

### HOSPITALITY LITIGATION

# Does Local Law 50 Enact An Unconstitutional Taking?



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The New York City hotel market is under pressure. Over the past decade, this market has experienced substantial growth in supply, adding 42 percent in new hotel rooms since 2010. (See “NYC Hotel Market Analysis: Existing Conditions and 10-Year Outlook,” New York City Department of City Planning (2017)). In fact, nearly 5,500 additional rooms in 30 new hotels came into the market in the last year alone. (See “Outlook for Hotel Development in NYC,” NYC & Co. (2017)). The confluence of over-supply and the omnipresence of Airbnb has put downward pressure on both rates and overall occupancy, causing NYC hotel assets to suffer loss of revenue.

In the midst of this perfect storm, when many hotel owners and operators in New York are looking for alternate ways to put their properties to use, the city passed a law banning conversion of more than 20 percent of rooms in hotels with over 150 rooms. Local Law 50 holds large hotel owners hostage,

and imposes restrictions on their ability to put hotel properties to their highest and best use. As described below, this may violate the Federal and New York State Constitutions.

### History of the Law

Local Law 50, informally known as NYC’s Hotel Conversion Moratorium of 2015 (as extended via a 2017 amendment), effected certain restrictions on the conversion of hotel to ‘non-hotel’ uses. (See New York City, N.Y., Code (“Admin. Code”) §25-702(a)). Essentially, the law prohibits owners of hotels with more than 150 rooms from converting more than 20 percent of those rooms to other uses—including condominiums. (See New York City, N.Y., Local Law No. 50 Int. No. 592-A (2015), as amended, New York City, N.Y., Local Law No. 109 Int. No. 1586 (2017) (Local Law 50)).

By its own terms, the law seeks to protect the hotel industry in New York City as “a crucial source of revenue for the city [that] supports 360,000 jobs.” Local Law 50 at §1(1). The law purports to prevent the “potentially irreversible consequences” of fur-

ther “significant loss of quality jobs,” which “poses a significant risk to the city’s economy, its tourism, its market for quality jobs and the quality of life for city residents and visitors.” *Id.* at §1.(1)-(5). The moratorium remains in place only until an analysis can be performed on “the short-term and long-term impacts of such conversions on the city’s economy, including tourism and the availability of quality jobs for city residents, and the potential economic, land use and other impacts of restrictions on such conversions.” *Id.* at §3.(1). It will come as no surprise that, to date, no such analysis has been released by the city.

Local Law 50 also contains a provision by which individual hotel applicants can apply for a ‘hardship waiver,’ on a showing that inability to convert more than 20 percent of their rooms is causing a significant detriment (discussed further below). See Admin. Code §25-702(a). The inclusion of the waiver appears to be a facade designed to backstop challenges that the law is unconstitutional on its face. *C.f. Koultukis v. N.Y.C. Dept. of Bldgs.*, Index No. 103643/01, 2001 WL 1722885,

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at \*1 (Sup. Ct. N.Y. Co. 2001) (possibility of obtaining administrative relief prevents ripeness of land use dispute).

### REBNY Intervenes

Within a matter of months, the Real Estate Board of New York (REBNY), a trade association for property owners, developers, lenders, managers, architects, designers, appraisers, attorneys and brokers in the NYC area, filed two lawsuits seeking to strike down the law. In the first, REBNY sought CPLR Article 78 relief in the form of an injunction barring enforcement of Local Law 50 for its failure to comply with certain provisions of local and state laws. The second sought a declaratory judgment in State Supreme Court that the law was invalid for violating the federal and New York State constitutions. Both REBNY litigations were dismissed for lack of standing by the Supreme Court, because the organizational plaintiff had failed to show the injury to any of its individual members. (See *REBNY v. City of New York*, Index Nos. 101798/2015 & 160081/2015 (Sup. Ct. N.Y. Co. June 23, 2016)).

The court declined to reach the merits of REBNY's constitutional arguments, leaving the issues open for future litigation by a proper plaintiff: namely, a hotel in New York City with more than 150 sleeping units seeking to convert more than 20 percent of its space to a non-hotel use. The strongest of the constitutional arguments is that the NYC government has enacted a regulatory taking of private property without just compensation, in violation of the Fifth Amendment of the Constitu-

tion, as well as in violation of Article I, §7 of the New York Constitution.

### Regulatory Taking?

As of May 2, 2017, no hotel owner had sought a permit to convert more than 20 percent of its space to a non-hotel use. (See Joe Anuta, "Bill Curbing Hotel-to-Residential Conversions Poised for Renewal," *Crains*, May 2, 2017). This may be because the law purports to be temporary on its face, leading hotel owners and operators to 'wait out' the sun-

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set provision of the law. However, given that it has already been renewed once, the effect of Local Law 50 has been to chill development or conversion of hotel properties into more lucrative uses—potentially effecting a regulatory taking.

Should a proper hotel plaintiff pursue relief from Local Law 50, the question will be whether a regulatory taking has occurred—meaning that the government acting in a regulatory capacity effectively deprives a property owner of their property. This analysis involves applying the test laid out by the Supreme Court in the 1978 case *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104 (1978), which

requires an intensive ad hoc inquiry into the circumstances of each particular case. . . weigh[ing] three factors to determine whether the interference with property rises to the level of a taking: (1) the economic impact of the regulation

on the claimant; (2) the extent to which the regulation has interfered with distinct investment-backed expectations; and (3) the character of the governmental action.

*Sherman v. Town of Chester*, 752 F.3d 554, 565 (2d Cir. 2014), quoting *Penn. Central Buffalo Teachers Fed'n v. Tobe*, 464 F.3d 362, 375 (2d Cir.2006).

Although "[a] reduction in the value of the regulated property is insufficient, standing alone, to establish a compensable regulatory taking," (*In re City of New York*, 35 Misc. 3d 1224(A) (Sup. Ct. N.Y. Co. 2012), if a hotel plaintiff can demonstrate that Local Law 50 has significantly impacted its ability to develop its property for non-hotel purposes, the analysis will continue by evaluating the hotel owner's 'investment-backed expectations' in the property. The reasonableness of a hotel owner's development expectations is a factual issue to be resolved at trial. *Haberman v. City of Long Beach*, 298 A.D.2d 497, 498 (2d Dept. 2002).

Where, as here, the moratorium purports to be 'temporary' on its face, similar moratoria that deny an owner all reasonable use of land have been held to constitute a 'taking' "when the interim period is not reasonably limited as to time or the city is not acting in good faith to expeditiously adopt a final zoning plan or zoning change." (See 1 Rathkopf's "The Law of Zoning and Planning" §13:17 (4th ed.); see also *Lakeview Apartments of Hunns Lake, Inc. v. Town of Stanford*, 108 A.D.2d 914 (2d Dept. 1985) (where a local law creating development moratorium was enacted in 1977 and renewed yearly through 1982, when petitioner applied for a variance, lapse of time was found to be "excessive" and law declared void); *Mitchell v. Kemp*, 176 A.D.2d 859, 859 (2d Dept. 1991) (holding same after a five-year delay in

evaluating moratorium); *Duke v. Town of Huntington*, 153 Misc. 2d 521, 524 (Sup. Ct. Nassau Co. 1991) (three years); but see *Noghrey v. Acampora*, 152 A.D.2d 660 (2d Dept. 1989) (six-month moratorium valid). Local Law 50 as originally enacted was effective only for two years, from June 2, 2015 through June 2, 2017. As amended, it is effective through June 2019, which may be held to be “excessive” pursuant to New York caselaw.

In addition to looking at the duration of a law in determining whether it constitutes a regulatory taking, courts evaluate whether it contains exceptions or waivers. Courts “have upheld the validity of moratorium ordinances containing waiver or special exemption provisions.” (See 1 Rathkopf’s “The Law of Zoning and Planning” § 13:19 (4th ed.); e.g. *Lo Conti v. City of Utica, Dept. of Bldgs.*, 52 Misc. 2d 815 (Sup. Ct. Oneida Co. 1966)).

The reasoning behind this rule is that where an applicant may seek relief from a development moratorium by means of a variance or other waiver, the moratorium “thus theoretically allow[s] some reasonable use of land,” which cuts against “landowners attempting to assert temporary taking claims” by reason of a development moratorium. See Rathkopf at §13:19.

The inclusion of the hardship waiver in Local Law 50 may be a sham, but it also may prevent an owner from establishing the first two elements of a regulatory taking as laid out in the Sherman test—the economic impact of the regulation on the claimant and the extent to which the regulation has interfered with distinct investment-backed expectations—because it has been argued that the possibility of an exemption prevents a total eradication of value from a landowner’s property. However, an as-applied challenge to the

law may prove successful where a hotel owner applies for a hardship waiver, and is denied in whole or in part. See *Congregation Rabbinical Coll. of Tartikov, Inc. v. Vill. of Pomona*, 915 F. Supp. 2d 574, 595 (S.D.N.Y. 2013) (as-applied challenge in the context of land use or regulatory takings dispute requires final decision from administrative agency). Here, the fact that Local Law 50 contains a hardship waiver

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and also has been subject to a short extension tends to show that the City seeks to dissuade waiver applications by making the process appear futile. And added to that mix is the fact that the so-called study that NYC residents have all been waiting for has never materialized.

### The Best Strategy

As described above, Local Law 50 contains within its terms an ‘exemption’ provision, that permits hotel owners seeking to convert more than 20 percent of their ‘primary hotel space’ to a non-hotel use to seek approval from the board of standards and appeals (BSA). The applicant must apply to the BSA for a variance, which requires a showing that barring conversion, the applicant cannot achieve a “reasonable rate of return” on its space, which takes into account:

the financial state of the existing... space, including...revenue, income,

expenses, profit, revenue per available room, average daily room rate, occupancy levels, any information presented at the public hearing on the application and any other information deemed relevant by the board.

Admin. Code §25-703(d).

A search of BSA decisions in the New York City community boards in which many affected hotels are located (midtown Manhattan [Community Board 5], Chelsea and Clinton [4], and Lower Manhattan [1]) did not reveal a single application for a hardship waiver by a hotel applicant seeking to convert more than 20 percent of its primary hotel space to non-hotel purposes. Because applicants are subject to the procedures and timing of the BSA, hotel owners and operators may have decided not to invest the time and expense necessary to apply for a waiver, given that the moratorium expires by its own terms on June 2, 2019. (See Admin Code at § 25-701). However, given that the law was designed as a short-term stopgap while a ‘study’ of hotel conditions was conducted, and given that nearly three years have elapsed with no report having been issued, property owners should be prepared for the possibility of another extension.

To ensure the best result, hotel owners and operators can apply for a hardship waiver, and, upon excessive delay or denial of the waiver in whole or in part, commence litigation seeking a determination that Local Law 50 as applied to that particular hotel enacts an unconstitutional regulatory taking, and should be invalidated.