculiar," entails the relationship between two separate, complex regulatory systems—the Mitchell-Lama program and the Rent Stabilization Law. The "unique or peculiar" clause cannot be stretched to permit an agency to restructure rents as a way of reconciling these systems.


97. N.Y. PRIV. HOUS. FIN. LAW § 31(3) (McKinney 1976). The surcharges are approximately proportional to the percentage by which the tenant's income exceeds the maximum, but are limited by statute to 50% of the base rent to which they are added. In theory, tenants who are more than 50% over-income face eviction, but the sanction is never invoked.

98. There is no mention of surcharges in the ETPA. See N.Y. UNCONSOL. LAWS §§ 8621-8634 (McKinney 1987).
new rent. The DHCR has adopted this approach in its regulations. In addition to the statutory basis for this result, it should be noted that excluding surcharges would reduce the rent for the highest-income tenants in the project while keeping other rents unchanged—hardly an equitable result.

b. Conversion of Rental Projects to Cooperatives

The preceding discussion suggests that the rent levels of a Mitchell-Lama project located in New York City or any other community with rent stabilization do not change significantly when the project leaves the program. The project, however, would face major cost increases resulting from surrender of its two subsidies—the favorable mortgage and the tax exemption. These costs, at least in the short run, would be absorbed by the owners of the projects.

99. Although it is not stated as a rental figure in the lease, the rent including the surcharge would in fact be the last rent being paid when the apartment came under the system. Thus, including the surcharge as a part of the rent base is consistent with the statutory language.

100. The applicable section of the Rent Stabilization Code sets the initial stabilized rent at “the rent charged to and paid by the tenant in occupancy on the date such regulation [under the Mitchell-Lama law] ends.” N.Y. COMP. CODES R. REGS. tit. 9, § 2521.1(l) (1988).

101. As a result, initial rents would vary with tenant income at the time of conversion. In the future, however, this relationship would not be preserved. This result is unavoidable, given the nature of the rent laws. Except for the rent increase exemptions for elderly and disabled tenants with very low incomes, rent control and rent stabilization provide for neither income reporting nor for keying rents to ability to pay. Although this type of initial rental structure would be unusual in purely private housing, it does not pose a substantial problem. The skewing of the rents would presumably be no greater than that which often occurs under the rent laws based solely on accidents of history such as how many times the apartment has changed occupants.

102. There is no provision in the Rent Stabilization Law for passing on landlord cost increases of a particular building to rental tenants, other than those associated with increases in services or so-called “major capital improvements.” However, some costs may be passed on by way of a rent adjustment that compensates for increased owner costs under the “hardship” provision, which takes two forms. The hardship provision originally in the RSL operated by comparing the return to the owner for the last three years with that in 1968-1970. It granted the same percentage rate of return on costs as was being earned when the building entered the system. See former NEW YORK, N.Y. ADMIN. CODE § YY51-6.0(c)(6) (1978), as enacted as part of the original Rent Stabilization Law by New York City Local Law No. 16 of 1969. When the fuel crisis and other inflationary trends of the 1970s produced a situation in which this formula would yield sharply higher profits, the law was amended to provide only for a preservation of approximately the same net dollar return. 1975 N.Y. Laws 392, amending NEW YORK, N.Y. ADMIN. CODE § YY51-6.0(c)(6).

This scheme, coupled with the decline in the value of the dollar, the increase in financing costs, and the decreasing relevance of a base date at the end of the 1960s, led to major industry pressure for a new formula. The addition of an alternative hardship provision was one of the major features of the Omnibus Housing Act of 1983. It permits (subject
Thus, the simple withdrawal of a Mitchell-Lama rental project from the program would not give rise to any great windfall to the owner, at least while rent regulation exists in its present form. The owner of a Mitchell-Lama rental project, however, could profit substantially from a buyout if the project's location lends itself to conversion to a cooperative or condominium. There are now a significant number of such conversion candidates among the Mitchell-Lama housing stock in New York City.\textsuperscript{103}

Conversion of Mitchell-Lama rental projects would be governed by the same laws and regulations that apply to the cooperative or condominium conversion of other rental property.\textsuperscript{104} Under these laws, there is no bar to an owner exercising his buyout right and immediately proceeding with a cooperative or condominium conversion.

Furthermore, there is no legal obstacle to structuring this conversion as an eviction plan.\textsuperscript{105} Presumably, however, most project owners, like the overwhelming majority of owners converting buildings in New York City, would decide as a matter of business judgment to proceed on a non-eviction basis.\textsuperscript{106} Even the theoretical possibility of

\textsuperscript{103} See supra notes 12-19 and accompanying text.

\textsuperscript{104} See N.Y. GEN. BUS. LAW §§ 352-e, -eee, -eeee (McKinney 1984).

\textsuperscript{105} An eviction plan is one which

- can result in the eviction of a non-purchasing tenant by reason of the tenant failing to purchase pursuant thereto, and which may not be declared effective until at least [51\%] of the bona fide tenants in occupancy of all dwelling units in the . . . development on the date the offering statement or prospectus was accepted for filing by the attorney general . . . shall have executed and delivered written agreements to purchase . . . .

N.Y. GEN. BUS. LAW § 352-eeec(c) (McKinney 1984).

\textsuperscript{106} A non-eviction plan is one "which may not be declared effective until written
an eviction plan, however, is likely to give rise to a substantial degree of tenant anxiety. An eviction plan also raises a much sharper and more immediate question of public policy: should the persons for whom Mitchell-Lama housing was built lose their homes if they cannot afford to buy?

2. Cooperatives and Condominiums: Application of the Martin Act

As a matter of law, a Mitchell-Lama cooperative has a right to withdraw from the program after twenty years. As noted above, the statute makes no distinction, in any provision relevant to this issue, between rentals and cooperatives. Moreover, neither the Mitchell-Lama law nor its legislative history offer any guidance in applying the buyout provisions to the special procedural problems involved in converting Mitchell-Lama cooperatives to private cooperatives. Furthermore, it is unclear to what extent the Martin purchase agreements have been executed and delivered for at least [15%] of all dwelling units in the . . . development by bona fide tenants in occupancy or bona fide purchasers who represent that they intend . . . to occupy the unit when it becomes vacant.” Id. § 352-eeee(b).

As one treatise has noted, “except under unusual circumstances, eviction plans involving buildings containing units that are subject to [tenant protection laws] are relatively rare. In their place converters now resort to non-eviction plans . . .” 4 E. MORRIS, NEW YORK PRACTICE GUIDE: REAL ESTATE § 37-03(3)(b) (1986). In the first six months of 1989, in the five counties comprising New York City, 220 non-eviction plans for conversions to cooperatives or condominiums were accepted for filing, as against only 24 eviction plans. See tabulations of departmental figures in New York Co-op and Condo Insider, May 1989, at 43; June 1989, at 44; July 1989, at 50; August 1989, at 52; September 1989, at 52; October 1989, at 55.

Since a large portion of eviction plans are in very small buildings, the disparity in number of apartments affected is even greater. For the first six months of 1989, the non-eviction plans accepted for filing in New York City affected 14,499 apartments as against 549 apartments in eviction plans. Id. In particular, there have been virtually no attempts to convert highly visible or well-known properties, such as Parkchester in the Bronx, Lincoln Towers, Tudor City, London Terrace or Park West Village in Manhattan, on an eviction basis. It seems safe to assume that the same course would be followed in any Mitchell-Lama project, if only to avoid the extraordinary outcry that would result from an eviction plan.

107. See supra notes 28-70 and accompanying text.

108. See supra note 63 and accompanying text. As in the case of rentals, the government mortgage may be paid off, the real estate tax exemption surrendered, and the project conveyed to a newly organized unregulated corporation owned by the previous owners of the Mitchell-Lama company. N.Y. PRIV. HOU. FIN. LAW § 35 (McKinney 1976).

109. The buyout provision applies to cooperatives simply as a result of a lack of limiting language, rather than a specific intent one way or the other. This lack of focus on the cooperatives is hardly surprising. Virtually no one in the late 1950s and early 1960s could have envisioned a situation in which cooperative apartments in areas of New York City far removed from the well-known “Gold Coast” neighborhoods would be the immensely valuable assets they are today. The prospect of unit owners in a subsidized mid-
the set of complex laws and regulations governing the creation of cooperatives and condominiums in New York, applies or should apply to the conversion of a Mitchell-Lama cooperative from a governmentally regulated entity to a private unregulated entity.

Application of the Martin Act to conversion of Mitchell-Lama projects raises two issues: first, whether the Martin Act applies at all to Mitchell-Lama conversions; and second, assuming it does, whether the form of regulation now prescribed for ordinary cooperative conversions is workable or even appropriate in these transactions. These issues are complicated by the fact that the drafters of the existing regulatory scheme, understandably, did not address the issue of the "conversion" of a housing development which is already a cooperative.

a. Application of the Martin Act to Mitchell-Lama Conversions

In regulating cooperative conversions, the Martin Act is both a securities law and a housing law. As a regulation of securities, the Act applies only to an "offering," even though the term "security" is explicitly defined to include cooperative or condominium interests in real property. If reorganization of a Mitchell-Lama cooperative into a non-regulated cooperative involved both the creation of a new entity and the raising of additional equity, an "offering" would clearly have taken place and the Martin Act would apply. If, however, reorganization was accomplished by amending an existing corporate charter, or by organizing a new company without the need for raising additional equity, it is unlikely that an "offering" has taken place for the purposes of the Act.

Viewed as a tenant protection law, on the other hand, the Martin Act should apply regardless of the form of the transaction. The New
York Attorney General has adopted this position and has asserted jurisdiction under the statute over all such conversions.\textsuperscript{114}

\textit{b. An Appropriate Regulatory Structure Under the Martin Act}

The problem of applying the specific regulatory structure of the Martin Act is more complex. There are three levels of regulation. The first level is the basic language of the Martin Act regarding realty offerings, which, as a part of a securities law rather than a housing law, addresses primarily the protection of investors rather than homebuyers.\textsuperscript{115} The second level is a series of sections chiefly related to tenant protection,\textsuperscript{116} such as the right of rental tenants to purchase their own apartments and the protections afforded against evictions. The third level consists of the detailed regulations issued by the New York Attorney General governing cooperative and condominium offerings, particularly conversions, which include requirements for the contents of an offering's prospectus.\textsuperscript{117}

Each level of regulation contains material that is difficult to apply to the reorganization of an existing government-regulated cooperative. The extraordinarily detailed regulations now applicable\textsuperscript{118} do not address, nor were they intended to address, a Mitchell-Lama-type "conversion." If the legislature permits Mitchell-Lama cooperatives to go through the buyout process, some substantial modifications of the existing regulatory structure will be needed. The policy question...
raised is whether the goals of disclosure and protection of the present residents will best be met by forcing such a transaction into a mold into which it does not fit. The best approach would be a separate section of law assuring full disclosure, requiring majority or super-majority consent, protecting those unable to afford any additional equity that might be required as a result of a buyout, and yet not imposing requirements developed for a completely different kind of transaction.

III. Constitutional Questions

Any governmental action to eliminate or substantially restrict Mitchell-Lama's twenty-year prepayment provision is likely to implicate at least two constitutional concerns. First, legislative repeal or modification of the statutory prepayment right, part of the inducement for investors to enter the program, may constitute a breach of contract between the state and the owner and could thus violate the contract clause of the United States Constitution. Second, the state's requirement that owners continue to make their projects available for a substantial additional period to members of a specific income group arguably constitutes a violation of the fifth amendment's takings clause: the state "takes" the property for "public use" without providing "just compensation" to the Mitchell-Lama project owner.

A. The Contract Clause

In order to establish that modification of the buyout provision is a violation of the contract clause, the Mitchell-Lama owners must show: (1) that the Mitchell-Lama law constitutes a contract between the state and the owners; (2) that such a modification is an "impairment" of that contract; and (3) that the impairment is not permit-

120. U.S. Const. amend. V. The fifth amendment provides in pertinent part that "[n]o person shall be . . . deprived of . . . property, without due process of law; nor shall private property be taken for public use, without just compensation." Id.
121. See United States Trust Co. v. New Jersey, 431 U.S. 1, 17 (1977). The contract clause is only triggered when there is evidence of a contract. A statute "may contain provisions, which when accepted as the basis of action by individuals, become contracts between them and the state" and consequently subject to the contract clause. State of Indiana ex rel. Anderson v. Brand, 303 U.S. 95, 100 (1938). In the case of legislative enactments, a contract is created "when the language and circumstances evince a legislative intent to create private rights of a contractual nature." United States Trust Co., 431 U.S. at 17 n.14.
122. 431 U.S. at 17 n.14. In order for an action to succeed under the contract clause,
ted under the contract clause of the Constitution.\textsuperscript{123}

1. Mitchell-Lama as a Contract

Current case law suggests that there is considerable reason to doubt whether the prepayment provisions of the Mitchell-Lama law, however much they may have induced developers to join the program, constitute a contract between the state and the Mitchell-Lama owners.\textsuperscript{124} In the absence of explicit statutory language creating a contract, the Supreme Court has generally not recognized a contractual obligation between a state and a private entity arising out of a statute.\textsuperscript{125}

The Mitchell-Lama law does not contain such explicit contractual language. The buyout clause, which provides that the company “may

\begin{itemize}
  \item subsequent legislative or regulatory action must have impaired the contract. \textit{Id.} A contract is impaired by legislative or regulatory action when it decreases the value of a public contract. \textit{See id.} at 18-21.
  \item 123. \textit{Id.} at 21. According to the Supreme Court, not every impairment of a public contract violates the contract clause. \textit{Id.} As the Court stated in Home Bldg. & Loan Assn. v. Blaisdell, 290 U.S. 398 (1934), “the prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula.” \textit{Id.} at 428. Consequently, a court must analyze whether the particular impairment is unconstitutional.
  \item This part of the contract clause analysis is by far the most involved. Initially, it must be determined whether the obligation of the state is one which falls “within the reserved powers which can not be contracted away.” \textit{United States Trust Co.}, 431 U.S. at 23-25. The two principal reserved powers cited by the courts as permitting impairment of public contracts are the power of eminent domain and the police power. \textit{Id.} at 24. As a general rule, laws and regulations which can be construed as an exercise of either of these powers are upheld as long as they are reasonable. \textit{Id.} at 24-25. Cases, however, which involve a financial obligation of the government do not automatically fall within a reserved power, and therefore must meet the standard of “reasonable and necessary to serve an important public purpose.” \textit{Id.} at 25.
  \item 125. \textit{See Atchison}, 470 U.S. at 451. The Supreme Court in \textit{Atchison} rejected the contention that the statute that created the National Railroad Passenger Corporation (Amtrak), and that the prescribed financial relations between it and the railroads whose passenger service it was to take over was a contract between the government and the railroads. The Court stated the governing doctrine as follows:
  \item \textit{For many decades, this Court has maintained that absent some clear indication that the legislature intends to bind itself contractually, the presumption is that ‘a law is not intended to create private contractual or vested rights but merely declares a policy to be pursued until the legislature shall ordain otherwise.’ This well-established presumption is grounded in the elementary proposition that the principal function of a legislature is not to make contracts, but to make laws that establish the policy of the state. Policies, unlike contracts, are inherently subject to revision and repeal, and to construe laws as contracts when the obligation is not clearly and unequivocally expressed would be to limit drastically the essential powers of a legislative body. Thus, the party asserting the creation of a contract must overcome this well-founded presumption.}
\end{itemize}

470 U.S. at 465-66 (citations omitted).
voluntarily be dissolved, without the consent” of the regulatory body, after twenty years, is no more contractual in substance than any other statutory provision which provides that a party “may” perform a certain act.

The buyout clause may be contrasted with statutory provisions dealing with the issuance of government bonds, which explicitly “covenant” that the government will take (or refrain from taking) certain actions, in order to protect bondholders. Courts have recognized that these provisions create a contractual obligation between the state and its bondholders. Similar explicit covenants for the benefit of bondholders are common in statutes authorizing government or agency debt. The most relevant example, found in the Private Housing Finance Law immediately following provisions of the Mitchell-Lama law, is the act creating New York State’s Housing Finance Agency (HFA). After authorizing HFA debt, the statute explicitly provides that the state “does hereby pledge to and agree with the holders of any notes or bonds issued under this article” that their rights will not be impaired. Furthermore, the state explicitly “covenants” with HFA bondholders “in consideration of the acceptance of and payment for the notes and bonds” that the HFA and its notes and bonds will remain exempt from taxation.

The HFA Act is particularly relevant as a comparison to the Mitchell-Lama Law, since it concerns the same subject matter and was in fact enacted originally for the purpose of financing Mitchell-Lama housing. Its language clearly illustrates that the legislature is

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126. See N.Y. PRIV. Hous. FIN. LAW § 35(2)-(3) (McKinney 1976).
127. See United States Trust Co. v. New Jersey, 431 U.S. 1 (1977). United States Trust Co. is one of the few modern cases in which the Supreme Court invalidated a statute as an impairment of a government’s contractual obligation. New York and New Jersey, in connection with the establishment of a Port Authority commuter rail subsidiary, enacted strict limits on the Authority’s future involvement with deficit mass transit operations, and embodied this limitation in the statute in words of covenant with bondholders. See id. at 10. The Court held that subsequent repeal of this limitation was unconstitutional, at least as to bond issues which took place while the covenant was law.

The Atchison Court, citing United States Trust Co., relied on the difference between language explicitly creating a contract (such as “covenant”) and other statutory language in determining when a contract is created for contract clause purposes. The Atchison Court noted the presence of language of covenant in the laws at issue in United States Trust Co., and found the absence of such language significant in finding that no contract existed in the case before it. Atchison, 470 U.S. at 469-70.

129. Id. The law authorizes HFA “to include this pledge and agreement of the state in any agreement with the holders of such notes or bonds.” Id.
130. Id. § 54.
131. See generally supra notes 39-53 and accompanying text. See also Message of the Governor, Middle Income Housing Loans, 1959 N.Y. Laws 1764.
capable of explicitly creating a contractual obligation when it wishes to do so. Thus, regardless of how much a change would upset the expectations of those who entered the program, the HFA Act furnishes a strong argument against reading the buyout provision as a legally enforceable contract between New York State and Mitchell-Lama owners.132

2. Impairment

If the courts do find that the Mitchell-Lama buyout provisions constitute a contract, the next question is whether or not the contract has been “impaired” under the Constitution. The law on this issue, and on the related question of whether an impairment is unconstitutional, is far from clear.133

The most accepted case of an unconstitutional impairment of con-

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132. Another analogy to the Mitchell-Lama buyout provision exists in what has come to be known as a “moral obligation” bond. The New York State Constitution imposes the same limits on state-guaranteed debt as on direct state debt: “[t]he credit of the state [may not] be given or loaned to or in aid of any individual, or public or private corporation or association . . . .” N.Y. CONST. art. VII, § 8 (1). Various exceptions are provided in this section and elsewhere in the constitution. If a proposed loan of the state's credit—i.e., the placing of its credit behind a private or agency borrowing, such as by providing a guarantee—does not fall within one of these exceptions, it would require a constitutional amendment, which must be approved by voter referendum after approval by two separately-elected legislatures. Id. Thus, the purpose of creating an agency like the HFA is to permit bonds for self-sustaining projects to be issued outside of these restrictions.

The need for some additional security to lenders, in the form of state backing not amounting to a guarantee, led to the development of the “moral obligation” device. Under this scheme, a reserve fund is set up by the agency to secure payment of debt service. If this fund falls below the amount prescribed by the statute (the maximum principal and interest required to be paid, under existing bonds, in any one future year), the agency certifies the shortfall to the Governor and the budget director. Then, the amount needed to restore the funds “shall be apportioned and paid to the agency during the then current state fiscal year.” N.Y. PRIV. Hous. Fin. Law § 47(1)(d) (McKinney 1976).

A contractual obligation to stand behind the HFA bonds would be an unconstitutional guarantee under the New York Constitution. Accordingly, this language, despite its mandatory phrasing, does not create—and is specifically designed not to create—a contract. The state is expected to back up the bonds. In fact, it has never failed to honor its obligations under these clauses when shortfalls have arisen. This duty to repay, however, is not legally enforceable—it is a moral obligation.

The HFA “moral obligation” language surely sounds more like a contract than does the Mitchell-Lama buyout provision. Yet the former is clearly not a contract; it is difficult, then, to see how the latter can be held to create enforceable contracts. The state may well commit a breach of faith if it now eliminates 20-year buyouts, but this is quite different from a legally cognizable breach of contract.

133. See United States Trust Co. v. New Jersey, 431 U.S. 1 (1977) (invalidating change in Port Authority bond covenant legislation); City of El Paso v. Simmons, 379 U.S. 497, 516-17 (1965) (upholding change in land grant procedures cutting off originally unlimited right of buyers to redeem their defaults and reclaim land).
tract by a state is where a statute denies or delays payments that it has promised to its citizens. Thus, in *Flushing National Bank v. Municipal Assistance Corp.*, the New York Court of Appeals had no difficulty in striking down a temporary moratorium on payment of certain New York City notes enacted in response to the fiscal crisis of the mid-1970s. The *Flushing* decision was grounded in the requirement of the New York State Constitution that municipal debt be backed by the "full faith and credit" of New York City. This "full faith and credit" requirement was held to bar the legislature from temporarily relieving New York City of its payment obligation.

Although the *Flushing* decision was not based on the federal Constitution, the court's approach and the opinion make it clear that the state’s actions would have been considered an unconstitutional impairment of contract if it had been necessary to reach that issue.

The policy considerations underlying the *Flushing* decision, however, are distinguishable from those in the Mitchell-Lama buyout scenario. In *Flushing*, the state was the debtor, and the temporary moratorium weakened the position of its creditors. Under the Mitchell-Lama program, the roles are reversed: the government is the lender, and a modification of the twenty-year moratorium would prevent the debtor from making a prepayment to the government. There appears to be no case law directly addressing the issue of impairment of contract in this rather unusual circumstance.

The federal government is currently confronting the same issue as that facing the state government in regard to the Mitchell-Lama program. Under various federal housing programs, the owners of housing projects have a right to prepay their mortgages after twenty years and become free of governmental regulation. The Congres-

137. *See N.Y. Const., art VIII, § 2: “[n]o indebtedness shall be contracted by any county, city, town, village or school district unless such county, city, town, village or school district shall have pledged its faith and credit for the payment of the principal thereof and the interest thereon.”*
138. *See Flushing*, 40 N.Y.2d 731, 740, 358 N.E.2d 848, 854, 390 N.Y.S.2d 22, 29. Similarly, legislation potentially undercutting a public agency’s financial strength in a fashion inconsistent with promises made to bondholders (even where the new law does not by its terms purport to require or permit a delay in payment) has been struck down. *See, e.g., United States Trust Co.*, 431 U.S. 1 (1977).
140. *See infra* notes 201-03 and accompanying text.
141. *Id.*
sional Research Service (CRS) of the Library of Congress examined this issue last year at the request of the Senate subcommittee considering buyout moratorium legislation.142 Noting the broad scope of the legislative police power and the reluctance of courts to expand contract rights as a limit on this power, the memorandum suggested that congressional restrictions on existing prepayment rights "would likely be upheld if plausibly related to a broad public interest."143

The contracts clause of the federal Constitution limits only state legislative impairment of contracts.144 Interestingly, although the contracts clause would not directly apply, the CRS memorandum also considered the validity of a prepayment moratorium under the standard applied to state impairment of contracts.145 Its conclusion on this issue was considerably more tentative: "it would thus appear that . . . [such changes] may be arguably constitutional even if the reasonable and necessary standard applicable to state impairment of state contracts were applied."146

The federal legislation addressing this issue has essentially imposed a moratorium on project buyouts under certain programs unless it can be shown that the housing in question would remain affordable.147 This legislation was upheld by one federal court,148 after the court rejected challenges to the legislation's constitutionality and the statute's retroactive applicability in the particular circumstances of the case.149

143. Id. at 8.
144. See U.S. Const. art. I, § 10. This restriction, however, does not apply to the federal government. Congressional action impairing a contract right would be invalid only if the restriction amounted to a deprivation of property without due process, or a taking without just compensation. See U.S. CONST. amend. V.
145. CRS Memorandum, supra note 142, at 6-8.
146. CRS Memorandum, supra note 142, at 10.
149. Congress had placed a November 1, 1987 effective date on the provisions in a bill that was not signed into law until February 5, 1988, although its existence and progress were surely well-known to the industry. The project in question would have been eligible for prepayment in early January, and the owners sought to prepay at that time. Interestingly, the federal agency involved agreed with the owners that the provision was not to be applied retroactively. The court, in deciding a class action suit brought by affected tenants, rejected the agency's determination as inconsistent with clear statutory language, and upheld the legislation, including its retroactive effect. See Orrego, 701 F. Supp. at 1396-98.
B. Taking Without Compensation

The fifth amendment to the United States Constitution prohibits the government from "taking" private property for public use without paying the owner just compensation.\(^{150}\) Arguably, a modification or elimination of the Mitchell-Lama buyout provision by the New York State legislature would violate the takings clause.

The takings clause applies to actual appropriation of property by the government for some public use, i.e., the eminent domain power, but the Supreme Court has held that it is also possible for a state to violate the takings clause without completely confiscating property.\(^{151}\) A compensable taking can occur when the government merely regulates an owner's use of his property in such a way that the owner is required to put it to a certain use, or to make it available to others.\(^{152}\) Thus, any authorization of a physical intrusion into property by another—even to the extent of requiring an apartment house owner to let a cable television company run wires into the building—is a taking.\(^{153}\) Furthermore, the Supreme Court recently held that a California agency had committed a taking by conditioning a building permit on the requirement that an owner of coastal property grant a right of way to the public along the beach front. The Court relied heavily on the fact that the owner was not merely being subjected to regulation but was required to give others an easement through his land.\(^{154}\)

In each of these instances, the public purpose to be served by the regulation was valid, and the government had a legitimate, and, perhaps, compelling concern for making or keeping the property in question available for a particular use. However, the takings clause is intended to ensure that public needs should be financed through the public treasury, rather than imposing the burden on whomever happens to own the property in question. The importance of dedicating certain property to a particular use does not permit the government to avoid paying a judicially determined "just compensation" to the owner.

The Supreme Court has not clearly defined at what point regula-

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\(^{150}\) U.S. CONST. amend. V. This provision applies to the states through the due process clause of the fourteenth amendment.

\(^{151}\) See, e.g., Griggs v. Allegheny County, 369 U.S. 84 (1962); United States v. Causby, 328 U.S. 256 (1946).

\(^{152}\) Id.

\(^{153}\) See Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 438 (1982). Similarly, the use of air space as a flight path, although generally lawful, can be a taking if it significantly interferes with the owner's enjoyment of the land below. See Griggs v. Allegheny County, 369 U.S. 84 (1962); United States v. Causby, 328 U.S. 256 (1946).

tory control over property goes beyond permissible state "police power" and becomes a "taking."\textsuperscript{155} New York State court decisions on this issue also have been ambiguous.\textsuperscript{156} A federal district court recently held that restricting buyout rights under a federal program similar to Mitchell-Lama\textsuperscript{157} was not a taking.\textsuperscript{158} As noted above, owners were given the right to buy out their buildings after twenty years, but legislation required that owners desiring to prepay their mortgages must first show that low-income tenants would not be unduly burdened if the buyout took place.\textsuperscript{159} The court noted that "except for the expected ability to prepay and raise rents, [the owners] retain[ed] the same legal status as before."\textsuperscript{160} Thus, the owners had not been unconstitutionally deprived of a property right. The Emergency Low Income Housing Preservation Act, however, imposed only a two-year moratorium on buyouts pending development of a more long term solution. The Court's reasoning may not be so persuasive if simply locking owners into the program becomes the long term solution.

In the Mitchell-Lama context, owners could contend that New York State, by deciding that a project is to be targeted to a certain population group, and regulated accordingly for a substantial period of years beyond the current buyout period, has "taken" an interest in the project for that term of years. Even if public need justifies the "taking," the state cannot impose this change without compensation to the owner.\textsuperscript{161}

\textsuperscript{155} See Michelman, Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law, 80 Harv. L. Rev. 1167 (1967); Sax, Takings, Private Property and Public Rights, 81 Yale L. J. 149 (1971). A series of notable Supreme Court decisions late in the 1986-87 term suggests a closer and more critical scrutiny of government action in this area, but seems to do little to resolve the confusion. See, e.g., First English Evangelical Lutheran Church v. County of Los Angeles, 482 U.S. 304 (1987). The full impact of these decisions is not clear.


\textsuperscript{160} Orrego, 701 F. Supp. at 1396.

\textsuperscript{161} See Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922). As Justice Holmes
The basis for this contention derives both from the inherent nature of the “takings” doctrine and from the approach of the Supreme Court in the recent cases noted above in which the Court found takings where government mandated the intrusion on property for a cable television connection, and where a scenic easement was mandated as a condition for construction on the coastline.

According to this argument, a distinction would be made between regulation, however stringent, which merely tells an owner what he may not do, and a law putting an affirmative obligation upon an owner to make his property available for a purpose which serves the public good. The former may perhaps constitute a taking, but only if the regulation becomes confiscatory; the latter is, however, per se a taking. Such a per se taking is presumptively invalid.

This line of argument has very recently been given strong support by the New York State Court of Appeals in Seawall Associates v. City of New York, invalidating New York City’s legislation which sought to require owners of single-room-occupancy (SRO) housing not only to preserve the units for that use but to rent out (as SROs) those being held off the market or those which become vacant in the future. The sharp loss of affordable SRO-type housing units (partly as a result of tax benefits to encourage conversion to “standard” housing), and the appearance of many former SRO residents among the ranks of the homeless, led to a series of measures: eliminating the benefits awarded in connection with conversion of SROs, prohibiting many such conversions outright, and finally, affirmatively requiring that vacant SRO units be rehabilitated if needed and rented out—thus even denying owners the right to “warehouse” the units in hopes of a change in the law.

The Court of Appeals, in its 5-2 decision striking down the most recent enactment, focused on this last provision requiring owners to rent out vacant units as SROs. The court accepted the owners’ argument that the law “has resulted in a physical occupation of their stated, when the police power is not involved, no matter how small the private property interest, and no matter how great the public need, “the Fifth Amendment ... provides that it shall not be taken for such [public] use without just compensation.” Id. at 415.

162. For instance, zoning regulations, which are a form of negative obligations, are often upheld as constitutional under the police power. See, e.g., Village of Euclid v. Ambler Realty Co., 272 U.S. 365 (1926). More recently, the landmark laws have been upheld. Penn Central Transp. Co. v. City of New York, 438 U.S. 104 (1978).


165. Id. at 99-101, 542 N.E.2d at 1060-62, 544 N.Y.S.2d at 543-45.
properties [by others] and is, therefore, a per se compensable tak-

The decision cited recent Supreme Court decisions, particularly Loretto v. Teleprompter Manhattan CATV, supporting the view that if the government requires an owner to accept actual physical occupation of any part of his property for a public purpose, a compensable taking has occurred.

The majority in Seawall rejected the suggestion of the dissenters that its decision could lead to undermining the constitutionality of the rent control laws and other regulations imposing severe restrictions on owners' rights to manage their own property. Characterizing the SRO law as one which "forc[es] plaintiffs to rent their properties to strangers," the majority opinion drew a distinction between "restrictions [such as rent control laws or provisions for non-eviction co-operative conversions] imposed on existing tenancies where the landlords had voluntarily put their properties to use for residential housing" and a law designed to "force the owners, in the first instance, to subject their properties to a use which they neither planned nor desired." The decision also found the local law at issue to be an impermissible uncompensated regulatory taking, because the interference with the rights of ownership was so extreme.

Most significant in the context of Mitchell-Lama is the court's determination of "physical taking." Under present law, Mitchell-Lama owners who buy out have the right—subject to all of the rent laws and other restrictions applicable to housing generally—to rent apartments as they see fit, convert them, or not rent them at all pending a decision as to their future use. A substantial deferral or elimination of the buyout right would require them to continue to rent these apartments to members of a defined population group, at specially regulated rents, and under a detailed regulatory system.

This requirement would be motivated by a need to preserve the inadequate supply of affordable housing. But if governmentally-im-

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166. See id. at 102-06, 542 N.E.2d at 1060-65, 544 N.Y.S.2d at 545-48.
168. Id. at 427; Seawall, 74 N.Y.2d at 102, 542 N.E.2d at 1062, 544 N.Y.S.2d at 545.
169. See Seawall, 74 N.Y.2d at 112 n.11, 542 N.E.2d at 1068, 544 N.Y.S.2d at 551 n.11.
170. Seawall, 74 N.Y.S.2d at 105, 542 N.E.2d at 1064, 544 N.Y.2d at 547.
171. Id.
172. Id.
173. Id.
174. See supra notes 70-118 and accompanying text.
175. See Governor's Program Bill No. 30 (1989). The statement in support of the proposed bill to limit Mitchell-Lama buyouts states that "there is currently a shortage of safe, decent and affordable housing" and that legislative inaction "will exacerbate a grow-
posed requirements to rent out SROs are invalid, even where the fate of the poorest and most dependent population groups is at stake and even in the face of a severe homelessness crisis, can such requirements be sustained in the interest of preserving middle-income units?

The New York Court of Appeals, if it adheres to its view in Seawall Associates, may well answer “no” to such a question. A change in the rules on buyouts could easily be viewed (as was the New York City SRO moratorium) as an invalid attempt to “force individual property owners to bear more than a just share of obligations which are rightfully those of society at large.”

Apparently, the takings argument has not been raised by any party involved in the Mitchell-Lama dispute. However, if there is a constitutional argument against restricting buyouts, the strongest ground is the takings clause. But regardless of the ultimate result of any constitutional challenge, there are significant public policy considerations which should make the New York State legislature hesitate before creating a sweeping change in the Mitchell-Lama law.

IV. Policy Considerations

Assuming that the legislature can modify the buyout provision without violating the Constitution, it must determine what action, if any, to take. The policy questions involved in this decision are numerous, particularly in the case of rental projects, and there are substantial arguments in favor of every party’s interests. Here again, it is necessary to analyze rental and cooperative projects separately.

A. Rental Projects

The sponsors of post-1959 Mitchell-Lama developments entered the program under a set of rules that permitted withdrawal after a stated period. Those in favor of the present buyout scheme argue that the government should permit owners to exercise their buyout rights in fairness to those who were induced by that provision to develop Mitchell-Lama projects. Proponents of the current buyout provision also argue that changing the rules this late in the program’s life would cause potential investors to lose faith in the government’s ability to keep its promises, thus creating a disincentive to private develop-

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177. See supra notes 41-70 and accompanying text.
opers to participate in future housing programs.\textsuperscript{178}

The real estate industry unsuccessfully made similar arguments when rent regulation was extended to housing built when new construction was not regulated.\textsuperscript{179} Owners claimed that they developed new housing only on the understanding that it would not be regulated. The legislature was not persuaded by the prediction that breaking this "promise," as it was characterized, would prevent owners from trusting the government in the future.\textsuperscript{180}

Mitchell-Lama developers, however, appear to have a stronger argument than the opponents of rent stabilization, for two reasons. First, although the twenty-year buyout provision was not part of a formal contract, it was part of a package of inducements given to developers in order to draw the private sector into the program.\textsuperscript{181} Those who chose to develop a Mitchell-Lama project entered into a governmental program based on a series of ground rules. By contrast, in the case of housing not subject to the rent laws when built, there was no special relationship originally established between the government and the owner. The owner simply proceeded to build under the laws generally applicable to rental housing in effect at the time, and later had to change his course of conduct in order to comply with the change in that general body of law.

Second, the government usually "changes the rules" by a general amendment to the applicable law. For example, the legislature determines that existing housing should be rent-regulated or have smoke detectors. A builder who did not contemplate these rules when he chose to build may now be worse off, but only as a result of a general exercise of the legislative power which affects every builder in the industry. Thus, no one group of builders is singled out.

In the case of Mitchell-Lama, however, amending the buyout provision would withdraw a right which was explicitly conferred by law on a defined group. Although preservation of the Mitchell-Lama projects is arguably an important public interest, the legislature must

\textsuperscript{178} N.Y. Times, July 6, 1988, at B3, col. 1.

\textsuperscript{179} The New York City rent control law applies only to prewar housing. The Rent Stabilization Law of 1969 (New York City Local Law No. 10 of 1969) placed buildings built after the war that had six or more apartments under rent regulation, but post 1969 construction continued to be exempt. The ETPA, as an incidental revision to rent stabilization, brought buildings constructed between 1969 and 1974 under its scope.

\textsuperscript{180} See Message From the Governor, Middle Income Housing Loans, 1959 N.Y. Laws at 1764; Bill Jacket for 1959 N.Y. Laws 675.

\textsuperscript{181} See generally supra notes 28-34 and accompanying text. See also Walsh, supra note 1, at 13-14.
address the question of fairness when imposing the burden on one particular group whose rights were established by the original statute.

The argument in favor of restricting buyouts focuses on the need to preserve middle-income housing. The Mitchell-Lama projects are an important housing resource for those who cannot afford conventionally financed housing. In particular, they are a major source of affordable family-sized units, which are extremely scarce in many portions of New York and which the private sector cannot readily produce. Replacing any major portion of this housing with new middle-income units would entail enormous costs—far beyond those incurred in building the projects two or more decades ago—at a time when state and municipal resources are strained and when the drastic federal cutbacks of recent years have sharply reduced the major source of funding available for any such program.

On balance, assuming that the buyout can be carried out without adversely affecting existing tenants, the arguments favoring the buyout right, in the case of rental projects, appear more persuasive.

B. Cooperative Projects

The situation with respect to Mitchell-Lama cooperatives is somewhat different. The arguments for keeping units within the program are similar to those that apply to rental developments. The arguments for permitting withdrawal from regulation, however, are far weaker.

In the case of rentals, the argument for leaving the existing buyout provision intact rests on the notion that the government should respect the legitimate expectations of those who entered the program. The argument may be expressed in terms of fairness, sanctity of contract, or simply as a fear of deterring future private participation in housing programs. This argument, however, does not really apply to cooperatives. Residents of Mitchell-Lama cooperatives did not come into the program in order to make future profits by taking the projects private. They did so in order to obtain housing at reasonable costs.

In addition, cooperative owners, unlike the rental project owners, have been the direct beneficiaries of the Mitchell-Lama aid provided over the years. In contrast, the developer of a rental project is, in a sense, analogous to the builder under a government contract. He is

182. See N.Y. Times, July 6, 1988 at B3, col. 3.
“paid” in the form of the Mitchell-Lama subsidies for doing a job for the government—creating affordable housing. The program’s limits on rents and profits cause the bulk of this “payment” to be passed through to the intended beneficiaries—the rental tenants. A proposed buyout in a rental project pits the owner’s right to enter the private market against the rights of present residents, those on waiting lists, and the next generation of middle-income tenants to continued use of the project. Present rental tenants, however, who have received the benefits of Mitchell-Lama projects as long as they lived there, hardly have the right to demand private-market profits in addition to these benefits. The same argument should apply to cooperative tenant-shareholders.

Cooperative tenant-shareholders in Mitchell-Lama projects chose their housing for the same reason as did tenants in Mitchell-Lama rental projects—because it offered far more for the money than the private sector could provide. These shareholders, like renters, receive the benefits of the subsidy program each month when they pay low maintenance as a result of the governmental benefits given to the project. The cooperative owners in the typical Mitchell-Lama project, therefore, are more closely analogous to renters than to private sector cooperative owners.184

The cooperative projects are regulated in minute detail by the state or the city, under provisions substantially identical to those governing rental projects.185 Mitchell-Lama cooperative residents often find themselves being treated, and reacting, not like private sector tenant-shareholders, but like rental tenants whose landlord happens to be the government.

Mitchell-Lama cooperative residents may have a right to any profit on resale that deregulation would bring when the subsidies, by their own terms, expire. They may have some claim to a liberalization of the resale formula, particularly if some portion of the proceeds are to be used for public benefit. But they do not have a vested right to the major immediate profits that may result from taking the project private under the twenty-year buyout provision, and selling their apartments at free market prices.

184. Generally, Mitchell-Lama cooperative owners’ equity is 5% of a very low construction cost, usually a few hundred dollars per room. See N.Y. PRIV. HOUS. FIN. LAW § 12 (McKinney 1976).

185. The statute applies substantially all of its restrictions to all “projects” or “companies,” distinguishing only in rare instances between rental and “mutual,” or cooperative, developments. See supra notes 3-15 and accompanying text.
V. Alternative Solutions and Recommendations

A. Alternative Solutions

Several New York State housing programs other than Mitchell-Lama have recently faced the consequences of termination of tax benefits or other assistance and accompanying deregulation. In addition, an early-buyout clause under several federal housing assistance programs is a subject of national controversy. The approaches which follow, some of which have been used in these housing programs, suggest different ways of dealing with the Mitchell-Lama situation.

1. Preservation of the Status Quo

The simplest possibility is to leave the present law unchanged and permit buyouts to take place when market forces dictate. This would permit, after twenty years, the deregulation that would take place in any event a decade or two later upon the expiration of the tax exemption and the payoff (at the end of its full amortization schedule) of the project loan.

State government regulation has been permitted to expire for housing built under the Limited Dividend Housing Companies Law (LDHC).186 This program, originally enacted in 1926, provided assistance in the form of real estate tax exemptions but not government mortgages.187 Although they lack built-in governmental financing, limited-dividend companies are similar to Mitchell-Lama companies and operate under a very similar regulatory scheme.

Although tax exemptions under LDHC were provided for a period of up to fifty years, by the late 1970s and early 1980s the exemptions for the first generation of projects were expiring. At that point, the individual projects were receiving no special subsidies, yet were subject to comprehensive state regulation. The law permitted deregulation of cooperatives but not rentals.188 The DHCR, after unsuccessful attempts to amend the law and eliminate this restriction, permitted certain rental projects to be taken private by an indirect route. This was done by organizing a new company not subject to the Private Housing Finance Law, conveying the project from the old company

187. The original projects, a number of which were developed under union auspices, were financed privately. More recent projects used federally-insured mortgages or other forms of federal assistance.
188. N.Y. PRIV. HOUS. FIN. LAW § 84(8) (McKinney 1976). This provision permits DHCR to waive its regulatory powers over “mutual housing companies” (i.e., cooperatives) after the expiration of the tax exemption.
to the new company, and then authorizing dissolution of the old company.

2. Gradual Transition

Another approach is to provide a gradual transition to an unregulated status. This approach was followed by the other major class of New York regulated housing companies which predates Mitchell-Lama: the redevelopment company.189

Redevelopment companies received assistance in the form of municipal property tax exemptions, but did not receive governmental assistance in financing the project costs. The Redevelopment Companies Law authorized tax exemptions for a period of up to twenty-five years. Thus, in the early 1970s, when the tax exemptions for the initial projects were about to expire, the prospect of a sharp increase in real estate taxes, coupled with the termination of government regulation posed a threat to the continued ability of the projects to provide affordable housing.190

Separate legislative responses for rental projects and for cooperatives were developed. First, in 1972 the New York legislature authorized the conversion of rental redevelopment companies to cooperatives. These cooperatives would then be eligible (at the discretion of the municipality) for a twenty-five-year phase-out of the project's tax exemption after its initial term, in lieu of an abrupt transition to full taxpaying status. During this phase-out period, the project was placed under the same income eligibility and surcharge provisions as govern the Mitchell-Lama projects.191 In 1973, the same provisions were made available to projects originally set up as cooperatives.192

Finally, the Real Property Tax Law was amended in 1974 to ex-

189. N.Y. PRIV. Hous. Fin. Law §§ 100–126 (McKinney 1976 & Supp. 1989). The New York Legislature enacted the predecessor of the redevelopment companies law in 1942 to facilitate the development by the Metropolitan Life Insurance Company of the Stuyvesant Town project in Manhattan. 1942 N.Y. Laws 845. Provisions for Stuyvesant Town and its special needs shaped the law, although it was later used for a wide variety of other projects, both rentals and cooperatives.

190. Prior to the enactment of the ETPA in 1974, government-assisted housing emerging from regulations would not be subject to any rent limitations. Prior to 1974, the regulatory scheme, supra notes 74-77 and accompanying text, did not exist.

191. 1972 N.Y. Laws 641 (codified at N.Y. PRIV. Hous. Fin. Law §§ 125(1)(a), 126 (McKinney 1976)). The extension of tax benefits is limited to projects "which would require substantial increases in carrying charges after the period of tax exemption is ended unless relief is provided." This condition presumably would be met by virtually any development facing an end of substantial tax exemptions.

tend tax exemption for redevelopment companies for an additional ten years on a gradually declining basis. While the 1974 amendment applies to all projects, its practical effect is largely limited to the rental developments. Rental projects receiving the benefits of the 1974 amendment are placed under the Rent Stabilization Law for the life of the additional exemption period.

3. Permitting Buyouts But Protecting Present Tenants

Another possible approach is to permit buyouts, while at the same time protecting tenants presently living in the projects. This plan prevents hardship to those most immediately affected, but accepts the loss of the housing in question as units are vacated. Precedent for such a plan exists in the treatment of units in New York’s “421-a” projects.

A large portion of the multi-family rental housing developed in New York City since the early 1970s has received assistance in the form of partial tax exemption under section 421-a of the Real Property Tax Law. The properties are placed under rent stabilization for the life of the exemption—ten years under the initial program and a longer period under later amendments for certain developments outside Manhattan.

Three years after the program’s 1971 enactment, the Emergency Tenant Protection Act brought buildings built between 1969 and 1974 under rent stabilization. Thus the first 421-a properties to come to the end of their tax-exemption period remained under regulation. When the ten-year tax exemptions for the first post-1974 projects were about to expire, however, a major battle ensued. Owners insisted that the arrangement under which the units were built contemplated deregulation at the end of the tax benefit period. They argued that changing the rules amounted to breaching a contract. Tenants, of course, were opposed to the loss of rent protection.

The legislative solution was a compromise under which pre-1974 projects remain regulated, while regulation ceases in later projects as

193. 1974 N.Y. Laws 941 (codified at N.Y. REAL PROP. TAX LAW § 423 (McKinney 1984)). This provision is self-executing for any project not receiving the phase-out benefits under the redevelopment companies law.

194. Cooperative Redevelopment Companies can use the considerably more generous 25-year phase-out provisions of the 1972 and 1973 amendments to the law. Although this benefit, unlike that provided under the 1974 law, is discretionary with the municipality, it seems unlikely that a locality would be unwilling to provide the benefit of gradual transition to fully-taxpaying status to a project to which it originally granted a tax exemption.


each individual apartment is vacated. Existing tenants remain under rent regulation unless their original lease gave clear warning of the chance of loss of this status.\textsuperscript{197}

4. \textit{"Carrot and Stick"} Approach

Another possible approach consists of adopting a combination of restrictions on buyouts and incentives to stay in the program. Governor Cuomo's administration adopted this "carrot and stick" approach in its 1987 program bill. The proposal prohibited deregulation at the twenty-year point without governmental approval. The proposal also permitted the projects in question to take advantage of a series of liberalizations of the program which would have created, in effect, a class of housing midway between Mitchell-Lama and the normal private market.

5. Elimination of the Buyout Provision

The New York legislature could simply eliminate the twenty-year buyout provision without significant liberalization of the existing formula. This approach was followed in the Governor's 1988 legislative proposal.\textsuperscript{198} This bill prohibits buyouts for the first thirty-five years of the project mortgage.\textsuperscript{199}

A few small benefits were offered in the Governor's bill to projects which stay in the program. Provisions for eviction of over-income tenants (which have never been enforced in practice) would be repealed in exchange for provisions for higher surcharge payments by residents whose incomes substantially exceed the law's formulas. The rate of return to rental project owners is increased from 6\% to 8\%. In addition, there are provisions for distribution of project surpluses to the owners.

The real estate industry, however, is probably correct in viewing these changes as symbolic rather than substantive. An owner's equity based on a twenty-year-old project cost minus a 90\% mortgage is so minimal that an increase in the rate of return is not meaningful. Furthermore, the likelihood that the state or city would approve rent increases to generate surpluses over this amount is not very great.


\textsuperscript{198} Proposed "Mitchell-Lama Housing Preservation Act" (1988 New York Governor's Program Bill No. 164).

\textsuperscript{199} Id.
6. **Temporary Moratorium**

It is possible to defer the problem by adopting a temporary moratorium on project buyouts. This may be accomplished either through a simple freeze on the right to withdraw a project (perhaps accompanied by provisions for a study looking toward a long-range solution), or by a requirement that an owner seeking deregulation give one or two years notice to tenants and to the regulatory agency.

The temporary moratorium approach has recently been adopted by Congress in an attempt to deal with a controversy virtually identical to the Mitchell-Lama issue.\(^{200}\) Several major federal housing assistance programs provide a right to prepay and withdraw after twenty years under terms strikingly similar to the Mitchell-Lama buyout provisions.\(^{201}\) Newly-enacted federal legislation imposes what amounts to a two-year moratorium on buyouts from certain federal housing projects, although permission is granted for deregulation where it can

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\(^{201}\) As in the case of the Mitchell-Lama law, the great surge of production under these programs occurred in the 1960s and early 1970s. The programs in question provide assistance to supplement the mortgage insurance programs of the Federal Housing Administration under the National Housing Act in order to make the housing more affordable to moderate income tenants. They include provisions for below-market loan rates or direct annual subsidies as a means to decrease the effective interest rate to as low as 1%. 12 U.S.C. §§ 1715f(d)(3), 1715z-1 (1982).

Also at issue are contracts under the “section 8” program, which provides rent subsidies to make privately owned housing available to the same population group served by public housing at similar rents (originally 25%, now 30% of income). United States Housing Act of 1937 § 8, 42 U.S.C. § 1437(f) (1982). Each of these programs is administered by the United States Department of Housing and Urban Development (HUD). Analogous programs for rural housing, administered by the Farmers Home Administration of the Department of Agriculture, contain similar features. Title V of the Housing Act of 1949, codified as amended at 42 U.S.C. §§ 1471-1490h (1982). Projects comprising hundreds of thousands of housing units will be eligible to withdraw from these programs, and hence from federally-imposed rent and income limits, in the next few years. The legislative findings accompanying the Emergency Low Income Housing Preservation Act of 1987 describe estimated potential losses of more than 330,000 units under the § 221(d)(3) and § 236 programs over the next 15 years; more than 465,000 units under the § 8 program over the next decade; and perhaps 150,000 units under § 515 of the Housing Act of 1949, the principal subsidized portion of the Farmers Home Administration program. 1987 Act § 202(a)(1)-(3), 101 Stat. 1877.

The debate over the treatment of these projects is similar to that over the Mitchell-Lama buyouts. Owners have insisted that the arrangements under which the projects were developed constitute either a contract between them and the government or a moral obligation of the latter which would be breached by prohibiting withdrawal from the program. Advocates of preservation of the restrictions point not only to the plight of the present tenants but also to the loss of housing resources that will result when aid for new affordable housing is sharply curtailed.
be done without harm to tenants or to the community.\textsuperscript{202}

A similar short-term moratorium could be imposed on Mitchell-Lama projects by the New York State legislature. This approach keeps housing within the program, while permitting a more rational study of policy alternatives. Because this approach is less drastic and allows the government a reasonable time to think of alternatives, it seems less prone to constitutional challenge than either an outright elimination of the buyout right, or a long-term deferral of permission to exercise it, as in the Governor's current bill.

The problem with the moratorium proposal, however, is that it only postpones the "day of reckoning." Indeed, when a two-year freeze expires, the state would simply be confronted with a larger problem since additional units will have reached the twenty-year point. Moreover, the history of the legislative battles on this issue does not indicate that a solution which is satisfactory to all parties is likely to emerge in the interim.

\textbf{B. Recommendations}

Any resolution of the buyout issue must begin by recognizing that the rental and cooperative projects pose radically different conceptual and practical problems, and must be dealt with separately.

In the case of the rental projects, elimination of the twenty-year buyout provision would constitute at least a breach of faith with the

\textsuperscript{202} See Emergency Low Income Housing Preservation Act of 1987, 12 U.S.C. 1715f (1976 & Supp. 1989). Over a two-year period, owners cannot buy out of certain federal housing programs without approval of their plan by HUD. To grant such approval, HUD must find that present tenants would not be harmed by the buyout. 1987 Act § 255, 101 Stat. at 1880. If the plan for withdrawal involves "termination of the low income affordability restrictions" it can be approved only if HUD finds that it "would (a) not create hardship for current tenants or displace them where comparable and affordable housing is not readily available and (b) would not materially affect the general supply of low income housing in the market area, lessen the ability of low income people to find housing near job opportunities or reduce housing opportunities to minorities." H.R. CONF. REP. NO. 122(I), 100th Cong., 1st Sess. 196, reprinted in 1987 U.S. CODE CONG. & ADMIN. NEWS 3317, 3493. The actual statutory language is to the same effect. 1987 Act § 225(a), 101 Stat. 1880. Alternatively, HUD can accept compliance with a state program to preserve the project as affordable housing, under similar criteria. Id. § 226, 101 Stat. 1881.

Despite the two-year "sunset" clause on the new law's restrictive provisions, the industry has already indicated a readiness to mount a substantial challenge to its constitutional validity. In an attempt to forestall such litigation, the legislation contains an "alternative prepayment moratorium" under which, if the provisions in question are invalidated by any court, an absolute moratorium will be imposed on all prepayments of projects "located in the geographic area subject to the jurisdiction of such court." Id. § 221(b), 101 Stat. 1879. It is likely that this provision itself will be challenged, and that the Congressional battle over this issue has only just begun.
Regardless of the constitutional validity of any legislative modification, there is no doubt that the legislature held out the right to prepay as a specific inducement to the private sector to enter the program. Prepayment as of right was not permitted under the original Mitchell-Lama law, but rather was added by the governor and the legislature after the original law failed to attract significant private-sector participation. Thus, prepayment was not merely one incidental element of a complex scheme, but a provision specifically formulated as an incentive to potential participants. Consequently, outright withdrawal or significant postponement of the privilege, unaccompanied by significant liberalization of the rent restrictions under which Mitchell-Lama companies operate, would be unfair to rental project owners, and could drastically weaken the state’s credibility in dealing with the private sector in years to come.

The reduction in the state’s credibility merits serious consideration, since today nearly all new initiatives in New York State for the development of affordable housing rely heavily on public-private partnership. In the absence of the massive federal funding available a decade or two ago, there is virtually no alternative to this approach. A dramatic demonstration of New York’s readiness to change retroactively the rules under which the private sector agreed to develop housing could impair new programs to a degree that far outweighs the benefits of keeping existing Mitchell-Lama projects in the program for another ten to twenty years.

It is neither necessary nor appropriate, however, to leave the existing law intact. Some protection against serious adverse effects on current rental residents is clearly required; the more difficult question remains as to whether these units should be preserved as middle-income housing beyond the tenancy of the present occupants. With these considerations as background, some suggestions can be offered for a legislative resolution of this issue.

First, with respect to the protection of rental tenants, existing rent stabilization laws govern the majority of rental projects withdrawn from the Mitchell-Lama program. However, Mitchell-Lama tenants in areas of the state without rent stabilization would lose all rent

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203. See supra notes 178-84 and accompanying text.
204. See supra notes 122-82 and accompanying text.
205. See supra notes 28-34 and accompanying text.
206. See supra notes 34-53, 183-87 and accompanying text.
207. See generally supra notes 4, 183-87 and accompanying text.
208. See supra notes 74-86 and accompanying text. Although the majority of the projects are located in municipalities, particularly New York City, which have adopted the ETPA, some are not.
and eviction protection as their leases expire following a buyout. Some form of rental protection must be provided by law in these areas, at least for existing tenants.

Second, the Mitchell-Lama law has been supplemented by provisions that make some apartments in these projects affordable to those of lower income than the normal project rent would permit. These existing rental assistance programs must be continued for residents of the project despite its change in status. Indeed, owners who withdraw from the program should be required, not merely permitted, to keep the assistance in place in order to prevent hardship to the lowest-income residents.

Third, cooperative or condominium conversion of a rental property withdrawn from the Mitchell-Lama program should be permitted only on a non-eviction basis. Though an attempt to carry out an eviction plan in any highly visible project is unlikely in practice, eliminating the anxiety and polarization that even the possibility of such a plan would cause justifies a ban on such conversions.

Fourth, assuming the tenant protections noted above are in place, the twenty-year prepayment provision should be retained for existing projects. Appropriate incentives, however, should be developed to keep properties in the Mitchell-Lama program. These incentives could include a meaningful liberalization of the rate of return, or a reduction of the extremely detailed regulations currently in place. Such changes might induce many project owners to remain within the Mitchell-Lama law for the life of the mortgage rather than convert their projects to rent-stabilized status.

In the case of cooperative projects, unlike rental projects, the prepayment-and-deregulation process is inherently inappropriate. Mitchell-Lama cooperative buyers were induced to purchase by the prospect of affordable housing, not resale profit. No promise is broken, nor legitimate expectation frustrated, by barring the present residents from turning their small initial equity into a profit, which in

209. Most notably, the so-called "capital grant" program, administered by DHCR with funding through appropriations by the state to HFA, provides this financial assistance. See N.Y. PRIV. HOUS. FIN. LAW § 44-a (McKinney 1976). Originally, the subsidy was provided by renting apartments in the name of HFA at the Mitchell-Lama project rent, and subletting them to lower income tenants at lower rents, similar to those in public housing. See id. § 44-a(1), (2). A 1981 amendment permitted granting the aid more directly by making payments to the housing company in return for its accepting a lower rent from certain low income tenants. See id. § 44-a(5) (as added by 1981 N.Y. Laws 909).

210. See supra notes 102-18 and accompanying text.

211. See supra notes 185-86 and accompanying text.

212. See supra note 185.
some locations amounts to tens of thousands of dollars, at the expense of withdrawal of the project from the affordable housing market.

Furthermore, if a cooperative project were to be allowed to withdraw from the program, maintenance would necessarily rise sharply as the governmental benefits—the tax exemption, and the low-interest mortgage—expired. These costs would be born ultimately by the residents, since there is no separate "landlord" who would be required under the rent laws to absorb the increases (and hence perhaps think twice about leaving the program). In the cooperative, a sharp conflict of interest would arise between those residents willing and able to pay this cost in the expectation of profits upon resale and those who could not afford it, as well as between those planning to move in the near future and those viewing the project as a long range home. Consequently, permitting buyouts—particularly in the absence of protections for the remaining residents—is inconsistent with the intent of the Mitchell-Lama program, because, in effect, it would favor the higher income tenants and those ready to cash in and move, as opposed to those who need continued affordable housing.

VI. Conclusion

The Mitchell-Lama prepayment issue, already affecting many thousands of apartments, will be confronted by far more owners, renters, and cooperative shareholders in the next few years. Because of the public interest in affordable housing, the preservation of the present stock of such housing must be a major goal of any policy in this area.

In developing a solution, the New York State legislature must view the Mitchell-Lama debate not merely as a dispute between landlords and tenants, but rather as an issue which affects the future preservation of a major public resource. Any solution must accommodate the legitimate claims of the population group for which the Mitchell-Lama projects were developed, in a fashion which is perceived to be equitable by owners, so as not to discourage the private sector from participating in future middle-income housing programs. Because the dimension of the problem will increase sharply with each passing year, the New York State legislature should move promptly to seek to break the current deadlock over the issue.