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# **BUYER BEWARE: TEMPORARY CERTIFICATES OF OCCUPANCY & THE NEED FOR CONSUMER PROTECTION IN THE NEW YORK CITY REAL ESTATE MARKET**

## **INTRODUCTION**

Seventy-two people thought that they were buying a piece of the American dream in Brooklyn, New York.<sup>1</sup> They had found brand new luxury apartments at prices low enough to make homeownership a reality.<sup>2</sup> But their American dream soon turned upside-down. Due to building code violations and certain misrepresentations to the New York City Department of Buildings (the Department of Buildings), the developer who sold the units with temporary Certificates of Occupancy (TCOs) was unable to acquire the necessary final Certificates of Occupancy for any of the buildings.<sup>3</sup> The new homeowners found themselves unable to sell or refinance their units, but staying in the building meant violating New York law and being subject to a vacate order from the City.<sup>4</sup>

Most of these homebuyers had probably never heard of a Certificate of Occupancy, which is a document issued by the local building department that declares a building is habitable and complies with all local and state building codes.<sup>5</sup> Many municipalities, including New York City, issue TCOs so that homebuyers can move into their new homes while the developer completes the cosmetic details of construction.<sup>6</sup> However, TCOs are only valid for a short period of time, and if the developer does not obtain the final Certificate of Occupancy or extend the TCO before it expires, occupying the building becomes a violation of the New York City Administrative Code (NYCAC) and any occupants are subject to a vacate order.<sup>7</sup> If these homebuyers were like most people, when and if their attorneys explained to them the possible repercussions of buying real estate with a TCO, their eyes probably glazed over as they thought, “that is the developer’s responsibility, not mine.” Even if they understood the possible consequences of purchasing a home with a TCO, it is likely that there was

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1. See William Neuman, *Caught in the Twilight Zone*, N.Y. TIMES, Aug. 28, 2005, § 11, at 1.

2. See *id.*; see also The Developer’s Group, *Developments: The Spencer*, <http://www.thedevelopersgroup.com/buildings/building.aspx?buildingid=1005&> (last visited Apr. 7, 2008).

3. Neuman, *supra* note 1.

4. N.Y. City Dep’t of Bldgs., *Certificates of Occupancy: Temporary and Final — Fact Sheet* (Jan. 10, 2006), available at [http://www.nyc.gov/html/dob/downloads/pdf/co\\_factsheet.pdf](http://www.nyc.gov/html/dob/downloads/pdf/co_factsheet.pdf); see N.Y. CITY ADMINISTRATIVE CODE § 27-214 (2007); *Washington v. Culotta*, No. 034230/02, 2005 WL 2171189, at \*4 (N.Y. Civ. Ct. July 21, 2005).

5. New York City Real Estate Glossary, *Certificate of Occupancy*, <http://www.new-york-new-york-real-estate.com/c2.html> (last visited Apr. 7, 2008).

6. N.Y. CITY ADMINISTRATIVE CODE § 27-218 (2007); see *Howard v. Berkman, Henoch, Peterson & Peddy, P.C.*, No. 034411/04, 2004 WL 2732245, at \*11 (N.Y. Civ. Ct. Nov. 5, 2004).

7. N.Y. CITY ADMINISTRATIVE CODE §§ 27-218, -214 (2007); N.Y. City Dep’t of Bldgs., *supra* note 4.

still very little they could do about it, other than walk away from their dream apartments.

This note proposes the need for consumer protection to guarantee that real estate developers secure final Certificates of Occupancy for homebuyers. The Department of Buildings must ensure that developers who breach their contracts with homebuyers by allowing TCOs to lapse are restricted from receiving new building permits without first obtaining any outstanding final Certificates of Occupancy.

Part I of this note provides a brief overview and history of final Certificates of Occupancy and TCOs in New York City. Part II explores how and why homebuyers can be stranded without a final Certificate of Occupancy. Part III looks at the current liabilities of the mortgage lender, the homebuyer's attorney, and the developer and also examines the appropriateness and repercussions of increasing those liabilities. Finally, Part IV analyzes some possible solutions to the problem and proposes the suspension of the issuance of permits to offending developers.

## **I. CERTIFICATES OF OCCUPANCY AND TEMPORARY CERTIFICATES OF OCCUPANCY**

Many states and municipalities, including New York City, require building owners to keep a Certificate of Occupancy on file with the local buildings department.<sup>8</sup> A Certificate of Occupancy is a document that states that the property is habitable and complies with all local and state building codes.<sup>9</sup> The Department of Buildings defines a Certificate of Occupancy as “[t]he key document used to certify the legal use and occupancy of a building [that] describes how a building may be occupied, for example, a two-family home, a parking lot, a 40-unit multiple dwelling, or a store.”<sup>10</sup> According to a spokesperson for the Department of Buildings, the City enacted the Certificate of Occupancy requirement in 1938, and buildings built before then may not have one.<sup>11</sup> However, even buildings built before 1938 need a Certificate of Occupancy if there has been any post-1938 construction that resulted in a “change of use, egress, or occupancy.”<sup>12</sup>

Under the New York City Administrative Code, a building can not be legally occupied without a Certificate of Occupancy, and the City does not issue final Certificates of Occupancy until a building “conforms substantially to the approved plans and the provisions of [the] code and

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8. See, e.g., N.Y. CITY ADMINISTRATIVE CODE § 27-214.

9. New York City Real Estate Glossary, *supra* note 5.

10. N.Y. City Dep't of Bldgs., Certificates of Occupancy, <http://www.nyc.gov/html/dob/html/certificates/certificates.shtml> (last visited Apr. 7, 2008).

11. *Q & A: When a Building Must Install Ramps*, N.Y. TIMES, Sept. 29, 2002, §11, at 8; see N.Y. City Dep't of Bldgs., *supra* note 4.

12. N.Y. City Dep't of Bldgs., *supra* note 4.

other applicable laws and regulations.”<sup>13</sup> Because of these regulations, a lag time developed between when a residential building or house was safe for occupancy and when the sale could close and the building be legally occupied.<sup>14</sup> Some of the requirements for obtaining a Certificate of Occupancy were deemed “cosmetic” rather than safety related and could be delayed by things as trivial as the weather.<sup>15</sup> In many cases, “[t]he only items that remained to be completed might be things like sodding of the lawn or pavement of the street to the curb in front of the house.”<sup>16</sup> In 1985 the New York City Council decided that it was “not fair to postpone the closing owing to items beyond control of the parties.”<sup>17</sup> To solve the problem, the City Council amended the Administrative Code to permit the issuance of TCOs when occupancy would “not endanger public safety, health, or welfare.”<sup>18</sup>

According to the Department of Buildings, a TCO “means that while the Buildings Department has determined that the house or apartment building is safe to occupy, the approval is only temporary and is subject to expiration.”<sup>19</sup> TCOs are issued for an initial period of either 90 or 180 days.<sup>20</sup> The Department of Buildings will renew a TCO three times before inquiring into why the required “open” items have not yet been resolved.<sup>21</sup> An expired TCO makes it very difficult, if not impossible, for buyers to renew homeowner’s insurance, sell, or refinance their homes.<sup>22</sup> Additionally, occupancy of a building without a final certificate of occupancy or a TCO is illegal, leaving the new owner subject to a vacate order from the Department of Buildings.<sup>23</sup>

At the inception of New York City Administrative Code (NYCAC) § 27-218, the problem of expiring TCOs was not accorded much weight by the New York City Council, as it was “predicated on the belief that the builder would act in good faith and a timely manner to secure the final certificate of occupancy” and the section was only expected to be used sporadically.<sup>24</sup> However, since the Department of Buildings began issuing

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13. N.Y. CITY ADMINISTRATIVE CODE § 27-214.

14. *Howard v. Berkman, Henoeh, Peterson & Peddy, P.C.*, No. 034411/04, 2004 WL 2732245, at \*11 (N.Y. Civ. Ct. Nov. 5, 2004).

15. *Id.*

16. *Id.*

17. *Id.*

18. N.Y. CITY ADMINISTRATIVE CODE § 27-218 (2007).

19. N.Y. City Dep’t of Bldgs., *supra* note 4.

20. N.Y. CITY ADMINISTRATIVE CODE § 27-218.

21. Sebastian M. D’Alessandro, *The ABC’s of the ‘C. of O.’*, GOTHAM CITY INSPECTOR, Spring 2005, at 3, available at [http://www.accuratebuilding.com/publications/inspector/gotham\\_inspector\\_spring\\_2005.pdf](http://www.accuratebuilding.com/publications/inspector/gotham_inspector_spring_2005.pdf).

22. N.Y. City Dep’t of Bldgs., *supra* note 4.

23. *See, e.g., Washington v. Culotta*, No. 034230/02, 2005 WL 2171189, at \*4 (N.Y. Civ. Ct. July 21, 2005).

24. *Howard v. Berkman, Henoeh, Peterson & Peddy, P.C.*, No. 034411/04, 2004 WL 2732245, at \*11–12 (N.Y. Civ. Ct. Nov. 5, 2004).

TCOs, it has become common practice in New York real estate deals to close on a property before the final Certificate of Occupancy has been issued.<sup>25</sup> According to Judge Straniere of the New York Civil Court, “it is more likely that you will see a yeti crossing the West Shore Expressway wearing a Mets Hat than a final certificate of occupancy at a closing.”<sup>26</sup> In fact, many New York real estate sale contracts contain a provision that states that while the seller agrees to deliver a final Certificate of Occupancy, the contract will not be voidable because of a failure to do so.<sup>27</sup> These provisions have relieved developers of any contractual pressure to obtain final Certificates of Occupancy prior to closing. Some developers thus simply move on to new projects without completing the necessary work to obtain the final Certificates of Occupancy for their buyers.

For this reason, the Department of Buildings “strongly recommends” that homebuyers negotiate their closings “based on a final [Certificate of Occupancy], not a TCO.”<sup>28</sup> It warns that the buyer bears the legal obligation of obtaining the final Certificate of Occupancy and a failure to do so could result in the issuance of a vacate order.<sup>29</sup> In order to create an incentive for the developer of property to obtain the final Certificate of Occupancy after the sale, the Department of Buildings suggests buyers obtain “written assurance and sufficient escrow”<sup>30</sup> to ensure any outstanding work is completed and the final Certificate of Occupancy is obtained.<sup>31</sup> The amount held in escrow for this purpose in a “standard real estate contract” is \$2,500.<sup>32</sup> But this amount is typically arbitrary and has nothing to do with the cost of completing the items listed as “open” on the TCO, and is very rarely negotiated by the parties for reasons that are discussed below.<sup>33</sup>

## II. REASONS FOR THE CURRENT PROBLEM WITH THE TCO SYSTEM

This section looks at some of the reasons for the failings of the TCO system. Part A discusses the buyer’s lack of bargaining power in insisting on a final Certificate of Occupancy at the closing. Part B looks at the insufficiency of the standard Certificate of Occupancy escrow. Part C

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25. *Id.* at \*12.

26. *Id.*

27. *See, e.g., Culotta*, 2005 WL 2171189, at \*1 (Real estate sale agreement stated, “Seller agrees to deliver a permanent Certificate of Occupancy for the dwelling but title shall not be adjourned for lack of same . . . . No closing will occur, however, without Seller first obtaining a temporary certificate of occupancy.”); *Divita v. Decker & Decker, P’ship*, No. SCR1192/04, 2004 WL 3178287, at \*1 (N.Y. Civ. Ct. Nov. 24, 2004); *Howard*, 2004 WL 2732245, at \*1.

28. N.Y. City Dep’t of Bldgs., *supra* note 4.

29. *Id.*; *see Culotta*, 2005 WL 2171189, at \*4.

30. N.Y. City Dep’t of Bldgs., *supra* note 4.

31. *Id.*

32. *Howard*, 2004 WL 2732245, at \*12.

33. *Id.*

explores how building code and zoning violations can lead to the city withholding final Certificates of Occupancy. Finally, Part D examines the Department of Building's self-certification process, which allows developers to issue TCOs to themselves, and how this process can lead to buildings that do not satisfy the building or zoning code receiving TCOs.

#### A. BUYER'S LACK OF BARGAINING POWER IN NEGOTIATING TO CLOSE WITH A FINAL CERTIFICATE OF OCCUPANCY

If the real estate market is strong, the buyer typically has very little bargaining power compared to the seller and the mortgage lender. In fact, a strong real estate market is often referred to as a "seller's market."<sup>34</sup> The buyer has less bargaining power than the seller because there could be multiple potential buyers trying to purchase a single property.<sup>35</sup> In addition, the buyer has less bargaining power than the mortgage lender because the lender typically brings a greater amount of money to the table.<sup>36</sup>

When there are multiple offers on a property, the seller can easily replace a "difficult" buyer with one who is more cooperative.<sup>37</sup> This forces potential homebuyers to accept the contract terms as presented by the seller, with little opportunity to negotiate.<sup>38</sup> Therefore, there is little incentive for sellers to negotiate with a potential buyer who insists on waiting for the final Certificate of Occupancy if there are many other buyers who are willing to close with a TCO.<sup>39</sup> Likewise, a potential buyer will be less likely to insist on (and even less likely to receive) a higher escrow from the seller when there are multiple potential buyers, many of which will not make the same demand.<sup>40</sup>

Buyers have less bargaining power than mortgage lenders in real estate transactions because the lenders typically have more money at stake in the

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34. A "seller's market" is defined as a "[a] market which has more buyers than sellers. High prices result from this excess of demand over supply." InvestorWords.com, Seller's Market Definition, [http://www.investorwords.com/4470/sellers\\_market.html](http://www.investorwords.com/4470/sellers_market.html) (last visited Apr. 8, 2008).

35. See Tracie Rozhon, *Housing Market Heats Up Again in New York City*, N.Y. TIMES, Feb. 19, 2007, at A1 (looking at an increased number of bidding wars on condos, co-ops, and townhouses as an indication of a strengthening real estate market).

36. Homebuyers often provide 20% or less of the purchase price of a home, with the lender providing the remaining money to the seller. See Yahoo! Finance, *The Down Payment Hurdle*, <http://loan.yahoo.com/m/finance8.html> (last visited Apr. 7, 2008).

37. See Blanche Evans, *Multiple Offers: How Can You Compete?*, REALTY TIMES, Mar. 31, 1999, [http://realtymtimes.com/rtepages/19990331\\_multipleoffers.htm](http://realtymtimes.com/rtepages/19990331_multipleoffers.htm) ("In a hot market, there are more buyers than homes for sale" and "[m]ultiple offers mean that the seller has his/her pick of offers . . .").

38. See Marty Latz, *Buyers Must Strategize in Today's Seller's Market*, NEGOTIATIONS.COM, <http://www.negotiations.com/articles/real-estate/> (stating that "[i]t's not easy" to "negotiate the best possible deals as a buyer in a seller's market") (last visited Apr. 8, 2008).

39. See Evans, *supra* note 37 (stating that in a strong real estate market "[t]he seller will only accept terms which meet his/her own needs, so [prospective buyers should] keep contingencies to a minimum").

40. *Id.*; see also discussion *infra* Part II.B.

transaction than the buyers.<sup>41</sup> According to Judge Stranieri, “there is said to be a ‘golden rule’ in real estate; that is, ‘he who has the gold, makes the rules.’”<sup>42</sup> In a typical residential real estate purchase, the homebuyer makes a down payment, which is traditionally about 20% of the purchase price.<sup>43</sup> The mortgage lender provides the difference between that amount and the price of the property.<sup>44</sup> Since the mortgage lender provides the majority of the purchase money, they have greater bargaining power and the buyer is unlikely to be able to negotiate out of contract terms that are beneficial to the lender.<sup>45</sup>

### B. INSUFFICIENCY OF THE CERTIFICATE OF OCCUPANCY ESCROW

The escrow amount of \$2,500 used in the standard real estate agreement,<sup>46</sup> which is intended to ensure that the developer obtains the final Certificate of Occupancy, is so low that in many instances it is more profitable for the developer to not complete the work.<sup>47</sup> In these instances, homebuyers are left with the responsibility of completing the necessary work and obtaining the Certificate of Occupancy themselves.<sup>48</sup> The New York Civil Courts have had at least one case where the homebuyer completed the work and obtained the Certificate of Occupancy himself.<sup>49</sup> However, when the buyer tried to have the escrow released to cover the cost, the developer brought an action because the escrow agreement was silent as to whether the buyer was entitled to the money if the developer failed to obtain the Certificate of Occupancy.<sup>50</sup>

If the buyer has closed on the property with a TCO, and the open items left to complete will cost more than the \$2,500 escrow amount, the

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41. See Yahoo! Finance, *supra* note 36.

42. *Divita v. Decker & Decker, P’ship*, No. SCR1192/04, 2004 WL 3178287, at \*7 (N.Y. Civ. Ct. Nov. 24, 2004).

43. Mortgage lenders have typically required borrowers to provide a down payment of 20% of the property’s purchase price. However, there are now mortgage companies that will lend to borrowers who put down as little as zero to three percent, as long as the buyer takes out private mortgage insurance. Yahoo! Finance, *supra* note 36; see also Jay Romano, *Ending Mortgage Insurance*, N.Y. TIMES, Mar. 9, 1997, § 9, at 3.

44. See generally NexTag, Mortgage Basics, <http://www.nextag.com/home-mortgage/0/Mortgage-Basics.html> (“A larger down payment on a property will result in a smaller loan . . . .”) (last visited Apr. 7, 2008).

45. See RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES, § Introduction (1997) (“Protection [of borrowers] is amply justified because it serves to restrain the often oppressive bargaining power lenders exercise over borrowers.”).

46. See *Howard v. Berkman, Henoch, Peterson & Peddy, P.C.*, No. 034411/04, 2004 WL 2732245, at \*12 (N.Y. Civ. Ct. Nov. 5, 2004).

47. *Id.* (“This escrow number is so artificially low that on many occasions the seller never completes the work, forfeits the \$2,500.00 and leaves the homeowner the task of obtaining the certificate of occupancy.”).

48. *Irardy v. Decker & Decker*, SCR 1279/04, 2005 N.Y. Misc. LEXIS 3268 (N.Y. Civ. Ct. Mar. 2, 2005); *Howard*, 2004 WL 2732245, at \*12.

49. *Howard*, 2004 WL 2732245, at \*12.

50. *Id.*

developer will actually lose money by completing the work and releasing the escrow.<sup>51</sup> Also, even if the work to be completed will cost the developer less than the \$2,500, the amount he would receive in the end is negligible compared to the money he could make by using his resources to start new projects.<sup>52</sup> Therefore, the standard escrow amount of \$2,500 is too low to serve its intended purpose, which is to ensure that the developer/seller obtains the final Certificate of Occupancy for the buyer.

### C. BUILDING CODE AND ZONING VIOLATIONS

Another scenario that has led to homebuyers being stranded without final Certificates of Occupancy occurs when a developer receives a TCO from the Department of Buildings, even though the building does not meet the building or zoning codes.<sup>53</sup> Buyers then get mortgages and purchase the property, only to find that the City will not issue a final Certificate of Occupancy due to those building code or zoning violations.<sup>54</sup>

An example of this occurred in late 2002 and early 2003, when a group of developers submitted plans to the City for four adjoined buildings and a fifth down the block on Spencer Street in Bedford Stuyvesant, Brooklyn.<sup>55</sup> The plans called for constructing these buildings to more than twice the height that the zoning in that area would typically allow.<sup>56</sup> The developers took advantage of a zoning “provision that permits bigger structures for certain community-friendly uses.”<sup>57</sup> They claimed that the buildings would be faculty housing for the Beth Chana School for Girls in Williamsburg.<sup>58</sup> However, when the developers filed their application at the Department of Buildings for faculty housing, they simultaneously submitted papers to the New York State Attorney General’s office stating that the apartments were to be sold as condominiums on the open market.<sup>59</sup>

The units, priced from \$280,000 to \$445,000, quickly sold out.<sup>60</sup> In the summer of 2004, while the buildings had a TCO, buyers began to obtain financing, close on their units, and move into the first four buildings.<sup>61</sup> However, extensive delays in the completion of the fifth building eventually

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51. For example, if the cost of completion is \$3,000 and the escrow is \$2,500, then it will cost the developer \$3,000 to receive the \$2,500, leaving him with \$500 less than he would have if he did not complete the work.

52. See Christine Haughney, *Manhattan Apartment Prices Hit Record High Despite Slump*, N.Y. TIMES, Apr. 2, 2008, at B1 (“The average price of a Manhattan apartment in the first three months of [2008] was \$1.7 million . . .”).

53. Neuman, *supra* note 1.

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.*

58. *Id.* Faculty housing is now no longer one of the permitted uses.

59. Neuman, *supra* note 1.

60. *Id.*

61. *Id.*

caught the attention of the Department of Buildings and the Attorney General's office.<sup>62</sup> Officials from the Department of Buildings looked into the development and realized that the oversized buildings were not being used as faculty housing.<sup>63</sup> "After discovering the zoning violations," the Department of Buildings conducted a more thorough inspection of the buildings and discovered other design flaws that would have to be corrected before occupancy of the buildings could be legal.<sup>64</sup> As a result, the Department of Buildings said that the buildings did not qualify for final Certificates of Occupancy and that the City would not renew the buildings' TCOs.<sup>65</sup> The City has kept that promise, and the Spencer Street condos' most recent TCO expired in May 2005.<sup>66</sup>

The negative effects of the situation have fallen mainly on the buyers. Although the City has not issued vacate orders to the buyers of the units even though occupancy without a Certificate of Occupancy is technically illegal, the buyers could not sell their units or refinance without Certificates of Occupancy.<sup>67</sup> To make matters worse, many of them had adjustable-rate mortgages<sup>68</sup> with rising rates.<sup>69</sup> The Department of Buildings recognized that the buyers should not have to suffer for the developer's mistakes, but they also wanted to send a message to developers who think they can violate the code and escape unscathed.<sup>70</sup> However, that is exactly what seems to have happened, since while the violations at Spencer Street were still outstanding,<sup>71</sup> the city granted the developers permits to begin other projects throughout the city.<sup>72</sup>

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62. *Id.*

63. *Id.*

64. William Neuman, *At Spencer Street, A Solution Meets Skepticism*, N.Y. TIMES, July 9, 2006, § 11, at 2. These flaws included "a failure to meet standards for access by people with disabilities and a fire-safety problem: the apartment doors open directly onto the buildings stairwells."

65. Neuman, *supra* note 1.

66. N.Y. City Dep't of Bldgs., Temporary Certificate of Occupancy, 191 Spencer Street, available at <http://a810-cofo.nyc.gov/cofo/B/301/399000/B301399840T2.PDF>.

67. N.Y. City Dep't of Bldgs., *supra* note 4.

68. Black's Law Dictionary defines "adjustable-rate mortgage" as: "A mortgage in which the lender can periodically adjust the mortgage's interest rate in accordance with fluctuations in some external market index." BLACK'S LAW DICTIONARY (8th ed. 2004).

69. Neuman, *supra* note 1.

70. *Id.*

71. After much negotiation, a settlement was reached between the developers, the city, and the homebuyers, but the contents of that settlement are not available to the public. Interview with a Spencer Street buyer's attorney, in New York, N.Y. (Oct. 15, 2006). However, as of the publication of this note, a search of the Department of Buildings' Buildings Information System indicates that the final Certificate of Occupancy has yet to be issued to the Spencer Street Condominiums. See N.Y. City Dep't of Bldgs., Building Information Search, <http://a810-bisweb.nyc.gov/bisweb/bispi00.jsp> (select borough "Brooklyn," enter House No. "191" and Street "Spencer Street") (last visited Apr. 7, 2008).

72. William Neuman, *Under the Radar in Brooklyn*, N.Y. TIMES, Sept. 4, 2005, § 11, at 2.

#### D. SELF-CERTIFICATION

Considering the building code and zoning violations in the Spencer Street condominiums, one would find it surprising that the developers received TCOs in the first place. However, the Department of Buildings issues tens of thousands of building permits each year, though the city employs relatively few inspectors.<sup>73</sup> In order to expedite the building process and lessen the burden on the inspectors, the Department of Buildings revised its certification procedure in order to allow “licensed architects and engineers hired by builders to self-certify that their plans and documents . . . comply with all zoning and building code requirements.”<sup>74</sup> Under this procedure, the Department of Buildings checks self-certified applications for completeness, but does not subject them to a rigorous examination.<sup>75</sup>

While the self-certification process has served the purpose of expediting the development process, it has also raised many questions of accountability. For example, during a 1997 investigation of one developer in Staten Island, former Richmond County District Attorney William L. Murphy stated:

It’s certainly the case that [the developer] was self-certifying his plans and the department wasn’t checking. If you look at the process, accountability doesn’t seem to be one of its high points . . . . The builder is saying, “I’m told by these people—the licensed electrician, the plumber—that the work has been done, so I’m applying for the temporary certificate.” It allows development to take place without the protections of a permanent certificate, and the homeowner is left holding the bag. There are hundreds, probably thousands, of temporary C. of O.’s issued.<sup>76</sup>

As Mr. Murphy alluded, when the problem of a dubious self-certification arises, the process allows each party involved to shift the blame to someone else; the Department of Buildings blames the developer for not giving proper information in the application, and the developer blames the contractors who supposedly assured him that the work has been properly completed.<sup>77</sup>

The self-certification process has been subject to numerous challenges,<sup>78</sup> and the Department of Buildings itself has admitted that it is

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73. See Dennis Hevesi, *When Builders Are Inspectors*, N.Y. TIMES, Dec. 3, 2000, § 11, at 1.

74. *Id.*

75. *Id.*

76. *Id.*

77. *See id.*

78. Most recently, Mayor Bloomberg has proposed two bills that would require the Department of Buildings to conduct more complete examinations of plans and applications and enforce the suspension or revocation of self-certification privileges of architects or engineers who “knowingly or negligently certify false or non-compliant building permit applications or plans.” Press Release, N.Y. City Office of the Mayor, Mayor Bloomberg Signs Two Bills Targeting Abuse of City’s Self-Certification System for Engineers and Architects (Feb. 15, 2007), *available*

not yet 100% satisfied with the current process.<sup>79</sup> Due to building code violations that the Department of Buildings did not catch because the parties self-certified, the self-certification process has been blamed as the “cause of collapsed buildings, cascading facades, chronic corruption and homeowners left stranded with slipshod construction and no permanent certificates of occupancy.”<sup>80</sup> However, the process is unlikely to be changed.<sup>81</sup> Supporters of self-certification argue that the time-saving process has greatly helped New York City complete much needed additional construction.<sup>82</sup> The process also saves tax dollars and helps the Department of Buildings perform more efficiently.<sup>83</sup> Additionally, the Department of Buildings is currently drafting “Rule 21” which would enable the Department to

revoke self certification privileges of architects who show ignorance of the building laws, submit plans that were not prepared under their own supervision, demonstrate incompetence, knowingly make false or misleading statements, falsify any application or form, are convicted of a criminal offense which arose out of their professional occupation, or show poor moral character.<sup>84</sup>

While Rule 21 may not eliminate all self-certification abuses, it gives the Department of Buildings the authority to respond to those abuses.<sup>85</sup>

Despite the myriad reasons for and scenarios in which homebuyers end up stranded without final Certificates of Occupancy, there remain few proposed solutions to mitigate these problems. A major issue in this respect is that there is a real debate as to who should be liable for failure to obtain a final Certificate of Occupancy. The following section examines this and concludes that when a final Certificate of Occupancy is not obtained, the developer should bear the liability.

### III. LIABILITY OF THE MORTGAGE LENDER, THE HOMEBUYER’S ATTORNEY, AND THE DEVELOPER

Currently, when homebuyers are left without final Certificates of Occupancy, they are subject to vacate orders and are unable to sell,

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at [http://www.ci.nyc.ny.us/portal/site/nycgov/menuitem.c0935b9a57bb4ef3daf2f1c701c789a0/index.jsp?pageID=mayor\\_press\\_release&catID=1194&doc\\_name=http%3A%2F%2Fwww.ci.nyc.ny.us%2Fhtml%2Fom%2Fhtml%2F2007a%2Fpr054-07.html&cc=unused1978&rc=1194&ndi=1](http://www.ci.nyc.ny.us/portal/site/nycgov/menuitem.c0935b9a57bb4ef3daf2f1c701c789a0/index.jsp?pageID=mayor_press_release&catID=1194&doc_name=http%3A%2F%2Fwww.ci.nyc.ny.us%2Fhtml%2Fom%2Fhtml%2F2007a%2Fpr054-07.html&cc=unused1978&rc=1194&ndi=1).

79. Hevesi, *supra* note 73.

80. *Id.*

81. *Id.*

82. David Mandl, *Professional Certification Program a Great Success*, REAL EST. WKLY., May 24, 2006, at 3C(1).

83. *See id.*

84. *Id.*; *see also* Press Release, N.Y. City Dep’t of Bldgs., Buildings Commissioner Launches Safety Outreach Campaign (Oct. 18, 2006), available at [http://home2.nyc.gov/html/dob/html/news/pr\\_construction\\_safety\\_101806.shtml](http://home2.nyc.gov/html/dob/html/news/pr_construction_safety_101806.shtml).

85. *See* Press Release, N.Y. City Dep’t of Bldgs., *supra* note 84.

refinance, or even renew homeowner's insurance.<sup>86</sup> When this occurs, there are three parties that could face possible liability: the mortgage lender, the homebuyer's attorney, and the developer. By exploring these parties' current liabilities, this section demonstrates that it is inappropriate to hold the mortgage lender or homebuyer's attorney liable for the developer's failure to obtain a final Certificate of Occupancy. This section also shows that the current liabilities faced by the developer are not enough and too difficult to prosecute to be an effective remedy.

#### A. LIABILITY OF THE MORTGAGE LENDER

Some courts have discussed placing liability for a homebuyer being stranded without a final Certificate of Occupancy on the mortgage lender.<sup>87</sup> However, the New York Supreme Court, Appellate Division's decision in *Myers v. L & M Developers*<sup>88</sup> held that lenders have no duty to ensure that a Certificate of Occupancy is issued to the buyer, even when there is a provision in the lender's commitment stating that they would not close without a final Certificate of Occupancy.<sup>89</sup> The court found that the provision in the commitment was solely for the protection of the lender, and did not provide the buyer with a cause of action.<sup>90</sup>

But the issue of mortgage lender liability was recently resurrected by the New York City Civil Court's opinion in *Howard v. Berkman, Henoch, Peterson & Peddy, P.C.*<sup>91</sup> According to *Howard*, a mortgage lender can face liability if it closes on property without a Certificate of Occupancy, knowing that the buyer intends to occupy the premises.<sup>92</sup> Most lenders

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86. N.Y. City Dep't of Bldgs., *supra* note 4.

87. See *Myers v. L & M Developers*, 569 N.Y.S.2d 301 (N.Y. App. Div. 1991); *Divita v. Decker & Decker, P'ship*, No. SCR1192/04, 2004 WL 3178287 (N.Y. Civ. Ct. Nov. 24, 2004); *Howard v. Berkman, Henoch, Peterson & Peddy, P.C.*, No. 034411/04, 2004 WL 2732245 (N.Y. Civ. Ct. Nov. 5, 2004).

88. *Myers*, 569 N.Y.S.2d 301.

89. *Id.*

90. *Id.*

91. *Howard*, 2004 WL 2732245, at \*10.

92. *Id.* ("A [lender] who loans money knowing that the mortgagor intends to occupy the premises as a primary residence cannot close the loan knowing full well that legal occupancy is prohibited."). New York City Administrative Code § 26-125(a) states:

[E]very person who shall violate any of the provisions of any laws, rules or regulations enforceable by the department or who shall knowingly take part or assist in any such violation shall be guilty of an offense and upon conviction thereof shall be punishable by a fine of not more than five thousand dollars. Such person shall also be subject to the payment of a penalty of not more than five thousand dollars to be recovered in a civil action brought in the name of the city in any court of record in the city.

N.Y. CITY ADMINISTRATIVE CODE § 26-125(a) (2007) (emphasis added). Additionally, New York City Administrative Code § 26-248(a) reiterates:

[T]he owner of any structure, or part thereof, or land, where any violation of this subchapter or chapter one of title twenty-seven of the code shall be placed, or shall

know of the borrower's intention because borrowers are required to complete a form stating whether they intend to use the premises as a primary residence within thirty days of the closing.<sup>93</sup> *Howard* posited that if the lender closes on a property without a Certificate of Occupancy, it cannot plead ignorance and demand payments from a borrower who cannot occupy the premises.<sup>94</sup>

*Howard* attaches liability to mortgage lenders by looking beyond the NYCAC to the New York Banking Law (the Banking Law).<sup>95</sup> Section 589 of the Banking Law requires all mortgage lenders to be licensed in order to protect consumers and "ensure that the mortgage lending industry is operating fairly, honestly and efficiently, free from deceptive and anti-competitive practice."<sup>96</sup> The Banking Law also provides that a lender's license can be revoked for violating any provision of the Banking Law or "any other law, rule or regulation of this state or the federal government."<sup>97</sup> *Howard* found that "any other law, rule or regulation" includes NYCAC § 27-214 (which creates the Certificate of Occupancy requirement).<sup>98</sup> Considering the legislative purpose behind the lender license requirements, and that the Banking Law permits licenses to be revoked upon any violation, *Howard* concluded that "lenders in the State of New York have the obligation to insure that a final certificate of occupancy is delivered on any building purchases they finance."<sup>99</sup>

Under the *Howard* analysis, when closing with a TCO, the lender is not in violation unless the developer fails to obtain the final Certificate of Occupancy.<sup>100</sup> Therefore, according to *Howard*, if a lender closes with a

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exist, and any person who may be employed or assist in the commission of any such violation, and any and all persons who shall violate any of the provisions of this subchapter or chapter one of title twenty-seven of the code or fail to comply therewith, or any such requirement thereof, . . . shall severally, for each and every such violation or non-compliance, respectively, be punished by a fine of not more than five thousand dollars.

N.Y. CITY ADMINISTRATIVE CODE § 26-248(a) (2007) (emphasis added).

93. *Howard*, 2004 WL 2732245, at \*10.

94. *Id.* ("If the lender wants to close, ignoring the law in regard to occupancy status, then it should be precluded from collecting the mortgage payments due it during that period of time.")

95. *Id.* at \*10-11.

96. N.Y. BANKING LAW § 589 (McKinney 2007).

97. N.Y. BANKING LAW § 595(1)(a).

98. Judge Straniere points out that the New York State Constitution Article IX and the Municipal Home Rule Law (10)(1) both grant local governments the power to regulate the use of property within their own locality. Since these local regulations are authorized by the state constitution and statute, they must be treated as state laws within their own locality. *Howard*, 2004 WL 2732245, at \*11.

99. *Id.*

100. *Id.* The court stated:

[O]nce the lender is aware that there is an escrow being held until a final certificate of occupancy is issued by the municipality, the lender has an obligation to insure that the

TCO and the developer breaches the contract and fails to obtain the final Certificate of Occupancy, then the lender has violated § 589 of the Banking Law<sup>101</sup> despite entering the deal in good faith.

The *Howard* court justifies placing this affirmative duty on lenders by stating that, as the wealthiest party in real estate purchases, the lender

has the ability, if not the best opportunity to insure that no closing takes place in the absence of a final certificate of occupancy or if a temporary certificate of occupancy is produced, that sufficient money is withheld at the closing and placed in escrow to insure that there is a fund available to remedy any violations that would prevent the issuance of a certificate of occupancy.<sup>102</sup>

The problem with this rationale is that even if lenders have the necessary leverage to require higher escrows, it seems inequitable to hold them liable for the actions of an independent third party.

Despite the *Howard* court's recent challenge to the *Myers* notion that lenders are not liable for a developer's failure to obtain a final Certificate of Occupancy, it is highly unlikely that lenders will go out of their way to increase pressure on developers to ensure final Certificates of Occupancy are obtained.<sup>103</sup> This is not only because there have not been any appeals confirming the Civil Court's opinion, but also because lenders could actually benefit from homebuyers being stranded without Certificates of Occupancy. A brief explication of the basics of refinancing helps explain this latter point.

Mortgage lenders loan money to purchasers of real estate, and in return, the borrower repays the principal of the loan plus interest over a set period of time, or the "term" of the loan.<sup>104</sup> When interest rates drop, many borrowers look to replace their existing high-interest debt by paying off their existing loans with new loans at the lower interest rate; this is called "refinancing."<sup>105</sup> However, when a borrower pays off a loan before the date of maturity,<sup>106</sup> the lender does not get the full amount of interest that it was

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final certificate of occupancy is issued or, in the City of New York, that the temporary certificate of occupancy is extended until the final certificate of occupancy is issued.

*Id.*

101. See *supra* note 96 and accompanying text.

102. *Howard*, 2004 WL 2732245, at \*11.

103. Likewise, until there is further support from the higher courts in New York, *Howard* is unlikely to deter mortgage lenders from continuing to collect payments from borrowers, whether or not they have final Certificates of Occupancy.

104. See Mortgage for Beginners, Mortgage Basics, <http://www.forbeginners.info/mortgage/mortgage-basics.htm> (last visited Apr. 8, 2008).

105. STEVEN W. BENDER ET AL., MODERN REAL ESTATE FINANCE AND LAND TRANSFER: A TRANSACTIONAL APPROACH 241 (3d ed. 2004).

106. Black's Law Dictionary defines "date of maturity" as "[t]he date when a debt falls due, such as a debt on a promissory note or bond." BLACK'S LAW DICTIONARY (8th ed. 2004).

expecting at the outset of the loan.<sup>107</sup> For this reason, many mortgage loans either prohibit prepayment or impose charges when a borrower wants to prepay.<sup>108</sup>

One way that mortgage loans restrict prepayment is by having a “lock-in” period, which prohibits prepayment for a certain period of time.<sup>109</sup> When homebuyers’ TCOs expire and they have not received final Certificates of Occupancy, they are not able to sell or refinance.<sup>110</sup> Therefore, no matter how lenient the prepayment clause in the mortgage note is, borrowers will not be able to refinance to take advantage of any declines in the interest rate until they obtain final Certificates of Occupancy.<sup>111</sup> Therefore, the lack of a Certificate of Occupancy creates an artificial lock-in period with real effects, preventing the borrower from prepaying the loans and assuring the lender that it will receive the rate of return anticipated upon entering the mortgage contract (at least until the homebuyer gets a final Certificate of Occupancy). Despite these incentives for the mortgage lender to not put pressure on the developer to raise the escrow or actually acquire the final Certificate of Occupancy, the lender is not necessarily acting in bad faith. Therefore, absent an agency relationship, when the contractual responsibility to obtain the final Certificate of Occupancy is the developer’s, and he fails to do so, it is inappropriate to place liability on the lender for that developer’s negligence or malevolence.<sup>112</sup>

### B. LIABILITY OF THE HOMEBUYER’S ATTORNEY

Another party who could face possible liability when a homebuyer is left without a final Certificate of Occupancy is the homebuyer’s attorney who represented the buyer in the closing.<sup>113</sup> In Judge Straniere’s opinion in *Howard*, he stated, “[i]t is malpractice [for an attorney] to permit a client to purchase a premises without a valid certificate of occupancy or under the current questionable system without a valid temporary certificate of occupancy.”<sup>114</sup> *Howard* also raised the possibility that an attorney could

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107. BENDER ET AL., *supra* note 105, at 241.

108. *Id.*

109. *Id.*

110. See N.Y. City Dep’t of Bldgs., *supra* note 4.

111. See, e.g., *Washington v. Culotta*, No. 034230/02, 2005 WL 2171189, at \*4 (N.Y. Civ. Ct. July 21, 2005).

112. An agency relationship “exists only if there has been a manifestation by the principal to the agent that the agent may act on his account, and consent by the agent so to act.” RESTATEMENT (SECOND) OF AGENCY § 15 (1958). In other words, unless the mortgage lender has given permission to the developer to act on the lender’s behalf, and the developer consents, there is no agency between the parties.

113. See *Divita v. Decker & Decker, P’ship*, No. SCR1192/04, 2004 WL 3178287, at \*7 (N.Y. Civ. Ct. Nov. 24, 2004); *Howard v. Berkman, Henoch, Peterson & Peddy, P.C.*, No. 034411/04, 2004 WL 2732245, at \*3 (N.Y. Civ. Ct. Nov. 5, 2004).

114. *Howard*, 2004 WL 2732245, at \*3.

face malpractice liability even if there was a valid TCO at the time of closing.<sup>115</sup> Since a TCO is issued for only a limited time,<sup>116</sup> if that time expires without a final Certificate of Occupancy being acquired or without the TCO being extended, the homebuyer's attorney may face liability for "assisting" in the violation of the NYCAC.<sup>117</sup>

Under this interpretation, whenever an attorney's client closes with a TCO, that attorney has the ongoing responsibilities of monitoring whether or not the buyer obtains a final Certificate of Occupancy and advising the client of the certificate's current status.<sup>118</sup> If no final Certificate of Occupancy is obtained before the TCO expires, the attorney must alert the client to the possibility of receiving a vacate order and facing potential civil or criminal penalties.<sup>119</sup> Whether not upholding those duties constitutes malpractice depends on if the attorney did not "render professional services with the skill, prudence, and diligence that an ordinary and reasonable lawyer would use under similar circumstances."<sup>120</sup> Typically, real estate lawyers' responsibilities include things such as helping the client understand the contract, clarifying mortgage terms, and ensuring valid title transfer.<sup>121</sup>

It is not typically the responsibility of the real estate lawyer to ensure that the parties uphold their future obligations under the contract.<sup>122</sup> Since ongoing monitoring of the real estate contract is not typically the responsibility of the real estate attorney, the attorney should not be subject to malpractice litigation for failing to do so. Additionally, attorneys are already legally obligated to act in their clients' best interests,<sup>123</sup> and homebuyers' attorneys are obligated to inform their clients of the possible

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115. *Id.* at \*6.

116. N.Y. CITY ADMINISTRATIVE CODE § 27-218 states:

[T]he temporary certificate of occupancy shall be issued initially for a period between ninety and one hundred eighty days, in the case of all buildings classified in occupancy group J-3 or three-family homes, and ninety days for all other buildings, subject to renewal for additional ninety-day periods at the discretion of the commissioner.

N.Y. CITY ADMINISTRATIVE CODE § 27-218 (2007). Occupancy group J-3 includes "buildings occupied as one-family or two-family dwellings, or as convents or rectories." N.Y. CITY ADMINISTRATIVE CODE § 27-266 (2007).

117. *Howard*, 2004 WL 2732245, at \*6.

118. *Id.*

119. *Id.*

120. BLACK'S LAW DICTIONARY (8th ed. 2004) (defining "legal malpractice").

121. Lending Tree, The Role of Real Estate Lawyers, <http://www.lendingtree.com/smartborrower/Finding-a-listing-agent/The-role-of-real-estate-lawyers.aspx> (last visited Apr. 7, 2008).

122. *See id.* Real estate lawyers' responsibilities typically include aiding clients up to and through closing, but do not typically include post-closing, ongoing tasks.

123. NEW YORK CODE OF PROF'L RESPONSIBILITY EC 7-9 (2002).

consequences of buying a home with a TCO.<sup>124</sup> Imposing additional responsibilities and liabilities on the attorney because the developer failed to satisfy his contractual obligations seems illogical.

### C. LIABILITY OF THE DEVELOPER

Similar to the lenders and attorneys discussed above, a developer who fails to obtain a final Certificate of Occupancy for a homebuyer could be subject to liability under NYCAC §§ 26-125 and 26-248.<sup>125</sup> However, if the developer was the party contractually obligated to obtain the final Certificate of Occupancy, it is logical that he should be the party held accountable for the failure to do so.

In *Washington v. Culotta*,<sup>126</sup> the plaintiff/homebuyers had each contracted with the defendant/developer for the purchase of homes.<sup>127</sup> The plaintiffs' contracts with the developer each contained a fairly common Certificate of Occupancy clause stating

Seller agrees to deliver a permanent Certificate of Occupancy for the dwelling but title shall not be adjourned for lack of same. It being understood and agreed that a sum not to exceed \$2,500.00 from the Seller's money will be held in escrow by the lending institution or the Seller's Attorney pending production and delivery of such permanent certificate. No closing will occur, however, without Seller first obtaining a temporary Certificate of Occupancy.<sup>128</sup>

Seven years after signing the contract, the developer still had not obtained the final Certificate of Occupancy for the homebuyers.<sup>129</sup> However, the court held that "[n]either the above cited 'Certificate of Occupancy' escrow paragraph[] nor any other clause of the agreement creates a cause of action in favor of the plaintiffs in the event there is a failure of the seller to procure the final Certificate of Occupancy."<sup>130</sup> A further complication exists because the injury caused by "the failure to deliver a final Certificate of Occupancy is . . . nebulous,"<sup>131</sup> and was therefore deemed too speculative for a court to award damages.<sup>132</sup>

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124. NEW YORK CODE OF PROF'L RESPONSIBILITY EC 7-8 (2002) ("A lawyer should exert best efforts to ensure that decisions of the client are made only after the client has been informed of relevant considerations.").

125. *Howard v. Berkman, Henoch, Peterson & Peddy, P.C.*, No. 034411/04, 2004 WL 2732245, at \*5-6 (N.Y. Civ. Ct. Nov. 5, 2004).

126. *Washington v. Culotta*, No. 034230/02, 2005 WL 2171189, at \*1 (N.Y. Civ. Ct. July 21, 2005).

127. *Id.*

128. *Id.* at \*1-2.

129. *Id.* at \*2.

130. *Id.*

131. *Id.* at \*3.

132. *Culotta*, 2005 WL 2171189, at \*4.

The court in *Culotta* stated that the homebuyers would have to complete the work and obtain the final Certificates of Occupancy themselves before the court would be able to determine the proper damages.<sup>133</sup> The court proposed one “remedy”:

Perhaps the proper remedy is for the plaintiffs to elect to declare that a forfeiture has occurred which would make the contract a nullity and entitle them to a refund of all the monies expended for the purchase and for occupying the premises since the date of the closing and all foreseeable expenses arising from that occupancy.<sup>134</sup>

However, requiring homebuyers’ to give up their homes in order for developers to feel the backlash of their actions could be viewed as more of a punishment for the homebuyer than for the developer.

One ray of light from the homebuyers’ perspective was the *Culotta* court’s statement that when a developer ignores a contractual obligation and makes no effort to procure the final Certificate of Occupancy, the developer’s actions might be “so egregious” that they could warrant punitive damages.<sup>135</sup> But it is not enough that a homebuyer stranded without a final Certificate of Occupancy can only recover from a breaching developer if the developer’s actions were so egregious as to warrant punitive damages. Though the measure of damages may be debatable, the liability should still rest on the developer since the developer is the party who breaches the contractual duty to obtain a final Certificate of Occupancy for the buyer. Unfortunately, the current system of liabilities makes it very difficult for homebuyers to recover damages from a developer without giving up their homes.<sup>136</sup>

#### IV. SOLUTIONS

This section discusses three possible ways to prevent homebuyers from being stranded without final Certificates of Occupancy: elimination of the TCO system in its entirety, statutory enforcement of higher escrows, and restriction of the issuance of permits to offending developers. The section concludes that the option that would most effectively solve the problem presented is restriction of the issuance of permits to offending developers.

##### A. ELIMINATION OF TEMPORARY CERTIFICATES OF OCCUPANCY

One solution, presented by Judge Straniere of the New York City Civil Court, is to eliminate the TCO system in its entirety.<sup>137</sup> This solution is

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133. *Id.* at \*5.

134. *Id.* at \*4.

135. *Id.*

136. *See id.*

137. *See Divita v. Decker & Decker, P’ship*, No. SCR1192/04, 2004 WL 3178287, at \*8 (N.Y. Civ. Ct. Nov. 24, 2004) (suggesting that “[p]erhaps the solution is to eliminate [the TCO]

overbroad. While it is true there have been protracted legal issues due to misuse of the system, possible legal and contractual problems caused by the TCO system do not outweigh the benefits that the system creates.

The New York City Council created the TCO system because it determined that it was unfair to postpone closings when the items left for completion were not dangerous and the building could be safely occupied.<sup>138</sup> The fact that the City Council found it was not “fair” to postpone closings implies that it believed that there are benefits to expediting the process.<sup>139</sup> Indeed, there are possible benefits of closing earlier for all of the parties involved. The homebuyer is able to secure their newly acquired asset and begin benefiting from the advantages of homeownership earlier.<sup>140</sup> The lender is able to collect mortgage payments and interest sooner.<sup>141</sup> And, the developer is able to get a return on his investment earlier and have the opportunity to reinvest in future projects. The problems that arise from the TCO system are mainly due to bad faith actions on the part of a small number of actors. Eliminating the entire system by retracting NYCAC § 27-218 is far too overbroad, and would punish countless potential homebuyers, lenders, and developers for the actions of a few.

### B. ENFORCEMENT OF HIGHER ESCROWS

Another possible solution is the introduction of legislation mandating that higher escrows be put aside to ensure that the developer fulfills its contractual obligation and obtains the final Certificate of Occupancy. One method of achieving this would be amending NYCAC §27-218 to require that upon the issuance of a TCO the developer create an escrow equal to twice the projected cost of completing the open items, as determined by an independent appraiser.<sup>142</sup> The *Howard* court suggested an even more substantial escrow requirement, making the developer put aside 10% of the sale price or the amount that represents the entire profit margin on the

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system”); *Howard v. Berkman, Henoach, Peterson & Peddy, P.C.*, No. 034411/04, 2004 WL 2732245, at \*3 (N.Y. Civ. Ct. Nov. 5, 2004) (referring to the TCO system as “questionable, if not absurd”).

138. See *Howard*, 2004 WL 2732245, at \*11; see also N.Y. CITY ADMINISTRATIVE CODE § 27-218 (2007).

139. See *Howard*, 2004 WL 2732245, at \*11.

140. See Habitat for Humanity, Benefits of Homeownership, available at <http://www.habitatnyc.org/pdf/Toolkit/homewonership.pdf> (last visited Apr. 7, 2008).

141. Mortgage Professor, Mortgage Closing Date: Does it Matter? [http://www.mtgprofessor.com/A%20-%20Options/closing\\_date.htm](http://www.mtgprofessor.com/A%20-%20Options/closing_date.htm) (“The interest clock on your loan starts ticking on the closing date, because the lender expects to be paid beginning the day the funds are disbursed.”) (last visited Apr. 7, 2008).

142. Therefore, if it would cost the developer an additional \$2,500 to complete a project and obtain the final Certificate of Occupancy, the developer would be required to create an escrow of \$5,000 that can only be released upon obtaining the final Certificate of Occupancy.

sale.<sup>143</sup> While this solution appears logical, it interferes with the parties' freedom of contract, and might not be effective in all situations or might be unduly restrictive on developers.

Freedom of contract is important to retain in mortgages because the needs of every homebuyer are different. While homebuyers are required by law to have Certificates of Occupancy in order to occupy their homes, some may prefer to contract for different terms than the ones set out above. Perhaps it is beneficial for some homebuyers and developers to have the homebuyers complete the open items on the TCO themselves in exchange for something else, such as a lower base price or upgraded appliances. Though there are often imbalances of power in real estate negotiations, it is imperative that the parties are not restricted to government-mandated contract terms, and are allowed to create a contract that is as beneficial as possible to all parties.

Another issue with a possible escrow amendment is that the "twice-the-cost escrow" would not always be effective and the "profit-margin escrow" could be too detrimental to developers. If the developer is one who would abandon his contractual duties in order to pursue a new development with greater income potential, it might not matter to him whether he loses \$2,500 or \$5,000. The amendment would cause such developers to lose more money than they otherwise would have, but it is not a sufficient deterrent to stop developers who are willing to act in bad faith in order to make the most money possible in the shortest period of time. However, the escrow requirement suggested by the *Howard* court could be destructive to the livelihood of many developers. Many developers survive financially by being able to work on multiple projects simultaneously, using the income from one as the capital for another.<sup>144</sup> That means, if developers were required to obtain a final Certificate of Occupancy before receiving any profit from a project, it could make it difficult for them to begin new projects before completing previous ones.<sup>145</sup> Withholding developers' entire profit margins, or even 10%, until their projects are complete could seriously hinder developers' income streams and could slow down the entire development industry. Also, like the elimination of the TCO system altogether, this solution is overbroad, restricting all developers because of the actions of a few.

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143. *Howard*, 2004 WL 2732245, at \*12.

144. Answers.com, Real Estate Developer: The Economics of Real Estate Development, <http://www.answers.com/topic/real-estate-developer-1> (one common form of real estate development financing is equity financing, the "use of cash flows from other projects owned by the developer") (last visited Apr. 7, 2008).

145. *See id.*

### C. RESTRICTING THE ISSUANCE OF PERMITS TO OFFENDING DEVELOPERS

The best way to deter developers from breaching their obligations to obtain final Certificates of Occupancy is to suspend delinquent developers' ability to obtain any new building permits from the city once they have let a TCO lapse. This is a variation of a solution proposed by the *Howard* court which would preclude developers from receiving any new permits until all of their current projects have received final Certificates of Occupancy and require that permits only be issued to individuals, not corporations.<sup>146</sup>

The problem with the *Howard* proposal is that it is overbroad and the restriction on corporations would put developers at an undue risk of personal liability. Not allowing developers to receive permits until all previous projects have received final Certificates of Occupancy would have the same negative effects on all developers as requiring the escrow to equal the profit margin.<sup>147</sup> It would greatly decrease the profitability of being a developer and could slow the whole development industry. Forcing developers to receive permits as individuals, as opposed to as corporations, would have the desired effect of opening the developer up to personal liability for stranding the homebuyer without a Certificate of Occupancy. However, it would also make developers personally liable for any of the myriad of issues that could arise during development. Such heavy legal responsibility could be too much of a burden on any individual to make it worthwhile to be a developer.

Simply suspending developers' ability to receive new building permits until they correct any lapses in TCOs for which they are responsible addresses both of those problems. First, this does not affect all developers, but only those that abandon homebuyers without final Certificates of Occupancy. Developers could continue beginning new projects while previous ones still have TCOs. However, if a developer allows a TCO to expire and has not yet obtained the final Certificate of Occupancy, the developer will be restricted from obtaining any future permits until the final Certificate of Occupancy is obtained. This solution would require the homebuyer to remain vigilant as to whether the necessary work is completed and the Certificate of Occupancy is delivered. If it is not, it would be the homebuyer's responsibility to report the developer's indiscretion to the Department of Buildings.<sup>148</sup> The Department of Buildings would then be responsible for placing an alert on the offending

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146. *Howard*, 2004 WL 2732245, at \*12.

147. See discussion *supra* Part IV.B.

148. This would also require the homebuyer's attorney to make the homebuyer aware of these responsibilities when purchasing a home with a TCO. The homebuyer could also contract for the attorney to monitor whether the filing of the Certificate of Occupancy occurs and report any failure to the Department of Buildings.

developer's name, disallowing any permits from being issued to that developer by self-certification or any other means.

Second, instead of disallowing the issuance of permits to any corporations, the principal officers of the corporations need to be held responsible for the corporation's actions. Under NYCAC §27-151, if a corporation applies for a building permit, all of the principal officers' names must be listed on the application.<sup>149</sup> Therefore, if a homebuyer reports the expiration of a TCO where the developer was a corporation, the restriction on permits would apply not only to that corporation, but to all of the principal officers as individuals, and to any other corporations in which those principle officers are members.

This solution is optimal not only because it only punishes the offenders and does not interfere with freedom of contract, but also because it justly distributes different responsibilities to the parties that are most likely to fulfill them. Developers are responsible for obtaining the final Certificate of Occupancy (unless they contract out of that duty) and their livelihood is put on hold if they do not fulfill that responsibility. Homebuyers are responsible for monitoring whether the work is completed, as they are in the best position to observe the progress (or lack thereof), and are subject to a possible vacate order if it is not. The Department of Buildings is responsible for checking the records when a complaint is reported by a homebuyer and placing the developer/corporation's officers on a "no-permit" list until the final Certificate of Occupancy is recorded. It is in the best position to do so since it maintains the files and is responsible for the issuance of permits. It would also be the responsibility of the Department of Buildings to maintain records of offending developers and report repeat offenders to the Attorney General for possible revocation of their license.

## **CONCLUSION**

TCOs are beneficial to everyone involved in a real estate transaction. They allow people to take advantage of the benefits of homeownership earlier, and they help put money into the continued development of land by providing for earlier returns for developers and for lenders. But, despite all of the benefits brought by the issuance of TCOs, they also open the door for some bad actors to leave homebuyers stranded in desperate situations, unable to sell, refinance, or insure their homes. To quell this problem, the New York City Department of Buildings should effectuate a restriction on all offending developers, preventing them from receiving new building permits, as individuals or as corporations, until they have rectified their actions and received the final Certificates of Occupancy that they are contractually obligated to obtain.

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149. N.Y. CITY ADMINISTRATIVE CODE § 27-151 (2007).

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\* The George Washington University, B.A.; Brooklyn Law School, J.D. (expected 2008). I would like to thank my parents and my in-laws for all of their love, support, and guidance. I would also like to thank my wonderful wife, who truly is lovely and stubborn and brave.