

Lowering the Variance Bar: New York City Board of Standards and Appeals Further Eases Requirements for Variance Applications

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The Board of Standards and Appeals of the City of New York, on September 23, 2010, posted on its web site new instructions for owners seeking variances from the application of the Zoning Resolution of the City of New York.² Departing from earlier versions of these instructions³ and from statutory and judicial requirements, and even from the BSA's own recent decisions,⁴ the new instructions further signify the intent of the BSA to ignore explicit law to make it easier for applicants to obtain variances.

The BSA in its new instructions (a) attempts to eliminate the statutory requirements that the condition creating the hardship justifying a variance be a *physical* condition, (b) eliminates previously required information showing that there is no possibility of obtaining a reasonable return, and (c) changed its prior instruction for the methodology for the return analysis, substituting a return on investment standard for the more difficult return on equity (leveraged) standard, for both rental and condominium projects.

¹ Alan Sugarman is an attorney practicing in New York City. He currently is representing property owners challenging the failure of the BSA to apply the requirements of the Zoning Resolution by granting variances for luxury condominiums located on property owned by the Congregation Shearith Israel. On September 7, 2010, a brief was filed with the Appellate Division, First Department arguing that the BSA had failed to make the mandatory finding that the hardship on which the variances were granted were created by a *physical* condition, that hardships created by landmarking did not constitute such a *physical* condition, and that the Congregation could in fact earn a reasonable return on the property. *Kettaneh v. BSA and Congregation Shearith Israel*, No. 113227/08, Appellate Division, First Department. A version of this comment linked to cited sources and other documents are available at <http://www.protectwest70.org>.

² See [City of New York, Board of Standards and Appeals, Instructions for Completing BZ Applications, September 23, 2010](#). This version of the instructions is archived at http://www.protectwest70.org/2010-docs/bz_instructions_september_2010.pdf.

³ The prior version of the BSA instructions, in effect at least since 2007, may be found at <http://www.protectwest70.org/appendix/A-814-A-823.pdf>.

⁴ See note 14 below.

The BSA did not invoke its rule making processes in releasing these new instructions⁵: There was no notice to the public, no hearings, and importantly no memoranda or studies by any real estate valuation economists as to the economic analysis of reasonable financial return. In such a situation, one can fairly conclude that the BSA acted both arbitrarily and capriciously.

The BSA provided no rationale for eliminating the requirement that applicants describe the hardship-creating *physical* condition justifying the variance. In this instance, the BSA acted in direct opposition to its governing statute.

This latest move by the BSA to relax requirements for variance applicants is consistent with a 2004 study of the BSA by Municipal Arts Society of New York to address the "loose application of the standards governing variances and a lack of oversight."⁶ The study found an "extremely high variance approval rate."

The new BSA instructions impede meaningful oversight of the BSA variance decisions by reducing the detail of supporting information required by applicant. The BSA increases its flexibility to act arbitrarily and capriciously, by stripping the record of facts that could conflict with the purposes of the variance laws.⁷ Even were the courts to ignore the BSA's attempt to legislate its own governing statutes, the BSA administrative record will not contain all of the evidence required to make a rationale determination as to whether a variance is warranted, obscuring arbitrary decisions by the BSA.

I. The Five Findings of Section 72-21 of the Zoning Resolution

The BSA is authorized by the New York City Charter to grant variances from the strict application of New York City's Zoning Resolution as provided by Section 72-21.⁸ Section 72-21 defines the specific findings that must be made by the BSA when approving a variance. These findings are often referred to as the "five findings", with the individual findings themselves identified as findings (a) through (e).

⁵ [§1-14 Rules of Procedure and General Rules and Regulations, Rules of Practice and Procedure of the NYC Board of Standards and Appeals](#). These procedural rules require that notice of rulemaking be published in the BSA's weekly Bulletin, now available on the BSA web site.

⁶ The Municipal Art Society of New York, *Zoning Variances and the New York City Board of Standards and Appeals*, 30 Columbia Journal of Environmental Law 193 (2005) available at http://mas.org/images/media/original/MAS_BSA_Report.pdf.

⁷ See *Montauk Improvement v. Proccacino*, 41 N.Y.2d 913 (1977). The Court of Appeals stated in that case "A court cannot surmise or speculate as to how or why an agency reached a particular conclusion. Failure of the agency to set forth an adequate statement of the factual basis for the determination forecloses the possibility of fair judicial review and deprives the petitioner of his statutory right to such review." See *id.* at 914. Despite this statement, the courts rarely overturn BSA decisions.

⁸ See <http://www.nyc.gov/html/dcp/pdf/zone/art07c02.pdf#page=4>. The Zoning Resolutions are enacted by the New York City Council, and thus are statutory law.

Substantial New York jurisprudence addresses the relevant factors to be considered by zoning boards in granting variances, protecting both the private and public interests involved. The five findings are in some respects codification of judicially-developed law.⁹ The BSA approaches the consideration of reasonable return in the context of its self-created informal rules and practices, rules and practices which ignore the constitutional and judicial basis of the no reasonable return requirement, as well as commonly applied real estate valuation economics.

II. Finding (a) Unique Physical Condition.

Section 72-21(a) requires a BSA finding that the hardship claimed by the property owner must arise from "unique *physical* conditions, including irregularity, narrowness or shallowness of lot size or shape, or exceptional topographical or other physical conditions."

The requirement that the hardship relate to a "*physical*" condition is specific to New York City, perhaps because of the higher density of buildings in New York City. New York City's variance statute differs from statutes applicable elsewhere in New York State in that it includes that specific requirement.

The "*physical*" condition requirement has made it difficult for the BSA to legally grant variances in many situations - so, the BSA engages in sophistry to avoid the statutory requirement, and as illustrated transparently by the new instructions.

The previous instructions require "The financial submission should illustrate the hardship caused by the *claimed unique physical conditions* present at the site." The new version simply states: "The financial submission should illustrate the hardship caused by the "A" Finding in ZR Section 72-21."

The previous instructions state: "3. The economic hardship that arises from the *unique physical conditions* must be quantified and the cost to remedy such hardship should be given in dollar figures." The new instructions state simply: "The economic hardship that is stated in the uniqueness finding must be quantified for all financials in order to substantiate the hardship finding ("B" Finding) and the minimum variance finding ("E" Finding.)"

The BSA has mutated the requirement for a *physical* condition into just a "unique hardship." Clearly, the BSA wishes to eliminate the restrictive requirement that the condition be "physical." The BSA in the new instructions signals to applicants that the BSA intends to ignore the statutory requirement that there be a unique *physical* condition.

⁹ [*Otto v. Steinhilber*, 282 N.Y. 71 \(1939\)](#) is credited as having first announced the requirement that the land in question cannot yield a reasonable return. The BSA's attempt to narrow the meaning of "reasonable return" ignores the constitutional and judicial basis of the requirement.

III. Finding (b) - No Possibility of Obtaining a Reasonable Return

The reasonable return BSA finding mandated by Section 72-21(b): "that because of *such physical conditions* there is no reasonable possibility that the development of the zoning lot in strict conformity with the provisions of this Resolution *will bring a reasonable return.*" In BSA jargon, the study substantiating that there is not possibility of obtaining a reasonable return is described as a "feasibility study."

Substituting for the requirement in the prior version of the instructions that financial feasibility studies provide a leveraged return on equity analysis, the new instructions provided for the far less onerous return on investment analysis. And, in conflict with the position taken by the BSA in its own decisions, the BSA is covertly announcing that it will now apply the return on investment standard to rental projects, rather than the return on equity standard, making it far easier to obtain variances for rental projects.¹⁰

Variances from zoning regulations are a safety valve so that governmental land use regulations do not result in the effective "taking" of property, providing relief from hardships resulting from the regulations.¹¹ The requirement that the property owner show that a reasonable return may not be earned is a codification of innumerable court decisions requiring a "dollar and cents" analysis.¹²

The BSA has developed a series of informal "practices" for evaluating the reasonable return analysis, often with no explanation of economic rationale. The submission of these studies has become the domain of a small group of real estate consultants who are familiar with BSA's arcane practices, which may depart from general practices in the real estate investment industry and may also depart from the equitable taking rationales required by the courts.

A. Instructions for rental properties - Feasibility Studies

The previous instructions for rental properties stated:

¹⁰ As observed in [Soho Alliance v. Board of Standards and Appeals, 264 A.D.2d 59 \(1st Dep't 2000\)](#), there is no hard and fast rule as to what constitutes a reasonable return, but the standard of rationality applies. *Id.* at 69. By disregarding and indeed excluding relevant information from the administrative record, there is an absence of information on which to base a rational determination.

¹¹ The United States Supreme Court decision in [Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 \(1922\)](#) held that a land use regulation could amount to a taking; *see also* later cases such as [Penn Cent. Transp. Co. v. New York City, 438 U.S. 104 \(1978\)](#) and [Lucas v. S.C. Coastal Council, 505 U.S. 1003 \(1992\)](#): "We think, in short, that there are good reasons for our frequently expressed belief that when the owner of real property has been called upon to sacrifice all economically beneficial uses in the name of the common good, that is, to leave his property economically idle, he has suffered a taking." *Id.* at 1019.

¹² [Fayetteville v. Jarrold, 53 NY 2d 254 \(1981\)](#).

4. Generally, for rental development proposals, the following information is required: market value of the property, acquisition costs and date of acquisition; hard and soft costs (if applicable); total development costs; construction/rehabilitation financing (if applicable); equity (total cost less financing); breakdown of rental income by floor and square footage, vacancy/collection loss percentage and estimate; effective income; operating expenses; real estate taxes; water and sewer charges; net operating income; debt service; cash flow estimate and *percentage return on equity* (cash flow divided by equity).

In the new instructions, the BSA removes the requirement to provide data as to the acquisition costs and date of acquisition, the equity, and the return on equity.

Generally, the Board expects to see the following data on all properties: *market-based acquisition costs*; hard and soft costs (if applicable); total development costs; construction/rehabilitation financing (if applicable).

* * *

For rental properties: breakdown of rental income by floor and square footage, gross income; vacancy/collection loss percentage and estimate; effective income; operating expenses; real estate taxes; water and sewer charges; net operating income; calculation of overall return, i.e., *net operating income divided by total development cost*.

The BSA had taken the position that a return on equity approach was the proper approach for rental properties but, significantly, abandons that position in the new instructions. For rental developers, the barrier to obtaining a variance has therefore been reduced substantially.¹³

B. Instructions for cooperative and condominium properties - Feasibility Studies

The previous BSA instructions for condominium and cooperative properties stated:

5. Generally, for cooperative or condominium development proposals, the following information is required: market value of the property, *acquisition costs and date of acquisition*; hard and soft costs (if applicable); total development costs; construction/rehabilitation financing (if applicable); *equity*; breakdown of projected sellout by square footage, floor and unit mix; sales/marketing expenses; net sellout value; net profit (net sellout value less total development costs); *and percentage return on equity* (net profit divided by equity).

In the new instructions, the BSA removes the requirement to provide data as to the acquisition costs and date of acquisition, the equity, and the return on equity.

¹³ See n. 14.

Generally, the Board expects to see the following data on all properties: market-based acquisition costs; hard and soft costs (if applicable); total development costs; construction/rehabilitation financing (if applicable).

* * *

For cooperatives or condominium properties: breakdown of projected sellout/value by square footage, floor and unit mix; sales/marketing expenses; capitalized value of leased portions; net sellout value; net profit (net sellout value less total development costs); and *calculation of return percentage (net profit divided by total development cost)*.

C. Relevance of Return on Equity versus Return on Investment

One important issue is whether the reasonable return is to be based upon a return on equity (leveraged analysis) or a return on investment (unleveraged analysis). The BSA has taken the position in its own decisions and court challenges that the leveraged analysis is appropriate for rental properties, but an unleveraged analysis for condominium properties, without ever having provided a rationale at all for the distinction. At the same time, its prior instructions required the submission of a leveraged return on equity analysis for both types of projects. Leveraged returns will be substantially higher than unleveraged returns.¹⁴

In the real world of investment, leveraged analysis is used for many investment decisions. By merely allowing or disallowing leveraged analysis, the BSA can arbitrarily allow or disallow a variance, based upon whether the BSA thinks it is a good idea. To prevent anyone (such as a reviewing court) from having an understanding of the economics of the transaction, the BSA can merely control what appears in the record by instructing the applicant to include or exclude information. Thus, the BSA apparently now wishes to have references to return on equity analysis expunged from the record.

¹⁴ The BSA has taken the position that a "*return on equity methodology is characteristically used for income producing residential or commercial property.*" *Application of Congregation Shearith Israel*, 74-07-BZ, p. 9, last paragraph (NYC BSA 2008.) Available at <http://www.nyc.gov/html/bsa/downloads/pdf/decisions/74-07-BZ.pdf>. The new instructions reverse this position, to the benefit of developers who now face a much lower bar. In *Matter of Red Hook/Gowanus Chamber of Commerce v. New York City Board of Standards and Appeals*, 49 AD2d 749 (2d Dep't), the return on equity model was approved for a mixed use project. The return on equity model has been used in *Kingsley v. Bennett*, 185 A.D. 2d 814 (2d Dep't 1992), *Morrone v. Bennett*, 164 A.D.2d 887 (2d Dep't 1990), and *Lo Guidice v. Wallace*, 188 A.D.2d 913, 915 (3d Dep't 1986).

D. Significance of Omission of Acquisition Cost and Acquisition Date

The previous instructions, in accordance with court decisions,¹⁵ required the applicant to provide the original acquisition cost and acquisition date, but the BSA has omitted this requirement in the new instructions. The new instructions also introduce a new heretofore unknown term “market-based acquisition cost.”¹⁶ Apparently the BSA means the market value, but, wishes to blur the meaning by this novel terminology.¹⁷

As a result of the new instructions, the BSA administrative record will not include information to determine the actual return on investment by the property owner, and, indeed, variances may be allowed based upon supposed economic hardship when in fact the property owner has earned enormous returns based upon the owner’s original investment.

That is not to suggest that the BSA should rigidly apply any specific standard - for flexibility is required to evaluate the particular situation. For example, a property owner may have paid too much for a property or interposed a third party related to the owner to buy and then resell the property to the current owner. But, those situations can be easily evaluated.¹⁸

On the other hand, the property owner may believe it has the ability to purchase the property "below market, and to increase the value by later obtain a value-adding variance.

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IV. Conclusion

It is beyond the scope of these comments to discuss the BSA’s application, or non-application as the case may be, of valuation economic theory as commonly used by sophisticated real estate investors. Needless to say, there are disparities between how the BSA views economics, and the view of experts in that field. For example, simple errors such as the inclusion of construction interest in total construction cost from day one

¹⁵ *Douglaston Civic Assn. v. Galvin*, 36 N.Y.2d 1, 9 (N.Y. 1974), *Curtiss-Wright Corp. v. East Hampton*, 82 A.D.2d 551, 553–554 (N.Y. App. Div. 2d Dep’t 1981), *Northern Westchester Professional Park Associates v. Bedford*, 92 A.D.2d 267, 272 (N.Y. App. Div. 2d Dep’t 1983), *Sakrel, Ltd. v. Roth*, 176 A.D.2d 732, 737 (N.Y. App. Div. 2d Dep’t 1991) (the failure of the petitioner to divulge its purchase price is fatal); *Varley v. Zoning Bd. of Appeals*, 131 A.D.2d 905, 906 (N.Y. App. Div. 3d Dep’t 1987).

¹⁶ A Google search for “market based acquisition cost” yields the result: “No results found for market based acquisition cost.”

¹⁷ Another example of the BSA invention of economic concepts and terms is the BSA use of to “return on profit” in at least one of its decisions. *Application of Congregation Shearith Israel*, 74-07-BZ, p. 9, 10 (NYC BSA 2008.) Available at <http://www.nyc.gov/html/bsa/downloads/pdf/decisions/74-07-BZ.pdf>.

¹⁸ See *Kingsley v. Bennett* at 816. *Chusud Realty Corp. v Village of Kensington*, 40 Misc. 2d 259, 261 (Sup. Ct. Nassau Co.1963), aff’d 22 A.D.2d 895 (2d Dep’t 1964).

through completion, even though costs are incurred over time, is an issue of no moment to the BSA in its simplistic approach to economics.

The BSA accepts feasibility studies from any "real estate professional," not even requiring for the more complex proposals that the analysis be provided by appraisers certified by institutions such as the Appraisal Institute. The Appraisal Institutes subjects certified appraisers to a peer review process; those submitting appraisals to the BSA are subject to no peer review or professional discipline.

Not only are there no qualifications required by those providing the feasibility studies, but also, basic procedural due process is not afforded by the BSA to those opposing variance applications. Significantly, opposition representatives are never afforded the opportunity by the BSA to directly question the self-described experts submitting feasibility studies on behalf of applicants. The BSA tightly controls the questioning of the applicant and its consultants, thereby controlling what appears in the record as expressed by the applicant and preventing the impeachment of even the most implausible claims by applicants.

The latest BSA instructions are just one more attempt by the BSA to limit the record to afford the BSA to make its decisions without consideration of the relevant facts and to ignore the requirements of statutes and precedent.

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