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Jersey City Short Term Rental Regulation Not a Regulatory Taking.

A week ago, the U.S. Third Circuit Court of Appeals decided that Jersey City's regulations limiting the ability to use private property for short-term rentals was not a taking. 2022-8-16 Nekrilov v Jersey City Third Circuit. Our associate Michael Realbuto detailed the lower court's decision – here – so I'll get right to why the Third Circuit's affirmed and reasoned there was no taking. Quite unlike my last post about the Texas Appellate Court affirming a regulatory taking's case, ("Because we conclude the evidence supports the trial court's findings and conclusions on the *Lucas* theory, we do not discuss the *Penn Central* theory"), the *Nekrilov* case is all about *Penn Central's* heightened (and ever-shifting) standard of proving that an owner's 'investment-backed expectations' were so frustrated as to render its property valueless.

In short, the owners purchased investment property intended to be used for short-term rentals after Jersey City passed an ordinance that broadly permitted said use (circa 2015) but prior to a subsequent municipal ordinance substantially curtailing that use (circa 2019). The owners alleged that the subsequent ordinance effected a regulatory taking of its property and was politically motivated because the Mayor was retaliating against AirBNB for failure to support his re-election campaign.

The Court of Appeals credited the owners' property investments as alleged in the complaint (which it must as the appeal was from dismissal on the pleadings):

"Between the passage of Ordinance 15.137 and Ordinance 19-077, the plaintiffs invested in properties in Jersey City to conduct short-term rental businesses. The Nekrilovs purchased two properties, which have monthly mortgage payments of $2,500 and $1,725. The Nekrilovs earned $9,500 and $5,183 per month, respectively, in short-term rental revenue, and allege that they would earn only $3,800 and $1,800 per month in long-term rental revenue. They also invested a total of $100,000 in renovating these properties. The Nekrilovs also entered into seventeen long-term leases with the intention of subleasing on a short-term basis. Tang and Jen purchased one property, which has a monthly mortgage payment of $3,300, and which Tang and Jen spent $40,000 to renovate and furnish. The property earned $4,500 per month in short-term rental revenue and would earn $2,600 in long-term rental revenue. Tang and Jen also entered into two long-term leases and spent $6,600 and $8,900 to furnish the properties. Suen purchased two properties, which have monthly mortgage payments of $2,500 and $3,500. Suen and his mother invested approximately $383,000 into renovating the properties, $40,000 into furnishing the properties, and $130,000 in other costs for the properties. Suen and his mother earned approximately $30,000 in monthly short-term rental revenues from the two properties." [Slip op. at 6-7].

While the Circuit Court rejected the owner's argument that their "forward-looking right to pursue their short-term rental businesses" was a cognizable property interest protected by the Fifth Amendment, it did recognize that the owner's use and enjoyment of its property and right to lease (either short or long term) were property rights protected by the Fifth Amendment. In that regard, "plaintiffs first allege that, as a result of Ordinance 19-077, they have lost all beneficial use of their

purchased properties. The District Court held that because the properties retain numerous beneficial uses, they have not been rendered economically idle. We agree. The plaintiffs can lease the properties on a long-term basis, live at the properties, or sell the properties." Thus, no total taking was found to have occurred, and the takings' claim would thus rise or fall under *Penn Central*. "One whose property has not been deprived of all economically beneficial use may still be entitled to compensation if the government action constitutes a partial taking under the *Penn Central* factors."

And even then, "the Supreme Court "has required compensation only in cases in which the value of the property was reduced drastically. The plaintiffs have undeniably lost potential future profits as a result of Jersey City's change in policy. But the plaintiffs' inability to continue to operate their short-term rental businesses profitably does not equate to a "drastic[]" reduction in the value of the property so as to require compensation, especially as the properties retain multiple economically beneficial uses." Slip op. at 20. The property owners admitted that the long-term leases were paying "market" rent. The Third Circuit harkened back to the original regulatory takings case – "Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law." *Penn. Coal Co. v. Mahon*, 260 U.S. 393, 413 (1922).

In the end "the plaintiffs may have relied on Ordinance 15.137 in deciding to invest in short-term rentals in Jersey City, but they failed to take into account the restrictions in place in the original ordinance and the City's strong interest in regulating residential housing. On balance, this factor weighs against the plaintiffs."

I'm not sure anything in the majority opinion will get the Supreme Court's attention.

But, Circuit Court Judge Bibas' concurring opinion might – I'll let you read the opinion – but here's a teaser: "regulatory-takings doctrine is a mess." (Bibas, Circuit Judge, concurring).

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