

# The **Ins** and **Outs** of MCIs

*What are they? How do they work? And how can building managers and owners work them to their buildings' best advantage?*

New York State lawmakers realized long ago that if owners received only maximum base rent (MBR) or stabilized, guideline rent increases annually, they would have no economic incentive to make building improvements. Original rent-control laws granted specific dollar amount rent increases for owners who performed qualifying capital improvements. Today, according to Paul Korngold, a partner in the Manhattan law firm of Tuchman, Katz, Schwartz, Gelles & Korngold and an expert on major capital improvement (MCI) rent increase benefits, most owners of rent-regulated apartment buildings continue to take advantage of MCI rent increases and rely on the increased rent roll to help meet expenses for necessary building improvements.

With the advent of rent stabilization, MCIs installed by owners were considered eligible for rent increases provided the improvement was (1) deemed depreciable under the Internal Revenue Code, (2) for the operation, preservation and maintenance of the structure, and (3) directly or indirectly beneficial to all tenants and was performed on all similar components in the building.

The current Rent Stabilization Code prequalifies 30 of the most commonly installed MCIs, including boiler/burners, windows, electric rewiring, roofs and intercoms. As Michele Cospito, MCI/J-51 coordinator at Tuchman, Katz points out, the list is not exclusive; items that meet the regulatory definition may still be eligible, but the owner may be required to carefully explain and document these "non-listed" improvements.

The Rent Stabilization Code also requires that any item that was replaced must have outlived its useful life. "Last December," says Korngold, "the New York State Division of Housing & Community Renewal (DHCR) finally issued a 'useful life schedule,' which lists 26 items that qualify for MCI rent increases. Now, in order for an improvement to be eligible for rent increase, the

replaced item must have outlived its useful life or fit into one of the exceptions to the schedule."

Applications for MCI rent increases are submitted to DHCR on forms provided by that agency. Cospito warns owners that the application may be submitted after the work is complete, but not more than two years after the completion of the work. In addition to completing the forms, Cospito explains, "the owner is required to provide additional supporting documentation, such as rent rolls, copies of contracts, canceled checks and city permits. Furthermore, the signature of the vendor of the capital improvement is required to verify the cost of the improvement."

After the application is submitted to DHCR, every tenant in the building receives a notice from DHCR and has an opportunity to object to the rent increase. The tenant has an opportunity to review the application, and tenant complaints are solicited from the agency. The owner will receive copies of all objections filed

by the tenants in the building and must respond to all tenant complaints—since DHCR clearly places the burden on the owner to show that the tenant's objection should be disregarded. On many occasions, DHCR will send an inspector to verify the accuracy of the tenant's objection. According to Korngold, "An owner's failure to promptly and properly respond to a tenant's objection is clearly the number-one reason for an otherwise eligible improvement being denied a rent increase."

If the application is approved, the owner will be granted a rent increase based on the cost of the work as determined by DHCR. In most cases this is the actual cost of the work, but DHCR does have the authority to reduce the approved costs if it feels such a reduction is warranted.

The rent increase benefit is granted by DHCR on a per-room basis. DHCR has issued a policy statement that discloses how the agency defines a room. "The owner's failure to compute rooms in the



**(Left to right): Paul Korngold, Michele Cospito, their advice to New York area building owners is, primarily, to understand how MCIs work. A firm knowledge of MCIs intricacies can only help your chances for rent increases.**

same manner as DHCR," warns Korngold, "may also result in the denial of the building owner's application for a rent increase."

For work commenced prior to July 28, 1990, the approved rent increase is granted based on a five-year amortization period, Korngold explains. This means that recovery of the cost of the improvement is spread over a five-year period. For work commenced after July 28, 1990, the cost recovery period is seven years. "The state's highest court recently ruled that the rent increase is permanent and does not cease after the applicable time period," he says. Thus, today, if an owner installs a new boiler for \$70,000, the increase will be \$10,000. Here, an owner of a 100-room building would receive a \$8.33-per-room, per-month increase. (The \$8.33 was determined by dividing the \$70,000 cost by seven years, then by 100 rooms and then by 12 months.)

### Get What You Can

There is a limitation on the percentage that a rent-stabilized or rent-controlled tenant's rent can be increased in an annual period. A rent-stabilized tenant's rent cannot increase by more than 6%

per year based on the rent at the time the application is submitted. The rent-controlled tenant has a 15% annual limitation based on the rent at the time the application is approved.

"If a J-51 tax abatement has been granted on the building, a portion of the increase will be waived until the J-51 benefit has expired," says Cospito. "For rent-controlled tenants, the waiver is two-thirds of the annual J-51 abatement. For rent-stabilized tenants, the waiver equals 50% of the annual tax abatement benefit." Although this does decrease the benefit gained by an MCI rent increase, according to Korngold, it still makes economic sense for the owner to apply for both J-51 and an MCI rent increase.

He offers the example of an owner in a fully rent-stabilized building who spends \$70,000 for a new boiler but receives a J-51 tax abatement of only \$42,000 since J-51 benefits are based on a cost schedule and not on the actual expense. "In this scenario," remarks Korngold, "the \$10,000 current MCI rent increase will be reduced by \$1,750, which represents 50% of the annual J-51 real estate tax abatement."

Currently, an application for an MCI rent increase takes DHCR an average of

two and one half years to process. DHCR will award an owner a retroactive increase of rent for stabilized tenants where the processing of the application takes more than 30 days. The retroactive increase is subject to the same 6% annual limitation as the prospective rent increase.

Sponsors of cooperative offering plans that have unsold units subject to rent control or rent stabilization are also eligible for a major capital-improvement rent increase, even if the improvement was paid for by the cooperative corporation and not by the sponsor. The only restriction is that the money used to pay for the improvement cannot come from the cooperative reserve fund nor can the sponsor take a credit at the closing against the reserve fund for the improvement costs.

Korngold and Cospito both point out that the processing of an application for an MCI rent increase should be a simple matter. Unfortunately, however, due to numerous technical requirements as well as DHCR's insistence on answering all tenant complaints, the application procedure has become a complex maze that should be navigated by owners only with the assistance of a qualified professional who specializes in these applications.

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