IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF HAWAI'I

KUKUI GARDENS ASSOCIATION, FAITH ACTION FOR COMMUNITY EQUITY Plaintiffs, v. ALPHONSO JACKSON, in his capacity as SECRETARY OF THE UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, KUKUI GARDENS CORPORATION, CARMEL PARTNERS, INC. Defendants.	Civil No. CV06 00534 SOM LEK **MEMORANDUM IN SUPPORT OF PLAINTIFFS' MOTION FOR PRELIMINARY INJUNCTION**

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I. INTRODUCTION

More than twenty years ago, recognizing a crisis resulting from the loss of federally assisted affordable housing, Congress enacted Section 250 of the National Housing Act to prohibit HUD from approving prepayment of the mortgages on restricted properties where such properties continue to meet the need for affordable housing. HUD has adopted a policy that directly violates section 250, and pursuant to its policy, will authorize the prepayment for Kukui Gardens though the project continues to meet a critical need for low income rental housing. This will subject Kukui Gardens tenants to unwarranted rent increases, obviate the possibility of continued non-profit ownership, and result in the loss of over $100 million that would otherwise be available to address Hawaii's affordable housing crisis

Faced with the project owner's notice establishing a prepayment date as early as **December 22, 2006**, Plaintiffs seek a preliminary injunction to prevent the prepayment of the mortgage and sale of the project pending a determination on the merits. Absent preliminary relief *prior to* the pending prepayment, Plaintiffs will be irreparably harmed and the intervening interests of third party lenders will substantially complicate the ability of Plaintiffs to secure complete relief on their meritorious claims.

II. FACTS

A. Statutory Framework

The Congressional goal in enacting the National Housing Act is to assure "a decent home and a suitable living environment for

every American family." 12 U.S.C. § 1701t. Congress has further declared it a matter of "grave national concern" that this goal has not been reached for many lower income families. *Id.* As part of that Act, Congress provided that HUD, through the Federal Housing Administration (FHA), would issue insurance to lenders who provided financing to enable the construction of multifamily rental housing projects. These insurance programs were "designed to assist private industry in providing housing for low and moderate income families and displaced families." 12 USC § 1715*l*(a).

Among the mortgage insurance programs authorized by 12 USC § 1715*l* is the section 221(d)(3) below market interest rate program under which Kukui Gardens was developed and has operated since 1971. These programs are subject to extensive and comprehensive federal regulation to assure that the national housing goals are given effect for the long term, providing for federal monitoring of housing quality, limitations on occupancy and rents, limiting their transfer to new owners, and protecting the interests of tenants. See the discussion in Section III.B. below.

By 1983, Congress had become concerned that multifamily rental projects could be lost as a low income housing resource when owners prepaid their mortgages and escaped use restrictions imposed by the federal housing programs. In Section 250(a) of the National Housing Act, added by Section 433 of the Housing and Urban-Rural Recovery Act of 1983 and codified at 12 USC 1715z-15, (hereafter, "Section 250") Congress provided that HUD could only permit such prepayments in limited circumstances. Although this

provision has been amended since 1983, the key language of the current provision, prohibiting acceptance of prepayment if the project is meeting a need for rental housing for lower income families, remains unchanged:

> **Sec. 1715z-15. Limitation on prepayment of mortgages on multifamily rental housing**
>
> (a) Acceptance of offer to prepay; qualifications. During any period in which an owner of a multifamily rental housing project is required to obtain the approval of the Secretary for prepayment of the mortgage, the Secretary shall not accept an offer to prepay the mortgage on such project or permit a termination of an insurance contract pursuant to section 1715t of this title unless –
>
> (1) the Secretary has determined that such project is no longer meeting a need for rental housing for lower income families in the area;
>
> (2) the Secretary (A) has determined that the tenants have been notified of the owner's request for approval of a prepayment; (B) has provided the tenants with an opportunity to comment on the owner's request; and (C) has taken such comments into consideration; and
>
> (3) the Secretary has ensured that there is a plan for providing relocation assistance for adequate, comparable housing for any lower income tenant who will be displaced as a result of the prepayment and withdrawal of the project from the program…

12 U.S.C. 1715z-15. By its plain, express terms, Section 250 absolutely prohibits HUD approval of prepayments unless the three conditions set out above have been met. See discussion in Section III.A. below.

Prior to 1988, Section 250(a)(1) permitted HUD to approve a prepayment upon finding either that the property is no longer meeting a need (the current standard), or that substituting other federal assistance would "more efficiently and effectively" meet the needs of the property's lower income residents. Pub. L. 98-

181, § 433, 97 Stat. 1221 (Nov. 30, 1983). In 1988, Congress repealed the second basis for approval of prepayment. Pub. L. 100-242, § 261, 101 Stat. 1815, 1890 (1988). This repeal was part of the Emergency Low Income Housing Preservation Act of 1987 (ELIHPA), a comprehensive legislative effort to preserve federally-assisted low-income housing threatened by prepayment.

B. HUD's rejection of the statutory framework.

Now, more than a decade later, HUD has ignored Congress' rejection of alternative grounds to permit prepayment of mortgages on projects which continue to meet a low income housing need. On August 20, 2004, HUD published Notice H-2004-17, indicating its position that the requirement of Section 250(a), for a finding by HUD that "the project is no longer meeting a need for rental housing for lower income families," is not necessary for HUD approval of a prepayment request. HUD will, instead, approve prepayment if the owner executes a Use Agreement which incorporates certain terms set out in the Notice. This policy was reiterated, in terms essentially identical to those in H-2004-17, in Notice H06-11, published on August 8, 2006. Declaration of Gavin Thornton (hereinafter "Thornton Decl.") at ¶ 2, Exhibit 5. HUD has adopted a standard form Use Agreement implementing Notice H06-11, which will be used for the prepayment of Kukui Gardens. Thornton Decl. at ¶ 3, Exhibit 6. This Use Agreement, as explained in Section III.B.1. below, is no substitute for the protections provided by the regulatory agreement and other federal controls over project operations.

The policy set out in H-06-11 has never been subject to public notice and comment. The policy is a rule subject to the notice and comment requirements of the Administrative Procedures Act. 5 USC § 553.

Further, the policy has obvious fair housing implications. Nationally, non-white families are more than two and a half times more likely to require affordable rental housing such as Kukui Gardens than white families. Declaration of John Cann (hereinafter "Cann Decl.") at ¶ 5. HUD is required to consider the fair housing implications of its decisions and administer its programs so as to affirmatively further fair housing. 42 U.S.C. § 3608. Yet HUD has promulgated a policy which threatens to reduce the supply of such housing with no apparent consideration of the fair housing implications.

C. The Threat to Kukui Gardens

1. Kukui Gardens is Low Income Rental Housing.

Kukui Gardens is a multifamily housing project located in Honolulu, Hawaii, which provides 857 affordable units to low income individuals. The project was built in 1970 by the Kukui Gardens Corporation ("KGC"), an Internal Revenue Code 501(c)(4) Corporation. KGC was formed by the trustees of The Clarence T.C. Ching Foundation in the 1960s for the explicit purpose of securing funding and overseeing the development of Kukui Gardens. Thornton Decl. at ¶ 4, Exhibit 7. Were Kukui Gardens ever to be sold, the KGC incorporation documents provide that any revenue from the sale would go into the Ching Foundation trust. *See* Exhibit 7.

To finance the project, in 1969 KGC obtained a 42-year $16,101,100.00 mortgage from the Ford Foundation. Thornton Decl. at ¶ 5, Exhibit 8. HUD insured the mortgage, which covered the entire cost of development of the project, pursuant to section 221(d)(3). *See* Exhibit 8. This HUD insurance for one hundred percent of the project cost made possible the below-market 3% annual interest rate. *Id.* The terms of the mortgage note, executed at the same time as the Regulatory Agreement, provided that prepayment is prohibited before maturity in 2011 without the prior written approval of HUD. *Id.* Thus, prepayment is covered by the requirements of Section 250. The current mortgage loan balance is approximately $ 2,960,000. Declaration of Drew Astolfi (hereinafter "Astolfi Decl.) at ¶ 10.

As a condition of securing the mortgage, HUD required KGC to enter into a "Regulatory Agreement for Non Profit and Public Mortgagors Under § 221(d)(3) of the National Housing Act, as Amended". Thornton Decl. at ¶ 6, Exhibit 9. The Regulatory Agreement was executed between HUD and KGC on February 11, 1969 (the same date that the mortgage note was executed) and does not expire until 2011. *See* Exhibit 9.

Pursuant to the Regulatory Agreement KGC agreed, *inter alia*, that admission to the project shall be limited solely to families of low or moderate income. Exhibit 9, Sections 4(a)(3), 5(c).

To maintain affordability for Kukui Gardens' low and moderate income tenants, Section 4 of the Regulatory Agreement provides that a rent schedule would be approved by HUD, and that subsequent rent increases would be regulated by HUD and only

permitted to the extent needed to cover operating cost increases. Exhibit 9. Accordingly, the rent schedule for Kukui Gardens establishes current rents in the $444 to $818 range, depending on unit size, far below market levels. Unruh Decl. at ¶ 2.

The Regulatory Agreement further provided that KGC could not convey, transfer, or encumber any of the mortgaged property without the prior written approval of HUD. Exhibit 9, Section 7(a).

In addition, a variety of federal regulations protect tenants' interests: termination of tenancy is permitted only for good cause (24 C.F.R. Part 247); tenants of the project are guaranteed the right to organize and to participate in a variety of decisions which will affect their living environment, such as rent increases and major capital additions (24 C.F.R. Part 245); and the project is subject to annual physical inspection under HUD's Real Estate Assessment Center (REAC) program. 24 C.F.R. Part 200, Subpart P; www.hud.gov/offices/reac/aboutreac.cfm.

The Regulatory Agreement for Kukui Gardens remains in effect. However, the mortgage loan will be fully paid off and all federal controls will terminate in May of 2011, absent further federal legislation. A prepayment of the mortgage will terminate the existing Regulatory Agreement and other federal controls prior to 2011.

Kukui Gardens continues to fulfill a critical need for low-income rental housing in the Honolulu area and therefore Section 250 does not permit HUD approval of the prepayment of the Kukui Gardens mortgage. Astolfi Decl. at ¶ 6. HUD's own data, which

local governments are required to use for housing planning purposes, indicates 50,653 renter households currently paying more than they can afford for rent or living in overcrowded units or units without basic facilities. Cann Decl. at ¶ 3, Exhibit 1. A 2003 "Hawaii Housing Policy Study" created for a number of state and local agencies involved in housing projected increasing demand for rental housing with "very low or no" production of new rental units, causing "low-income households to be squeezed out of the market altogether." Thornton Decl. at ¶ 7, Exhibit 10.

2. The Proposed Sale of Kukui Gardens

On or about January 11, 2006, the Star Bulletin reported that KGC had publicly announced that it intended to sell Kukui Gardens "to ensure the continued viability of the Clarence T.C. Ching Foundation." Thornton Decl. at ¶ 8, Exhibit 11; Astlofi Decl. at ¶ 8. Based on its actions, it is apparent that KGC did not intend to use the proceeds of the sale for affordable housing purposes.

On or about April 18, 2006, the Star Bulletin reported that Carmel Partners Inc., a private real estate firm based in San Francisco was going to pay about $130 million to purchase Kukui Gardens. Thornton Decl. at ¶ 9, Exhibit 12; *see also* Astolfi Decl. at ¶ 8.. The Bulletin later reported that on May 2, 2006, Carmel Partners issued a statement confirming that it was the buyer. Thornton Decl. at ¶ 10, Exhibit 13. Given the current loan balance of $ 2.96 million, the sale would result in net proceeds of approximately $ 127 million.

Pursuant to the terms of the Regulatory Agreement, Kukui

Gardens cannot be sold without prior HUD approval. *See* Exhibit 9. Further, HUD can only approve the sale of a section 221(d)(3) project if certain conditions are met under HUD's rules regarding Transfers of Physical Assets ("TPA"). HUD's TPA requirements are set forth in Chapter 13 of HUD Handbook 4350.1, Multifamily Asset Management and Project Servicing (hereinafter "HUD Handbook 4350.1").

Included among the TPA rules is a requirement that, where a non-profit owner is seeking to transfer the property, the property must first be offered to a non-profit. Thornton Decl. at ¶ 11, Exhibit 14 (excerpt from HUD Handbook 4350.1, Section 13-18A). Non-profit purchase of Kukui Gardens would permit preservation of its use as low income housing far beyond the 2011 date when federal controls are removed.

Also included among the TPA rules is a requirement that any proceeds from the sale be put into a third party trust, the funds of which can only be used to promote the expansion of the supply of low and moderate income housing. Exhibit 14 (excerpt from HUD Handbook 4350.1, Section 13-19C).

These two TPA requirements were raised in a June 7, 2006 meeting hosted by U.S. Rep. Neil Abercrombie and involving HUD and state officials, Kukui Gardens tenants and tenant advocates, and representatives of KGC and Carmel Partners. Astolfi Decl at ¶ 10. The affordable housing trust requirement would prevent KGC from using the proceeds from the sale for the general purposes of the Clarence T.C. Ching Foundation as it initially indicated it wished to do. Instead the funds would be used by a trustee

solely for expanding the supply of affordable housing. Thus, even if a for-profit buyer purchased Kukui Gardens and converted it to a market rate use in 2011 when the federal controls are lifted, there would be approximately $127 million available to provide replacement housing.

3. The Proposed Prepayment

In order to circumvent HUD's TPA rules, KGC issued a July 26, 2006 notice to Kukui Gardens tenants informing them of KGC's intent to prepay the mortgage on or after December 22, 2006. Declaration of Carol Anzai (hereinafter "Anzai Decl.") at ¶ 6, Exhibit 17. After prepayment of the mortgage is approved, HUD approval for the sale of Kukui Gardens will no longer be required and the affordable housing trust requirement and the requirement that the property be offered to a non-profit seller will no longer be applicable.

In addition, rents after prepayment may increase substantially beyond those currently permissible. The KGC notice to Kukui Gardens tenants included HUD's standard form Use Agreement, which contained provisions for substantially higher rents than would be permitted by the Regulatory Agreement and did not specify the initial rents proposed under the Agreement. *See* Exhibit 6. In addition, the protections currently afforded by HUD regulations against arbitrary evictions, guaranteeing tenant participation, and providing for monitoring of project conditions will all be lost as a result of HUD's approval of the prepayment.

4. Injuries to Plaintiffs.

Plaintiff Kukui Gardens Association ("the Association") is

an association of Kukui Gardens residents organized in the 1970's. Anzai Decl. at ¶ 2. The members of the Association are all Kukui Gardens residents. *Id.* at ¶ 3. The purposes of the Association include: (1) serving to improve the living environment and quality of life for residents of Kukui Gardens; (2) ensuring that Kukui Gardens is a safe, healthy, and well-kept place for its residents to live; (3) seeking to preserve the affordability of Kukui Gardens for its current and future residents and applicants; (4) providing social and recreational activities for Kukui Gardens residents; and (5) educating Kukui Gardens residents regarding their tenant rights and advocating on their behalf. *Id.* at ¶ 4-5.

Plaintiff Faith Action for Community Equity ("FACE") is an Internal Revenue Code 501(c)(3) corporation, incorporated in the State of Hawaii on June 10, 1998. Astolfi Decl. at ¶ 2. FACE's membership is comprised of over 25 institutions located in the State of Hawaii which primarily consist of religious organizations, but also includes a local union and the Association. *Id.* at ¶ 3. FACE's mission is to allow its members to advocate for change in systems that perpetuate poverty and injustice to improve the quality of life for local communities in Hawaii. *Id.* at ¶ 4. One of FACE's primary purposes is to preserve and increase the availability of affordable rentals in the State of Hawaii and to house the homeless. *Id.* at ¶ 5. This purpose will be frustrated if the owner is allowed to circumvent HUD's TPA rules through a prepayment. *Id.* at ¶ 5. FACE began advocating on behalf of the Association and Kukui Gardens

residents for the preservation of Kukui Gardens in early 2006 and has had to divert a significant portion of its resources towards preventing the sale and prepayment of Kukui Gardens. *Id.* at ¶ 7.

As set out in Section III.C. below, HUD's approval of the prepayment for Kukui Gardens will cause Plaintiffs FACE and the Association and its members to suffer significant irreparable harm.

5. HUD's Policy Requires Approval of the Owner's Prepayment Request.

On September 15, 2006, counsel for Plaintiffs sent a letter demanding that by September 22, 2006, HUD indicate its intent to abandon the provisions of Notice H-2006-11 that do not comply with federal law and, further, indicate its intent to deny KGC's request to prepay the mortgage on Kukui Gardens. Thornton Decl. at ¶ 12, Exhibit 15. The letter also summarized potential fair housing consequences of HUD's approval of prepayment and demanded compliance with HUD's duty to affirmatively further fair housing under 42 U.S.C. § 3608. *See* Exhibit 15.

In a letter dated September 26, 2006 from Beverly Miller, the Director of the HUD Office of Asset Management, HUD responded that it would not abandon the prepayment policy set forth in Notice H-2006-11 and would apply its policy to the prepayment of Kukui Gardens. Thornton Decl. at ¶ 13, Exhibit 16.

III. ARGUMENT

Plaintiffs seek a preliminary injunction which would prohibit HUD's approval of the prepayment of the Kukui Gardens mortgage proposed by the owner until a final determination on the

merits. The request for a preliminary injunction is necessitated by HUD's Notice H06-11, in which HUD indicates that, contrary to the requirements of Section 250, HUD will permit a prepayment if the owner adopts a Use Agreement including the restrictions set out in the Notice. The HUD policy described in the Notice dictates that HUD approve the owner's pending prepayment request in violation of the requirements imposed by Section 250. Pursuant to KGC's prepayment notice and HUD's policy, the prepayment could occur any time on or after December 22, 2006. Once the prepayment has occurred, it will be very difficult to reverse as a practical matter, in that approximately $ 2.96 million of third party funds will have been committed to prepay the existing mortgage and $130 million will have changed hands in the sale of the project pursuant to the current purchase agreement. These transactions will cause irreparable harm to plaintiffs, requiring issuance of a preliminary injunction **prior to December 22, 2006** to maintain the status quo pending a decision on the merits.

A. Standard for Preliminary Injunction

The Ninth Circuit has "repeatedly instructed" that:

> ...to obtain a preliminary injunction, the moving party must show either (1) a combination of probable success on the merits and the possibility of irreparable injury or (2) that serious questions are raised and the balance of hardships tips in its favor. These two formulations represent two points on a sliding scale in which the required degree of irreparable harm increases as the probability of success decreases.

United States v. Nutri-cology, Inc. 982 F.2d 394, 397 (9th Cir. 1992)(citations and internal quotations omitted); Roe v.

Anderson, 134 F.3d 1400, 1401-02 (9th Cir. 1998), *aff'd sub nom. Saenz v. Roe*, 119 S.Ct. 1518, 526 U.S. 489 (1999).

In this case, Plaintiffs can establish both probable success on the merits and that they will suffer irreparable harm. Thus, Plaintiffs provide more than is required to support a temporary restraining order and preliminary injunction.

B. Plaintiffs Will Succeed on the Merits.

1. Plaintiffs Will Succeed on their Section 250 Claims.

The language of Section 250 is clear and unambiguous. Section 250 prohibits HUD from approving prepayment unless every one of three distinct requirements has been satisfied prior to its approval. The plain language of this section binds HUD. *Chevron, U.S.A., Inc. v. Natural Resources Defense*, 104 S.Ct. 2778, 2781, 467 U.S. 837, 843 (1984) (an agency "must give effect to the unambiguously expressed intent of Congress"); *Demarest v. Manspeaker*, *111 S.Ct. 599, 604,* 498 U.S. 184, 190 (1991), *quoting Griffin v. Oceanic Contractors, Inc*. 458 U.S. 564, 571 (1982) (citations omitted ("[w]hen we find terms of a statute unambiguous, judicial inquiry is complete except in rare and exceptional circumstances. . . where the application of the statute as written will produce a result 'demonstrably at odds with the intentions of its drafters.'")

Thus, this case requires no inquiry beyond Congress' statutory text. The plain language of Section 250 mandates HUD to make each of the three distinct findings indicated and provides that HUD "shall not" accept prepayment without making

the enumerated findings. Yet HUD has adopted a policy, embodied in Notice H06-11, which commits HUD to permit prepayments, without making a finding that the housing is no longer needed, and in circumstances where the need for such housing clearly continues.

In Brighton Village v. Malyshev, 2004 U.S. Dist. LEXIS 4703 (D.Mass. 2004), the court addressed a similar HUD attempt to disregard the plain language of Section 250(a). Notice H06-11 "interprets" the statutory language applying Section 250 to any "multi-family rental housing project" to apply only to subsidized projects. The Brighton Village court found the statute to be unambiguous, HUD's attempted interpretation of the statute impermissible, and HUD's policy pronouncements setting out its policy not entitled to deference. Id. The Court found HUD's position to be not substantially justified (that is, lacking a reasonable basis in law and fact) and awarded plaintiff's attorney's fees. Brighton Village v. Malyshev, 2005 U.S. Dist. LEXIS 12368 D. Mass. 2005), (D. Mass. 2005). Clear and persuasive authority thus dictates a similar outcome here.

Even if Section 250 were ambiguous and agency "interpretation" were permissible, HUD's policy contradicts the clear intent of Congress expressed in its 1988 repeal of the original provision of Section 250 which authorized HUD approval of prepayment upon a finding that superior alternatives to provide low income housing were purportedly available. The statute originally permitted HUD to approve prepayment when the

housing was still needed as a low income resource if federal assistance found by HUD to be more effective or efficient were available. That provision was repealed by Congress in 1988. Pub.L. 100-242, § 261, 101 Stat. 1815, 1890 (1988).

The repeal was part of ELIHPA, a comprehensive effort by Congress to address the need to preserve federally assisted housing units in the face of a "grave national crisis" threatened by prepayments of subsidized mortgages and other loss of federally assisted housing. Id., § 202, 101 Stat. 1877. The legislative history repeatedly indicates Congress' frustration with HUD's attempts to "skirt its preservation obligations" and seizing opportunities "improperly to avoid preservation." See, 101 Stat. 3353-3355. Congress obviously intended to remove language HUD might otherwise employ to avoid preservation.

With adoption of the policy set out in HUD in Notice H06-11, HUD seeks once again to skirt its preservation obligation. It has embarked on a policy for which Congress repealed the authority nearly two decades ago and which fails to provide low income housing as effectively as the federal insurance and assistance programs which would be replaced by HUD's Use Agreement:

- Under the current mortgage insurance program, rent increases are permitted only to cover actual increases in operating expenses. *See* Exhibit 9, Section Section 4(d). HUD's Use Agreement policy permits an "Initial Rent" which may constitute a rent increase in excess of that which would be permitted under the current mortgage and regulatory agreement if

project improvements are planned. *See* Exhibit 6, Section 3(a). Given the owner's notice indicating that the purpose of the prepayment is to permit financing of capital improvements, it is reasonable to expect that the initial rents will include rent increases to cover increased debt service due to the funding of capital improvements – increases that would not be permitted by the current regulatory agreement.

- The standard HUD Use Agreement also permits regular rent increases over the initial rent based on increases in area median income, a factor which has nothing to do with operating expense increases which are currently the only basis for rent increases. *See* Exhibit 6. Further, the Use Agreement actually mandates annual rent increases based on an "Operating Cost Adjustment Factor" derived statistically by HUD, without reference to actual costs at the project. *Id*.

- Current HUD regulations permit termination of tenancy only for good cause. 24 C.F.R. Part 247. HUD's policy imposes no such restrictions for new tenants. *See* Exhibit 6. Current HUD regulations provide tenants of the project the right to organize and to participate in a variety of decisions which will affect their living environment, such as rent increases and major capital additions. 24 C.F.R. Part 245. Those rights are not similarly guaranteed by HUD's Use Agreement policy. *See* Exhibit 6.

- Currently, the project is subject to annual physical inspection under HUD's REAC program. The Use Agreement policy does not provide for such monitoring. *See* Exhibit 6.

- Currently, sale of the project is subject to HUD's TPA policy. HUD's policy set out in H06-11 effectively guarantees the loss of approximately $127 million of sale proceeds to a trust for affordable housing, as well as loss of the opportunity for a non-profit to acquire the property for the purpose of retaining its low income character.

One court has declined to issue a preliminary injunction against a proposed prepayment, but this decision is both wrong and readily distinguishable. *Rubanenko v. Martinez*,2002 U.S.Dist. LEXIS 24740 (E.D. Cal. 2002). As demonstrated by the reasoning and holding in *Brighton Village*, [cite] *Rubanenko* was wrongly decided because it ignored the plain language of Section 250. Moreover, *Rubanenko* is distinguishable because the transaction at issue there markedly differs from the circumstances presented here.

Rubanenko involved a transaction where the owner proposed to prepay the loan as part of a sale to another owner who planned to utilize additional subsidies to extend the low income affordability restrictions for an additional 55 years. Absent the transaction, federal affordability restrictions would have expired in less than ten years. Here, in contrast, the Use Agreement will not extend the low-income use beyond the original final mortgage payment date.

Another important distinguishing feature of *Rubanenko* is that HUD there provided all current residents with special Section 8 vouchers, which operated to cushion rent increases and to continue many other federal protections, such as good cause

for eviction. However, both the statute authorizing replacement vouchers, 42 U.S.C. § 1437f(t), and HUD's official interpretation, HUD Notice PIH 2001-41(HA) (Nov. 14, 2001), establish that residents of projects restricted by Section 250 are ineligible for vouchers upon prepayment.[1] Because of these extraordinary factors -- factors not present in this case, the *Rubanenko* court concluded that Section 250 could not be fairly interpreted to prevent HUD's approval of a transaction which would extend affordability for an additional 45 years.

Here, in contrast, HUD's policy will have exactly the opposite effect. If HUD complied with Section 250, it could not approve the prepayment and its TPA rules would likely result in either a non-profit purchase of the property or availability of $127 million to replace it with other low-income housing at the end of the mortgage term. However, if HUD follows its Use Agreement policy, affordability protections would be seriously eroded and all low-income use of the property will terminate in 2011, with no replacement funds. Indeed, HUD has clearly stated that the new Use Agreement would allow rent increases at Kukui Gardens up to 30 percent of 95 percent of area median income, approximately twice their current level. Ex. 16; Thornton Decl. at ¶ 14. In the face of Section 250's preservation mandate, *Rubanenko* thus offers no support for upholding either HUD's policy or its approval of the Kukui prepayment.

[1] In any case, by its revision of Section 250's language in 1998 (see p. 3, 15, supra), Congress expressly repudiated any HUD authority to substitute vouchers in these circumstances, a key factor wholly ignored by the *Rubanenko* court.

2. **Plaintiffs Will Prevail on their Notice and Comment Claim under 5 USC § 553**

The Administrative Procedures Act at 5 USC § 553 and 24 CFR part 10 require that HUD provide notice to the public, an opportunity to provide meaningful comment prior to adopting a rule, and publication in the Federal Register. The mortgage prepayment policy promulgated in HUD Notice-2006-11 constitutes a rule subject to these rule making requirements in that it is a government-wide policy which imposes extra-statutory obligations and affects individual rights and obligations. *Vance v. Hegstrom*, 793 F.2d 1018, 1022 (9th Cir. 1986); *Southern California Edison Co. v. FERC*, 770 F.2d 779, 783 (9th Cir. 1985); *Walker v. Pierce*, 665 F.Supp. 831, 842 (N.D.Cal. 1987). Plaintiffs will prevail because the policy was not subject to notice and comment or published as required.

3. **Plaintiffs will Prevail on their Fair Housing Act Claims.**

HUD is required, under 42 U.S.C. §§ 3608(d) and (e)(5), to administer its programs so as to affirmatively further the purposes and policies of the Fair Housing Act. In addition, the Fair Housing Act prohibits acts which make housing unavailable to persons because of race, including adoption of facially neutral policies which have a disproportionately adverse effect on persons protected by the Act. 42 U.S.C. § 3604; *Pfaff v. HUD*, 88 F.3d 739, 745-6 (9th Cir. 1996). The federal courts have uniformly held that this affirmative duty, at a minimum requires, that HUD consider the effects of its proposed actions on the policies and purposes of the Fair Housing Act. *N.A.A.C.P. v.*

Secretary of Housing and Urban Development, 817 F.2d 149, 155 (1st Cir. 1987); *Shannon v. Department of Housing and Urban Development*, 436 F2d 809 (3rd Cir. 1970).

Nationally, the Fair Housing implications of HUD's policy permitting prepayments in situations where the housing is still needed threatens the continued availability of such housing. As demonstrated above, HUD's form Use Agreement will allow substantially higher rent levels than would have been permitted without prepayment and eliminates a variety of tenant protections available as the result of federal mortgage insurance.

HUD is surely aware that loss of low income housing will have a disproportionate adverse effect on non-whites. Data from the 2000 census on HUD's website demonstrates that non-white households are 2.76 times more likely to need housing such as that at Kukui Gardens than white households. Cann Decl. at ¶ 5. A discriminatory effect is generally presumed when such selection rates are only 1.25 times as high for one group than another.[2] The effect of the loss of the opportunity to preserve or replace Kukui Gardens falls similarly disproportionately on non-whites. In Honolulu non-white renters are low income households with housing problems at nearly 1.5 times the rate of white renter households. Cann Decl. at ¶4, Exhibit 3.

Plaintiffs are unaware of any evidence that HUD considered its effects on fair housing concerns when adopting the policy set out in Notice H06-11. Further, plaintiffs September 15, 2006

[2] See, 29 C.F.R. § 1607.4(d), Equal Employment Opportunity Commission rules, indicating that a selection rate for one group which is 80% or less of that of the group with the highest selection rate is evidence of disparate impact. If the minority group's rate is 80% of the majority group rate, then the majority group rate is 125% of the minority group rate.

demand letter to HUD laid out potential fair housing consequences of HUD approval of the Kukui Gardens prepayment. *See* Exhibit 15. HUD's response indicated that the agency would follow the policy set out in H06-11 and approve the prepayment. *See* Exhibit 16. The HUD letter did not respond to Plaintiffs' fair housing concerns and gave no indication that such concerns played any part in HUD's response. *Id.*

Thus HUD has violated its affirmative responsibilities under 42 U.S.C. § 3608 in adopting the policy set out in Notice H06-11 and in its decision to apply that policy to Kukui Gardens. Further, the application of the policy to Kukui Gardens threatens to disproportionately deny housing opportunities to non-white households, in violation of 42 U.S.C. § 3604.

C. Plaintiffs Will Suffer Irreparable Harm If Injunctive Relief Is Not Granted

Under the provisions of Notice H06-11, prepayment can occur as early as 150 days after the owner's notice of prepayment to the residents. The owner's notices are dated July 24, 2006 and prepayment can thus occur as soon as December 22, 2006. Sale of the property could occur essentially simultaneously with the prepayment. Cann Decl. at ¶ 6.

Plaintiffs will be irreparably injured by the following consequences of prepayment and sale, described in more detail in II.B.1. above:

- Kukui Gardens residents would lose current tenant protections provided for throughout HUD's regulations governing insured projects.

- Kukui Gardens residents would be deprived of a meaningful opportunity to comment on the prepayment as required by Section 250(a) since the notice omits an absolutely essential piece of information: the "Initial Rents" under the proposed Use Agreement.

- KGC would circumvent HUD's TPA policy, eliminating the possibility of a non-profit purchase and the availability of approximately $127 million of sale proceeds for affordable housing development

- Rent increases would be permitted in excess of those currently permitted by the regulatory agreement.

- HUD would thus deliberately contribute to a substantial worsening of the housing crisis for lower income families, in violation of its obligations under Section 12 U.S.C. § 1701t of the National Housing Act. Kukui Gardens' 857 affordable housing units will be lost within six years with no replacement funding available. This will have a disproportionate adverse effect on non-white renters in Honolulu where non-white renters are low income households with housing problems at nearly 1.5 times the rate of white renter households.

- Approval of the prepayment and the resulting increases in Kukui Gardens' rents and the loss of sale proceeds that will be diverted from the production of affordable housing will interfere with FACE's mission and efforts to promote more affordable housing by reducing the available supply from what it otherwise

would be. The mission of the Association to preserve the affordability of Kukui Gardens will be similarly frustrated.

These consequences of prepayment will be very difficult to reverse as a practical matter as third parties will have invested at least approximately $2.96 million to prepay the existing mortgage balance, and a substantial portion of the $130 million sales price. Thus it will be very difficult to grant Plaintiffs complete relief if prepayment occurs before a decision on the merits.

The Plaintiffs' motion should be granted because they have demonstrated probable success on the merits and that they will suffer irreparable harm if the motion is not granted.

IV. THE REQUIREMENT FOR BOND SHOULD BE WAIVED

"The court has discretion to dispense with the security requirement [under F.R.C.P. 65(c)], or request mere nominal security, where requiring security would effectively deny access to judicial review." *People ex. rel. Van De Kamp v. Tahoe Regional Planning Agency*, 766 F.2d 1319, 1325, *amended*, 775 F.2d 998 (9th Cir. 1986).

Courts have frequently waived the bond requirement for indigent plaintiffs. *See e.g. Wayne Chemical, Inc. v. Columbus Agency Services Corp.* 567 F.2d 692, 701 (7th Cir. 1977); *Miller v. Carlson*, 768 F.Supp.1331, 1340-1 (N.D. Cal. 1991) (waiving security for indigent plaintiffs who relied on public benefits for the necessities of life). In particular, waiving security for low income tenants of HUD subsidized properties is appropriate. *Walker v. Pierce*, 665 F.Supp. 831, 843 (N.D. Cal.

1987). The reason for such a waiver is obvious. "Poor persons . . . are by hypothesis unable to furnish security as contemplated in Rule 65(c), and the court should order no security in connection with this preliminary injunction." *Bass v. Richardson*, 338 F.Supp. 478, 490 (S.D.N.Y. 1971), *quoting Denny v. Health and Social Services Board*, 285 F.Supp. 526, 527 (E.D. Wis. 1968).

Courts have also waived the bond requirement for nonprofit public interest organizations where such organizations are unable to post a substantial bond and where the likelihood of success of the merits tipped in their favor. *Van de Kamp*, 766 F.2d 1319, 1324-26 (allowing nonprofit environmental group to proceed without posting a bond where the "public interest" supports the preliminary injunction); *Environmental Defense Fund, Inc. v. Corps of Engineers of U.S. Army*, 331 F.Supp. 925, 927 (D.C.D.C. 1971) (ordering nonprofit environmental group to post bond of $1.00). Even where the potential financial injury to a company is great, courts have ordered the payment of only nominal bonds in order to avoid stifling the intent of the remedial statutes under which a case is brought. *See Natural Resources Defense Council, Inc. v. Morton*, 337 F.Supp. 167, 169 (D.D.C. 1971), *aff'd on other grounds* 458 F.2d 827 (D.C. Cir. 1972)(requiring environmental organization to post a bond of $100 instead of the $750,000 for the first month and $2,500,000 for each month thereafter requested by the defendant as compensation for its estimated loss of revenue).

The plaintiff resident association and nonprofit organization are unable to post a bond, as they have no income available for such purpose. Anzai Decl. at ¶ 7-9, Astolfi Decl. at ¶ 11. The Kukui Gardens Association is merely an association of low-income tenants that earns no income with which they could pay a bond. Anzai Decl. at ¶ 9. The requirement of a bond would stifle the purpose of the remedial housing acts under which Plaintiff FACE brings these claims since this "'concerned private organization[]' would be precluded from obtaining judicial review of the defendant's actions." *Natural Resources Defense Council, Inc.*, 337 F.Supp. at 169. Because the Plaintiffs have demonstrated their inability to post a bond, as well as a clear likelihood of success on the merits, the bond requirement should be waived.

V. CONCLUSION

For the reasons set out above, the court should grant Plaintiffs motion for preliminary injunction.

DATED: Honolulu, Hawaii, November 3, 2006

/s/ Gavin K. Thornton
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