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CONSTITUTIONAL IMPLICATIONS OF RENT- AND MORTGAGE-RELIEF LEGISLATION ENACTED IN RESPONSE TO THE COVID-19 PANDEMIC

To Our Clients and Friends:

I. Overview

In a previous alert, we discussed the constitutional principles governing legislative responses to COVID-19 under the Takings, Contracts, Due Process, and Equal Protection Clauses of the U.S. Constitution.[1] Here, we apply those principles to proposals currently being debated in state legislatures that would provide broad residential and commercial rent and mortgage relief. For example, a recent amendment to California Assembly Bill No. 828 would both prohibit residential eviction proceedings for failure to pay rent during the declared state of emergency, and, upon the resumption of such proceedings after the emergency, provide that a tenant could have her rent judicially reduced by 25% for 12 months if the pandemic has adversely affected the tenant's ability to pay, absent material economic hardship to the landowner. Importantly, under the California bill, landowners owning 10 or more rental units would be presumed *not* to suffer material economic hardship due to rent reduction.

New York also is considering several bills suspending rent payments for residential or small-business commercial tenants. One such bill (Senate Bill S8125A) suspends rent payments for 90 days, without any obligation to later pay back the suspended rent, for those tenants who have lost income or shuttered their place of business due to government-ordered COVID-19 restrictions. The bill also would provide mortgage relief to landowners experiencing financial hardship from the lost rental payments.[2] Another bill (Senate Bill S8140A) would provide vouchers to tenants whose rent burden is more than 30% of their income and have experienced a substantial loss of income due to COVID-19, although those vouchers would have market-price caps.

These and other novel rent- and mortgage-relief schemes may raise constitutional considerations, both for landowners and for lenders with loans secured by the property in question.

II. Regulatory Takings

Landowners and lenders may be able to challenge rent- and mortgage-relief legislation by arguing that they are subject to a compensable regulatory taking. Whether a landowner or lender has been subjected to a regulatory taking will depend on the specific features of the particular legislation at issue and, to the extent the claim is brought on an "as-applied" basis, the landowner's or lender's specific circumstances. To raise a takings challenge, the challengers would want to highlight, *inter alia*, "the

extent to which the regulation interferes with reasonable investment-backed expectations.” *Palazzolo v. Rhode Island*, 533 U.S. 606, 617 (2001).

To be sure, some courts have previously upheld certain rent-control regimes in states like California and New York, based on the specific characteristics of those regimes at the time of the legal challenges. *See, e.g., Guggenheim v. City of Goleta*, 638 F.3d 1111, 1120-22 (9th Cir. 2010) (en banc); *Fed. Home Loan Mortg. Corp. v. New York State Div. of Hous. & Cmty. Renewal*, 83 F.3d 45, 48 (2d Cir. 1996) (collecting cases). But the recently proposed legislation appears to be unlike anything either state has previously enacted. For example, some of the proposed COVID-19 bills contemplate permanently depriving at least some landowners of their contractually expected rent, and depriving at least some lenders of the revenue stream that enable debt payments and the maintenance of their collateral, which are a sort of “interfere[nce] with distinct investment-backed expectations” unlike that presented in these prior court challenges. *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 539 (2005) (internal quotation marks omitted).

Cienega Gardens v. United States, 331 F.3d 1319 (Fed. Cir. 2003), is one example of a successful challenge to an onerous rent-regulation regime. There, the court held that federal legislation that forced certain landowners to provide low-income housing beyond the originally-agreed-upon period of twenty years constituted a taking requiring just compensation. The court concluded that the character of the government’s action was akin to a physical taking, as the developers were able to rent their properties only to low-income tenants for up to an additional twenty years. *Id.* at 1337-40. In addition, the law destroyed the owners’ reasonable investment-backed expectations, as they expected to be able to free themselves from the low-income housing restrictions at the end of the initial twenty years. *Id.* at 1346-53. Other cases, too, have contemplated that preventing a landowner from recouping the costs to maintain the property—thereby creating “negative value”—may amount to a regulatory taking. *See, e.g., Love Terminal Partners v. United States*, 126 Fed. Cl. 389, 425 (2016), *rev’d on other grounds*, 889 F.3d 1331 (Fed. Cir. 2018). Landowners thus may be able to rely on these cases in arguing that legislation akin to that proposed in California and New York constitutes an unlawful taking by forcing them to continue renting apartments to non-paying tenants, thereby severely diminishing—or even eliminating—their rental revenue and significantly impairing their investment-backed expectations in their rental properties. And in the same way, lenders may be able to argue that mortgage-relief schemes would undermine their reasonable expectations in the loans secured by the property.

The strength of each individual Takings claim will depend on the particular features of the challenged legislation, the particular characteristics of the affected buildings, and the particular harms inflicted on the plaintiffs and those similarly situated. Landowners and lenders facing COVID-19-related legislation should therefore keep in mind that they may have a viable regulatory-takings claim and should seek further guidance where appropriate.

III. Other Constitutional Challenges

A. The Contracts Clause

Landowners and lenders may also be able to challenge state rent- and mortgage-relief legislation as violating the Contracts Clause of the U.S. Constitution when the law effectively overwrites the terms of

existing agreements—for example, by reducing or suspending rent payments under the California and New York proposals—and thereby forces landowners and lenders to bear an outsized portion of the economic burden resulting from the COVID-19 pandemic.

State laws that “operate[] as a substantial impairment of a contractual relationship” and that are not “drawn in an ‘appropriate’ and ‘reasonable’ way to advance ‘a significant and legitimate public purpose’” violate the Contracts Clause. *Sveen v. Melin*, 138 S. Ct. 1815, 1821-22 (2018) (internal quotation marks omitted)). Landowners and lenders may argue that a statute permanently depriving them of all or part of their rental and mortgage payments—in addition to undermining the contractual bargain and interfering with their reasonable expectations under their rental and mortgage agreements—would exceed a reasonably necessary response to the pandemic and inappropriately shift to landowners and lenders the financial burdens of the economic interruption. Moreover, depending on the legislation being challenged, landowners and lenders may be able to identify more reasonable alternatives that the state legislature eschewed. For instance, if the legislation permanently deprives landowners of rental payments, it could be argued that the legislation is unreasonable, particularly in light of the fact that some other proposed bills contemplated a voucher-based system that would spread the costs of rent relief across taxpayers without undermining or altering previously entered contracts. But to the extent the voucher system does not permit full recoupment of the lost rental payments, even a voucher or other cost-spreading measure could be subject to constitutional scrutiny if challenged by landowners.

Some courts have previously upheld certain rent regulations against Contracts Clause attacks, primarily on the ground that residential leasing is a “heavily-regulated industry” and that, according to these courts, landowners therefore “cannot claim surprise that [their] relationships with certain tenants are affected by governmental action.” *Kraebel v. N.Y.C. Dep’t of Hous. Pres. & Dev.*, 959 F.2d 395, 403 (2d Cir. 1992). Cases like *Kraebel*, however, are distinguishable on multiple grounds. For example, *Kraebel* involved a rent-relief law that ultimately reimbursed landowners for any loss of expected rent payments. 959 F.2d at 398. Some of the California and New York bills, however, appear to contemplate permanently depriving at least some landowners of the reduced or suspended rent payments. Moreover, even if a particular landowner could anticipate regulations similar to those previously enacted by the state or locality in which the landowner’s properties are located, it could “not contemplate th[e] departure” from previous measures embodied in legislation that goes far beyond traditional limitations and requirements, including the permanent loss of their contractually expected rent payments. *West End Tenants Ass’n v. George Washington Univ.*, 640 A.2d 718, 735 (D.C. 1994).

Thus, the Contracts Clause may offer landowners and lenders a potential avenue for challenging state COVID-19 rent-relief legislation that interferes in their ongoing contractual relationships and shifts to them the financial burdens of the pandemic’s economic interruption.

B. The Due Process and Equal Protection Clauses

The Due Process Clause of the Fourteenth Amendment may also provide a potential ground for challenging state laws that deprive landowners and lenders of revenue. A plaintiff asserting a substantive due process claim must prove: (1) a valid property interest and (2) that defendants “infringed on that property right in an arbitrary or irrational manner.” *Royal Crown Day Care LLC v. Dep’t of Health &*

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Mental Hygiene of City of New York, 746 F.3d 538, 545 (2d Cir. 2014) (internal quotation marks omitted). As with the Contracts Clause challenge, affected entities could argue that a particular rent- or mortgage-relief law arbitrarily and irrationally infringes on landowners' and lenders' property rights. See, e.g., *Regina Metro. Co. v. New York State Div. of Hous. & Cmty. Renewal*, --- N.E.3d ---, 2020 WL 1557900 (N.Y. Apr. 2, 2020) (per curiam) (holding that retroactive extension of statute of limitations for time-barred rent-overcharge claims violated due process on rational basis review); *Richardson v. City & Cty. of Honolulu*, 759 F. Supp. 1477, 1494 (D. Haw. 1991) (holding that ordinance imposing maximum ceiling on renegotiated lease rents for condominiums did not rationally further the legitimate goal of reducing the cost of leasehold housing because it applied to condominiums not used for residential purposes, did not limit rates charged to sublessors, did not consider the market value of the property, and designated no government authority to oversee its application).

Similarly, the Equal Protection Clause of the Fourteenth Amendment may provide another path to challenge COVID-19 rent- or mortgage-relief legislation, particularly where the proposals would place unique burdens on landowners and lenders. The legislation could also be challenged under the corollary provisions of state constitutions. See, e.g., *Pennell v. City of San Jose*, 721 P.2d 1111, 1117 (Cal. 1986) (rejecting the claim that “equal protection is . . . denied simply because some landlords may receive rents different (albeit nonconfiscatory) from those received by other landlords with similarly situated apartments,” but noting that it “might be inclined to hold such a scheme unconstitutional if the disparity in approved rents among landlords with and without hardship tenants was shown to be so great as to be characterized as arbitrary or grossly unfair”).

Granted, some cases discussing the Due Process and Equal Protection Clauses in the rent-control or rent-stabilization context have concluded that the specific controls at issue in those cases were rationally related to a legitimate government purpose. See, e.g., *Pennell v. City of San Jose*, 485 U.S. 1, 12-14 (1988); *Harmon v. Markus*, 412 F. App'x 420 (2d Cir. 2011). But these cases did not involve anything like the proposals being discussed in response to COVID-19, including provisions that would retroactively and permanently deprive landowners of their contractually expected rent payments. Thus, notwithstanding decisions declining to grant Due Process Clause challenges to particular rent-control measures, the COVID-19-related rent-relief legislation may be sufficiently irrational—both in its substance and in targeting landowners—to constitute violations of the Due Process and Equal Protection Clauses.

IV. Conclusion

We cannot prejudge the constitutionality of any contemplated COVID-19 rent-relief legislation. The analyses under the clauses of the federal and state constitutions that most readily apply to economic regulation turn on the specific features of the challenged legislation, among other case-specific considerations. But as the nation moves through this crisis, and legislatures consider relief to those impacted by COVID-19, it bears remembering that the operations of federal, state, and local governments remain subject to constitutional scrutiny, and rent- and mortgage-relief legislation may raise significant constitutional questions in response to which affected landowners or lenders may be able to bring suit.

[1] See Gibson Dunn's March 27, 2020 Client Alert, Constitutional Implications of Government Regulations and Actions in Response to the COVID-19 Pandemic, *available at* <https://www.gibsondunn.com/constitutional-implications-of-government-regulations-and-actions-in-response-to-the-covid-19-pandemic/>

[2] Some states are considering or have already passed mortgage-forbearance legislation that may similarly impact constitutional protections afforded to lenders, as discussed in this alert. See, e.g., DC Act 23-286 COVID-19 Response Supplemental Emergency Amendment Act of 2020 (enacted Apr. 10, 2020) (establishing a system for deferred mortgage payments); N.J. Bill A3948 (as introduced) (establishing a system for deferred mortgage payments and rent suspensions) (introduced Apr. 13, 2020).



Gibson Dunn's lawyers are available to assist with any questions you may have regarding developments related to the COVID-19 outbreak. For additional information, please contact any member of the firm's Coronavirus (COVID-19) Response Team, the Gibson Dunn lawyer with whom you usually work, any member of the firm's Litigation, Appellate, Public Policy, or other practice groups, or the following authors:

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