

# Case Note

## Illegal Conversion of Project-Based Section 8 Property Resolved by Innovative Settlement

When senior residents living at 171 West Oak Street in Chicago, Illinois (Morningside I), started complaining that college students were moving into the 201-unit, Housing Finance Development Authority, project-based Section 8 development, the property's management told them that the U.S. Department of Housing and Urban Development (HUD) was allowing the management to house students there. The building's property management told residents and waiting-list applicants that no more low-income residents would be allowed to move into the development even though attrition and vacancies frequently occurred. Ultimately these facts led to an unusual housing preservation case and a novel model settlement for other preservation litigation or at-risk properties around the country.

### History of Morningside I

Morningside I was created in 1978 as part of a now-defunct HUD program targeting certain federal funds for use by state housing finance agencies to create low-income housing. In Illinois these funds went to the Illinois Housing Development Authority, which used tax-exempt debt for construction of properties, including Morningside I, where the rents guaranteed by the Section 8 contract provided for an income stream substantially higher than what would otherwise be available.

In return for this public support, the property's original owners, Moody House Associates, agreed to a number of contractual and regulatory obligations applicable to owners of project-based Section 8 properties. In 1978 Moody House Associates, the Illinois Housing Development Authority, and HUD entered into an agreement for Section 8 assistance. Called a housing assistance payments contract, this agreement created the subsidy structure that enabled Morningside I to provide 201 units of affordable, subsidized housing to eligible low-income seniors and disabled individuals.

The term for the housing assistance payments contract was for forty years and was scheduled to end in 2018, the same time that the property's original mortgage reached maturity. The Housing Finance Development Authority properties' housing assistance payments contracts included a provision for automatic renewals every five years. In other words, the project's owner must accept all contract renewals that the state housing finance agency offered.

At the same time that the parties entered into the housing assistance payments contract, the Illinois Housing Development Authority and HUD entered into an annual contributions contract. This contract provided the terms under which HUD would give the Illinois Housing Development Authority the money required to fund and administer the housing assistance payments contract.

### Moody Bible Institute's Efforts to Convert the Property

In 1993 Moody House Associates sold the property to a corporate affiliate, Moody Bible Institute, a nonprofit Evangelical Christian higher education institution with a school, church, and campus located near Morningside I. From 1993 to 1998 Moody Bible Institute operated the property as a typical project-based Section 8 property, and management properly filled all vacancies with applicants from the waiting list. Starting in 1999, however, Moody Bible Institute began converting the development into dormitory rooms for students attending its religious school. Each time a senior or disabled resident vacated the property, that particular unit would be quickly converted to a use other than low-income housing—a dormitory room for two to three students or guest accommodations for the students' parents or other Moody Bible Institute visitors. Indeed, two project-based Section 8 apartments were combined into one large unit and made available to Jerry Jenkins, a famous Moody Bible Institute alumnus, faculty member, and financial contributor.

In 2005 the senior low-income residents sought the assistance of the Jane Addams Senior Caucus, a Chicago-based nonprofit community-organizing project devoted to ensuring that seniors successfully and independently access affordable housing and health care. The Jane Addams Senior Caucus first sought to secure a resident services coordinator for the property but quickly assessed that something was very wrong about Moody Bible Institute's actions regarding the affordable housing at Morningside I.

In 2006 the Jane Addams Senior Caucus and Morningside I resident leaders asked the Sargent Shriver National Center on Poverty Law to investigate how a fully federally subsidized property came to be converted to a use other than low-income housing for seniors and persons with disabilities. When the Shriver Center became involved, approximately one-half of the units were occupied by students or other individuals who were not eligible to reside in project-based Section 8 housing. Moody Bible Institute's property manager rebuffed all inquiries from the public regarding potential vacancies or opportunities to add one's name to the waiting list (which, in 1999, included up to 300 persons needing affordable hous-

ing). Moody Bible Institute students received upgraded units, including Internet access, new paint, and new flooring, while the senior and disabled low-income residents received no similar upgrades. Moody Bible Institute even went so far as to rename the property “Jenkins Hall” allegedly in honor of Jerry Jenkins.

HUD became aware of the problem at Morningside I after receiving complaints from low-income Chicago residents who were denied the chance to apply for housing and Morningside I residents who were concerned and confused about the increasing number of students moving into the property. Because Morningside I was a Housing Finance Development Authority property and the Illinois Housing Development Authority served as the administrator of the housing assistance payments contract, HUD repeatedly asked the Illinois Housing Development Authority to direct Moody Bible Institute to comply with the housing assistance payments contract and the annual contributions contract and begin leasing vacant units to eligible low-income applicants. Despite these requests, students continued to move into the property, and the Illinois Housing Development Authority made no efforts to stop Moody Bible Institute’s illegal practices.

On July 6, 2006, Morningside I senior leaders, the Jane Addams Senior Caucus, and the Shriver Center met with the Illinois Housing Development Authority and HUD to discuss the status of Morningside I. At this meeting the Illinois Housing Development Authority revealed that it had agreed to allow Moody Bible Institute to violate the housing assistance payments contract and the annual contributions contract. In 1994, apparently without HUD’s knowledge or agreement, the Illinois Housing Development Authority and Moody Bible Institute entered into an agreement permitting Moody Bible Institute to prepay the original mortgage. The parties agreed that, after the mortgage was paid off, Moody Bible Institute could begin leasing vacant units to Moody Bible Institute students. Moody Bible Institute prepaid the mortgage in 1999 and shortly thereafter began refusing to rent to eligible low-income senior and disabled applicants and allegedly informed waiting-list applicants that Morningside I no longer had available housing for them.

A set of Freedom of Information Act requests revealed that for some time the Illinois Housing Development Authority had continued to receive administrative fees for all 201 units under the contracts even though the percentage of eligible low-income residents in the property had been declining for the last twelve years.

### Plaintiffs’ Demand Letter

In August 2006 the Shriver Center, the Housing Preservation Project (a Minnesota-based nonprofit law project devoted to affordable housing preservation throughout the country), and the private law firm of Reed, Smith, Sachnoff & Weaver—all three representing the Jane Addams Senior Caucus as an organizational plaintiff as well as a proposed class of residents and low-income seniors in need of project-based Section 8 housing—sent to the Illinois Housing Development Authority and Moody Bible Institute letters demanding that the parties cease their illegal conduct or face litigation in federal court. On behalf of their clients, the attorneys demanded that the

Illinois Housing Development Authority and Moody Bible Institute immediately comply with the housing assistance payments contract, the annual contributions contract, and applicable federal law and cease moving Moody Bible Institute students or staff or other ineligible individuals into units at Morningside I and converting units to anything other than housing for eligible low-income individuals.

In response to the demand letter, the Illinois Housing Development Authority agreed to work with the residents to bring the property into compliance with the housing assistance payments contract and the annual contributions contract. The Illinois Housing Development Authority thus sent a letter to Moody Bible Institute ordering it to comply with both contracts and to consider the 1994 agreement no longer in effect. After residents and the Jane Addams Senior Caucus convened a rally outside the Illinois Housing Development Authority’s offices, the Illinois Housing Development Authority apologized for entering into the prepayment agreement with Moody Bible Institute.

However, Moody Bible Institute would not accept a rescission of the 1994 agreement. Instead it sent to residents a letter indicating that it had the right to use the property for Moody Bible Institute staff, residents, and alumni and as low-income housing for seniors and persons with disabilities. It promised not to displace any current residents, but it would not commit to stopping the practice of converting units after a low-income resident died or left the property and that unit became vacant.

### *Jane Addams Senior Caucus v. Moody Bible Institute of Chicago*

The Jane Addams Senior Caucus and a proposed class of Morningside I residents, waiting-list applicants, and low-income individuals who were denied the opportunity to apply to the waiting list sued Moody Bible Institute (*Jane Addams Senior Caucus v. Moody Bible Institute of Chicago*, No. 06 C 4800 (N.D. Ill. filed Sept. 5, 2006) (Clearinghouse No. 56,037)). The suit alleged that Moody Bible Institute’s actions violated federal laws governing the Section 8 program, namely, Section 555 of Public Law 101-625, 104 Stat. 4233, the Cranston Gonzalez National Affordable Housing Act of 1990, 42 U.S.C. §§ 12701 *et seq.* (and its implementing regulation at 24 C.F.R. § 880.504) (prohibiting underutilization of a project-based Section 8 contract and the failure to use that contract assistance to provide housing for low-income and very low-income individuals).

The plaintiffs alleged as well that Moody Bible Institute violated its housing assistance payments contracts and related regulations, Title VIII of the U.S. Civil Rights Act of 1968 (42 U.S.C. § 3604), Section 504 of the Rehabilitation Act of 1973 (29 U.S.C.A. § 794), and the Illinois Human Rights Act (775 ILL. COMP. STAT. 5/3-102 & 3-101) (which, as the plaintiffs alleged, also protects individuals from discrimination on the basis of age) when it engaged in a pattern and practice of discrimination against persons with disabilities by refusing to rent its low-income housing to persons with disabilities, converting housing available to persons with disabilities into student housing, and failing to give the same level of maintenance and improvements to plaintiffs’ units as it gave to the

students. The plaintiffs claimed that these illegal actions had an adverse disparate impact on persons who had disabilities and overwhelmingly needed affordable housing.

The plaintiffs also alleged that Moody Bible Institute retaliated against them in violation of 42 U.S.C. § 3617 and 24 C.F.R. § 100.400 after the plaintiffs publicly sought to require Moody Bible Institute to comply with its statutory, regulatory, and contractual obligations, including compliance with the Fair Housing Act (42 U.S.C. § 3604). Specifically, in a letter hand-delivered shortly before the lawsuit was filed, Moody Bible Institute notified residents working with the Jane Addams Senior Caucus and their counsel that they could no longer use the property's community space without written permission from property management. Before this notification and the plaintiffs' public demand that Moody Bible Institute follow the law, Morningside I property management allowed students and low-income residents to use the common areas freely without seeking the property management's permission. After the residents received this presumably retaliatory letter from Moody Bible Institute, students continued to use and enjoy the property's community space without seeking the property management's permission. Moreover, after the plaintiffs' counsel issued its demand letter, Moody Bible Institute sent to Morningside I's project-based Section 8 residents a letter threatening to opt out of its Section 8 contract in 2008 unless it was allowed to continue to use Morningside I for both low-income senior housing and student dormitory space.

The plaintiffs also filed for a temporary restraining order and preliminary injunction. Their motion sought to stop Moody Bible Institute from moving any additional students into the property or converting any additional residential units into dormitory rooms or for any other use other than low-income housing for seniors and persons with disabilities. It requested that the waiting list for the development be reopened immediately so that vacant units could again be occupied by eligible low-income senior and disabled residents.

### The HUD Office of General Counsel Opinion

In the midst of the new litigation loomed a larger threat to the Morningside I development and potentially other Housing Finance Development Authority properties throughout the country. In 2002 the HUD Office of General Counsel issued a troubling legal opinion regarding the contractual provisions governing the term of a Section 8 housing assistance payments contract between a state housing finance agency, such as the Illinois Housing Development Authority, and an owner for a state housing finance agency-financed project executed before 1980. That opinion stated that HUD's legal position was that a sentence in the Section 8 housing assistance payments contract for those older Housing Finance Development Authority projects would permit an owner to opt out of the Section 8 program before the maturity date of the original mortgage by prepaying the mortgage. The contract sentence in question provided that the contract terminated "on the date of the last payment of principal due on the permanent financing." Section 1.1d of the November 1975 form specified that the "maximum total term" of the housing assistance payments contract (i.e., the initial five-year term and the successive five-year renewal terms) "shall be as speci-

fied in Section 1.4a. Section 1.4a provides that: "...the total contract term for any unit ... shall not exceed the shorter of (1)\_\_\_ years (blank filled in) or (2) a period terminating on the date of the last payment of principal due on the permanent financing ...."

Before the HUD Office of General Counsel opinion, the language in the pre-1980 contracts had always been interpreted and understood to mean that the contract would not terminate until the date of the originally scheduled maturity of the mortgage. Thus Housing Finance Development Authority properties were secure during the typically forty-year term of the original mortgage, whether the mortgage was prepaid or not, because these old Section 8 housing assistance payments contracts required the owners to accept all contract renewals that the state housing finance agencies offered to them. But because the HUD Office of General Counsel opinion stated that the contract would automatically terminate on the prepayment or refinance of the original mortgage, owners could now argue that the contract automatically terminated on prepayment of the original mortgage. The HUD Office of General Counsel opinion even eliminated the obligation of project-based Section 8 owners to issue opt-out notices at least one calendar year before the planned exit from the Section 8 program.

Housing advocates, the National Council of State Housing Agencies, and individual state housing finance agencies throughout the country decried this HUD Office of General Counsel opinion as politics taking precedence over established HUD policy. Despite many efforts to convince HUD to rescind this view, the HUD Office of General Counsel opinion remains to this day an official HUD position on the state housing finance agency-financed projects executed before 1980.

For its part, the Illinois Housing Development Authority reached out to the owners of the affected properties and sought a contract amendment that would nullify the HUD Office of General Counsel opinion and preserve the contracts until the original maturity date. Many owners of Illinois projects accepted this contract amendment; others, such as the Moody Bible Institute, did not. Shortly after the Morningside I litigation began, Moody Bible Institute made clear to all of the parties that it would rely on the HUD Office of General Counsel opinion to exit its project-based Section 8 contract.

### Settlement Negotiations

The *Jane Addams Senior Caucus v. Moody Bible Institute* suit and the Moody Bible Institute's threat of opt-out based on the HUD Office of General Counsel opinion motivated all of the parties, including HUD and the Illinois Housing Development Authority, to enter into settlement negotiations promptly. The parties ultimately settled on a novel solution that would provide for long-term preservation of all 201 units under the Section 8 contract and placement of a portion of the contract into the hands of an owner committed to providing affordable housing. The owners of a low-income housing tax credit property located just down the street from Morningside I volunteered to take 111 of the units under the Section 8 contract. In return for their acceptance of the Section 8 contract, the new owners agreed to renew the contract until 2033. At the same time Moody Bible Institute agreed to maintain 90

units under contract as project-based Section 8 housing until 2018, the original maturity date of the property's mortgage.

Using 42 U.S.C. § 1437f(bb), which provides that the HUD secretary "may transfer any budget authority remaining in the contract to another contract," HUD authorized the transfer of a portion of the Morningside I contract's budget authority to the nearby low-income housing tax credit property. Morningside I residents were offered the opportunity to move to the new development, with all expenses covered by Moody Bible Institute and the new owner, or to remain at Morningside I. At that time only one-half of the Morningside I units were being leased as project-based Section 8 units—meaning that not all of the available project-based assistance under the contract was being used. This circumstance enabled HUD to transfer more easily the remaining project-based Section 8 assistance to the new property and make it immediately available to low-income residents at the new property. Ultimately enough residents elected to move to Morningside I to make the contract split possible. Current residents at the new development who were income-eligible for project-based assistance participated in a lottery for the new project-based Section 8 assistance. Anyone who did not receive project-based assistance through the lottery was placed on a property waiting list.

### Lessons Learned

Many lessons can be gleaned from this case, but two are central:

1. *Consider Creative Resolutions.* Because early discussions with Moody Bible Institute made clear that Moody Bible Institute would not consider long-term preservation of the Section 8 contract and the HUD Office of General Counsel opinion had the potential for the client to win the battle (the litigation) but lose the war (opt-out), the parties had to find a solution that could still preserve this critical supply of affordable housing. At the same time, an owner of a nearby tax-credit development continued to make inquiries to HUD about Morningside I and the future of affordable housing there. This owner's persistence resulted in the idea to transfer

a portion of the contract to the tax-credit property as long as Moody Bible Institute would commit to maintaining a portion of the Section 8 contract for an extended period. This solution meant that no project-based Section 8 housing was lost, residents had their choice of residing in one of two developments, and Moody Bible Institute could continue to use a portion of the development to house its students. Most important, this "transfer of budget authority" concept probably will be used in Chicago for other at-risk project-based Section 8 developments in the near future as well as in developments around the country.

2. *Strong Organizing Can Make the Difference.* When plaintiffs' counsel was first asked to look into this case, the Jane Addams Senior Caucus already had organized a strong body of resident and community leaders committed to preserving Morningside I as affordable housing. However, this property was not easy to organize. Many residents, most of whom were in their 80s and 90s, were from the former Soviet Union and had fled to the United States in the 1980s to avoid persecution. This history caused many residents to fear questioning or publicly speaking out against Moody Bible Institute's actions. Despite these obstacles, the Jane Addams Senior Caucus organized a strong tenant body willing to speak out publicly against these injustices, meet with HUD, the Illinois Housing Development Authority, and Moody Bible Institute, and cooperate fully with the attorneys. This constant source of public pressure produced a quick and beneficial settlement.

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