Persistent Tenants Win Challenge to Wrongful Mortgage Prepayment

The United States District Court for the District of Massachusetts has issued a decision invalidating Department of Housing and Urban Development's (HUD) approval of a mortgage prepayment in 1986 as contrary to Section 250 of the National Housing Act.[1] Granting summary judgment in favor of the tenants on the illegal prepayment claim, the court also awarded financial restitution under the Administrative Procedure Act to those tenants who were harmed more than fifteen years later by the higher rents charged in the absence of the prepaid mortgage's regulatory restrictions. However, the court also granted summary judgment in favor of HUD on the tenants' disability discrimination claim. This decision marks the first reported decision against HUD for a violation of Section 250 and will prove useful to tenant advocates elsewhere harmed by such illegal prepayments.

Factual Background

The case arose about four years ago from the owner's threatened eviction of some of the property's elderly tenants for nonpayment of rent. Upon further investigation of the situation by the tenants and their counsel at Greater Boston Legal Services, it was discovered that the tenants' hardship was the result of a chain of unlawful actions stretching back many years. This chain involved the 1995 termination of a project-based Section 8 contract and the substitution of tenant-based Section 8 vouchers that were inadequate to cover the full cost of the unregulated rent increases. This project-based Section 8 termination was in turn made possible by the owner's earlier prepayment of a HUD-held mortgage and release from the regulatory agreement, which by its terms had required the owner to accept HUD's offer of renewal for the property's project-based Section 8 contract. As a result, the tenants in the eviction suit brought third-party claims against HUD for its wrongful approval of the mortgage prepayment, and HUD removed the case to federal court.

HUD had acquired the Brighton Village property through foreclosure or deed-in-lieu of foreclosure after a prior owner's default in 1976. HUD then sold the property to the current owners in 1980 with a forty-year HUD-held purchase money mortgage set to mature in 2020. As with most HUD purchase money mortgages issued in that period, the mortgage note prohibited prepayment without HUD approval. As was also common at that time, the owner signed a separate fifteen-year project-based Section 8 rent subsidy contract, with the first contract term set to expire in 1995. Under that contract, tenants paid 30% of their adjusted incomes for rent and HUD paid the balance as housing assistance payments based on the HUD-approved rent levels for the project. Significantly, the mortgage was also accompanied by a regulatory agreement between HUD and the owner stipulating that, so long as the mortgage was held by HUD, the owner was required to accept any offer by HUD to renew the Section 8 contract or to provide any other rental assistance.

In 1986, without following any established procedure or applying any substantive standards, HUD approved the owner's request to prepay the mortgage, terminating the regulatory agreement. The tenants received no notice of the prepayment request or the fact that the mortgage was prepaid. The project-based Section 8 contract did not terminate upon prepayment and remained in effect until 1995. In August 1994, the owner effectively rejected HUD's offer to renew the Section 8 contract. At that point, there was nothing explicitly requiring the owner to accept HUD's renewal offer because the regulatory agreement had been terminated years ago by the prepayment. One year later, in August 1995, the Section 8 contract expired and, under laws then in effect, the tenants received regular, non-enhanced tenant-based Section 8 vouchers. Authority for the issuance of enhanced vouchers for tenants affected by Section 8 opt-outs was not created until 1999.

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Without the affordability protections of the project-based Section 8 contract, the owner began raising the rent in October 1996 and proceeded to raise it annually thereafter. The rent increases raised the rent above the maximum level the tenant-based vouchers would cover, forcing the tenants to cover the difference—and thus pay more than the 30% of their incomes that would have been required under the project-based Section 8 contract—or face eviction for nonpayment.

The tenants sought relief from HUD, requesting that HUD increase the voucher payment level as a reasonable accommodation based on their individual disabilities under Section 504 of the Rehabilitation Act of 1973[2] and

[1] *Brighton Village Nominee Trust v. Malyshev,* No. 00-CV-12311-GAO, 2004 WL 594974 (D. Mass. Mar. 23, 2004). Section 250 is codified at 12 U.S.C.A. § 1715z-15 (West 2001).

[2] 29 U.S.C.A. § 794 (West, WESTLAW current through P.L. 108-228, approved May 18, 2004).

the Fair Housing Act.[3] HUD approved an increase in the voucher payments in January of 2000, but not to the full extent requested, requiring the tenants to continue paying rent in excess of 30% of their incomes. In October 2000, the owner began the eviction process when several tenants could not pay the latest rent increase. The tenants filed a counterclaim against the owner and a third-party claim against HUD. During the pending action, through new legislation, the tenants were provided with "enhanced vouchers," which paid increased subsidy levels,[4] allowing them to remain in their homes while only paying 30% of their incomes in rent. This new subsidy, however, failed to address the rent increases that had burdened the tenants in previous years. Because the owner apparently ceased pursuit of its eviction actions, the tenants also ceased pursuit of their counterclaim against the owner, leaving intact their claims against HUD, which HUD has removed to federal district court.

The tenants' third-party claims against HUD alleged violation of Section 250(a) of the National Housing Act[5] in allowing prepayment of the mortgage in 1986 and a violation of Section 8 of the United States Housing Act[6] for the failure to require the owner to renew the Section 8 contract upon expiration in 1995. The tenants also claimed that HUD discriminated against them and failed reasonably to accommodate their disabilities[7] by failing to provide adequate housing assistance after the Section 8 contract expired. The tenants sought reimbursement for the excess rent paid between 1995 and 2000 beyond 30% of their adjusted incomes, as well as protection from future adverse housing actions. Apparently because of the passage of time and the difficulties in obtaining such relief, they did not seek restoration of the mortgage and regulatory agreement, or the project-based Section 8 contract.

The District Court's Decision

In its March 23 decision, the district court granted summary judgment in favor of the tenants on their claims of statutory violations related to the mortgage prepayment and the failure of the owner to renew the Section 8 contract. Regarding the discrimination claim, the court granted summary judgment in favor of HUD.

The court concluded that HUD violated Section 250 when it allowed the owner to prepay the mortgage, rejecting HUD's justifications for the violation. Congress passed Section 250 in 1983 in response to HUD's standardless approval of prepayments for several properties where HUD approval was required. Section 250 states that, when an owner is required to obtain approval from HUD for prepayment, as is required for hundreds of HUD-insured and HUD-held mortgages,[8] HUD cannot approve prepayment unless:

- the project is no longer meeting a need for low-income housing,
- tenants have been notified and their comments considered, and
- there is a plan for relocation assistance for tenants displaced by the prepayment.

In its response to the tenants' request for admissions, HUD admitted that it did not comply with these statutory requirements prior to approving the prepayment. The court rejected HUD's defense that the statute did not apply to the Brighton Village property because it only applied to subsidized properties, and Brighton was characterized as "unsubsidized." The court ruled that by its unambiguous terms, the statute applied to "multifamily rental housing projects" and provided no express exceptions. It refused to consider HUD's arguments regarding the statute's legislative history or to defer to HUD's administrative interpretation set forth in unpublished memoranda. The court also rejected HUD's argument that, because the statute did not completely prohibit prepayment, had HUD complied with it, the outcome may have been the same and the loan could have been prepaid. It described this as an "unattractive invitation to speculate in favor of the party that defaulted on its obligation to follow what the statute mandated."[9]

The court also noted that the illegal prepayment subsequently permitted the owner's 1995 non-renewal of the Section 8 contract, contrary to the provisions of the long-gone regulatory agreement and the requirements of the then-extant version of 42 U.S.C. § 1437f(c)(9). The regulatory agreement had contained the owner's agreement to accept any HUD offer to renew the Section 8 contract, or provide any other rental assistance. In 1994, HUD had offered to renew the contract for a four-year term, but apparently

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[3]42 U.S.C.A. § 3601 (West, WESTLAW current through P.L. 108-228, approved May 18, 2004).

[4]Congress first authorized enhanced vouchers for certain prepayments in 1996 and extended their availability to eligible following the termination of project-based Section 8 contracts in 1999. Enhanced vouchers, unlike regular vouchers, have payment levels that cover reasonable market rents as long as the tenant remains in the same development. 42 U.S.C.A. § 1437f(t) (West 2003).

[5]12 U.S.C.A. § 1715z-15(a) (West 2001).

[6]42 U.S.C.A. § 1437f(c)(9) (West 2003)

[7]The tenants brought discrimination and reasonable accommodation claims under Section 504 of the Rehabilitation Act of 1973, 29 U.S.C. § 794, the Fair Housing Act as amended, 42 U.S.C. § 3601, and Executive Order 11063, and also alleged that HUD had failed to affirmatively further fair housing, as required by the Fair Housing Act, 42 U.S.C. § 3608(e)(5), and Executive Order 11063.

[8]Those mortgages requiring HUD approval for prepayment are typically those on properties that still are or were originally owned by nonprofit owners, still have a Rent Supplement contract, or received Flexible Subsidy funds after 1979 (many of these properties have executed Flexible Subsidy agreements restricting unilateral prepayment).

[9]*Brighton Village Nominee Trust v. Malyshev,* No. 00-CV-12311-GAO, slip op. at 6.

failed to reach an agreement with the owner regarding rent levels. The court held that but for HUD's failure to follow the prepayment approval statute, the owner could have been compelled to renew the Section 8 contract for four years, in accordance with the regulatory agreement.

Under 42 U.S.C. § 1437f(c)(9) as in effect in 1994, upon receiving notification of an owner's intent to terminate a Section 8 contract, HUD was required to evaluate the legal sufficiency of the owner's stated reasons and to determine if there were actions that could prevent the termination, such as a rent adjustment. HUD was also required to issue a written finding of the reasons for the termination and their legality, as well as the actions taken or considered to avoid the termination. The court first held that although the statute was not enacted until 1988, eight years after the contract was executed, HUD was nevertheless bound by the statute's requirements. The court found that HUD failed to comply with the statute by not issuing the required written finding. However, the court stated that it was unnecessary to decide whether HUD had complied with the statutory evaluation mandates, it having already concluded that HUD improperly permitted the termination by illegally approving the prepayment.

Here too HUD argued that, under the regulatory agreement, it could have offered the owner a different assistance contract, presumably vouchers, rather than renewing the contract. The court rejected this defense, stating once again that speculation of what may have happened had HUD followed its obligations was no excuse for non-compliance.

On the tenants' disability discrimination claim, however, the court granted summary judgment to HUD because a request for increased economic assistance did not qualify as a reasonable accommodation under applicable laws and cases. HUD had refused the tenants' request to waive its policies for determining the subsidy level provided by the vouchers. After reviewing similar cases, the court held that this request was not an accommodation of their specific disabilities, but rather a remedy to their economic condition and not actionable.

Turning to the remedy for HUD's violations, the court ruled that, under the Administrative Procedure Act (APA),[10] the tenants were entitled to restitution for the excess rents paid between 1995 and 1999 because HUD was legally was obligated to make these payments. HUD first attacked the tenants' ability to obtain any monetary relief under the APA, because the APA's waiver of sovereign immunity is limited to providing "relief other than monetary damages."[11] Because the tenants were not seeking to set aside the prepayment or order HUD to execute a new project-based contract, HUD claimed that they were entitled to no relief whatsoever. Refusing thus to absolve HUD, the court cited both authority for its discretion to tailor an equitable remedy[12] and other APA cases providing financial restitution of legally mandated payments.[13]

However, the court refused to grant injunctive relief after 1999 to provide further protection against "adverse housing actions"—actions permissible under the enhanced voucher program but which would have been impermissible under a renewed project-based contract, finding that the tenants' request rested on the premise that HUD would have been required to offer contract renewal until the mortgage matured in 2020. In contrast, the court's view of the facts was that the contract should have been renewed only through September 1999, and renewal for any subsequent period was speculative. Unfortunately, the court engaged in considerable speculation about what could have happened after 1999, hypothesizing that HUD might have approved a prepayment under Section 250 or provided some other housing assistance, with no analysis of how that would have been possible under the facts and applicable laws and appropriations.

Since the decision, the tenants have filed a motion to reconsider the court's denial of post-1999 relief, arguing that HUD would have been obligated to renew Section 8 contracts for the duration of the mortgage because of the continuing need for affordable housing. Because the current Section 8 enhanced vouchers do not offer the same protections against adverse housing actions, the tenants' motion alternatively requests dismissal of the tenants' claim for prospective relief without prejudice so that if harm does occur later, the tenants can then seek appropriate relief.

Conclusion

Brighton Village represents the first time a court has held HUD accountable for approving prepayments in violation of Section 250 and the financial injuries it causes to tenants. It also demonstrates the importance of persistent and thorough legal representation in what at first glance appeared to be a garden-variety eviction for nonpayment of rent case. Detailed research uncovered the twisted history of the prepayment and nonrenewal, and the statutory violations giving rise to defeating the evictions and obtaining a monetary remedy—a worthy result from exemplary advocacy. ■

[10] 5 U.S.C.A. §§ 701 et seq. (West, WESTLAW Current through P.L. 108-228 (End) approved May 18, 2004).

[11] *Id*. § 702 (West, WESTLAW Current through P.L. 108-228 (End) approved May 18, 2004).

[12] *Brighton Village*, slip op. at 13 (citing *NAACP v. Secretary of HUD*, 817 F.2d 149, 160-61 (1st Cir. 1987)).

[13] *Id*. (citing Zellous v. Broadhead Assocs., 906 F.2d 94, 98-99 (3d Cir. 1990) (reimbursement for Section 8 utility payments where HUD failed to implement timely adjustments in allowances); Bowen v. Massachusetts, 487 U.S. 879, 900-01 (1988)).