

State Court Invalidates Decision to Release Property from LIHTC Program for Noncompliance*

In a decision concerning an issue of national first impression, the Oregon Court of Appeals held that project owners and state agency regulators cannot mutually release federal Low-Income Housing Tax Credit (LIHTC) program-prescribed use restrictions. Reversing the trial court, the decision in *Nordbye v. BRCP/GM Ellington*¹ highlights the importance of local monitoring of LIHTC compliance and the utility of tenant enforcement of the terms of the federally prescribed use agreement.

Factual Background

The plaintiffs were tenants living at Rose City Village, a 264-unit housing complex in Portland. In 1991, the original owner received an award of approximately \$2.3 million² in tax credits from the Oregon Housing and Community Services Department (OHCS) through the federal LIHTC program.³ Under the program, the tax credits were contingent on the execution and recording of a covenant restricting use of all of the development's units to affordable housing for eligible low-income households for 30 years at restricted rents. Pursuant to these requirements, the original owner executed an extended use agreement with OHCS and recorded a declaration of land use restrictive covenants, which acknowledged the restrictions of the use agreement. In the LIHTC statute, Congress explicitly described only two situations in which the use restrictions terminate before the end of the 30-year period: (1) conveyance of title as a result of foreclosure or deed-in-lieu; and (2) the failure of the agency to procure a purchaser at a formula price when the owner wants to exit after the 14th year of the compliance period.⁴

In response to a 1991 audit identifying several areas of noncompliance, the original owner sought to resolve the issues. Subsequent audits revealed only minimal noncompliance. However, another inspection in 2002 identified

some noncompliance issue in “nearly every file.”⁵ In most cases, the original owner had failed to properly verify tenant income eligibility.

In 2003, without securing the approval of OHCS or the express agreement of the purchaser to assume the requirements of the declaration and the LIHTC statute, as required by the declaration, the original owner sold the property. This transaction occurred 12 years after the first tax credit was claimed and two years after the last tax credit was taken. Although this new owner made attempts to bring the project into compliance, in 2003 an OHCS staff person telephoned an IRS program analyst to ask whether “egregious noncompliance” was sufficient grounds to remove the project from the program.⁶ The IRS employee told the OHCS staff person that OHCS could “kick them out of the program.”⁷ Despite the fact that the new owner filed a compliance certification with OHCS reporting nearly full compliance, OHCS informed the IRS of its intentions to terminate the project from the program.⁸ Additionally, checking the preprinted box denoting that the “[p]roject is no longer in compliance nor participating in the [program],” OHCS submitted several noncompliance forms (IRS Form 8823) to the IRS.⁹ In 2005 OHCS and this second owner entered into a release agreement. The tenants were never notified and thus never consented to the release or the elimination of the use restriction.

In 2005, BRCP (the current owner) purchased the property from the second owner for \$5.4 million more than the second owner's acquisition price.¹⁰ Later that year, after issuing 30-day no-cause eviction notices, the current owner evicted the 110 low-income households still residing in the development, including the plaintiff.¹¹ Subsequently, the current owner reportedly performed some additional rehabilitation and rented the units at market rates to households at various income levels, many or perhaps most in excess of LIHTC eligibility levels.

Procedural History

The tenant filed suit, seeking declaratory and injunctive relief to enforce the use restriction, as expressly authorized by the declaration.¹² The current owner and

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¹*Nordbye v. BRCP/GM Ellington*, __ P.3d __, 2011 WL 5067104 (Or. Ct. App. 2011).

²The original owner received \$230,862 annually during the first 10 years after the property was placed in service under the LIHTC program.

³Pursuant to Section 42 of the Internal Revenue Code (IRC), the program uses tax credits, allocated to the states, which are in turn awarded to developers and claimable over a 10-year period, to incentivize the development of low-income rental housing. 26 U.S.C. § 42 (Westlaw Nov. 14, 2011). The Internal Revenue Service (IRS) regulates the LIHTC program.

⁴*Nordbye*, 2011 WL 5067104, at *5, n.11.

⁵Brief of Plaintiff-Appellant at 9, *Nordbye v. BRCP/GM Ellington*, No. A141698 (Or. Ct. App. Oct. 26, 2011) (on file on NHLP) [hereinafter Brief of Plaintiff-Appellant].

⁶*Id.* at 10

⁷*Id.*

⁸*Nordbye*, 2011 WL 5067104, at *3.

⁹*Id.*

¹⁰Brief of Plaintiff-Appellant, *supra* note 5, at 12.

¹¹*Id.* These evictions also violated the three-year protections from evictions following the two termination events specified in the LIHTC statute.

¹²Section 8(b) of the declaration, like most other LIHTC Agreements, provides, “The Owner acknowledges that the primary purpose for requiring compliance by the Owner with restrictions provided in this Declaration is to assure compliance of the Project and the Owner with IRC Section 42 and the applicable regulations, AND BY REA-

OHCS moved for summary judgment on the grounds that the release was valid and enforceable. The tenant filed a cross-motion, contending that the purported release was insufficient to abrogate her right to obtain specific performance of the declaration. The trial court granted the owner's and OHCS' motion for summary judgment, holding that OHCS' decision to remove the project from the program was valid and effectively abrogated the ability of low-income tenants to enforce the declaration. This conclusion was based upon its determination that OHCS' decisions to remove the project and execute the release were entitled to deference.¹³ Accordingly, the trial court dismissed the case.

Oregon Court of Appeals Analysis

The appellate court first evaluated whether *Chevron*-style deference applied to OHCS' decision to remove the project from the program. Under *Chevron*, when a federal agency has been charged by Congress with implementing a federal statute, courts should defer to that agency's interpretation of the statute, treating that interpretation as controlling as long as it is reasonable,¹⁴ where Congress has not directly addressed the precise question at issue.¹⁵ The defendants argued that OHCS' decision should be afforded *Chevron* deference, relying upon a 2009 Oregon Supreme Court decision holding that certain state agency interpretations of federal law are entitled to judicial deference where Congress granted the state agency rulemaking authority.¹⁶

However, the court held that OHCS' decision here was not entitled to judicial deference because a state agency's interpretation of federal statutes is not generally entitled to the deference afforded to a federal agency's interpretation of its own statutes. The court distinguished the present case from *Friends of Columbia Gorge v. Columbia River* because the LIHTC statute contains no grant of rulemaking authority to state agencies to fill gaps in the federal scheme.¹⁷ Lastly, in dismissing the defendants' attempt to

bolster their deference argument by relying on the informal IRS staff advice, the court found that "the oral advice of a federal employee, given on an ad hoc basis to a state agency, simply does not qualify" as an administrative interpretation with the force of law.¹⁸

The court also rejected the defendants' contention that the release abrogated the tenants' rights under the use agreement. Under Section 2(b) of the declaration, the use restrictions constitute covenants running with the land, conferring benefits on OHCS and any past, present or prospective tenant of the project.¹⁹ Moreover, the use agreement and the declaration incorporate Oregon law, which provides that a restrictive covenant cannot be terminated without the consent of the intended beneficiary. Accordingly, the court held that the tenant was an intended third-party beneficiary entitled to enforce the use restrictions.

In its opinion, the court noted that "the private enforcement rights conferred on qualified low-income tenants are an integral part of Congress's comprehensive design."²⁰ The LIHTC program is "front-loaded": tax credits are claimed during the initial 10 years of the project, but the extended use period runs for at least 30 years. In the later years, recapture of a small portion of the credits alone may not provide an effective mechanism to ensure compliance. The court recognized that "Congress anticipated that the enforcement role played by the pertinent government agencies gradually would diminish and effectively end before expiration of the 30-year extended-use period."²¹ Thus the tenants' private enforcement rights serve to ensure continued program compliance beyond the initial 15-year compliance period.

Moreover, citing an amicus brief submitted by the National Housing Law Project (NHLP), the court agreed that Congress, by explicitly establishing only two grounds for terminating long-term use restrictions, intended that

¹⁸*Id.*

¹⁹Section 2(b) of the Declaration provides: "The Owner intends, declares and covenants, on behalf of itself and all future Owners ..., that this Declaration and the covenants and restrictions set forth in this Declaration regulating and restricting the use, occupancy and transfer of the Project (I1) shall be and are covenants running with the Project land, ... (and the benefits shall inure to the Department and any past, present or prospective tenant of the Project) The Owner hereby agrees that any and all requirements of the laws of the State of Oregon to be satisfied in order for the provisions of this Declaration to constitute deed restrictions and covenants running with the land shall be deemed to be satisfied in full, ... or in the alternate, that an equitable servitude has been created to insure that these restrictions run with the Project. For the longer of the period this Credit is claimed or the term of this Declaration, each and every contract, deed or other instrument hereafter executed conveying the Project or portion thereof shall expressly provide that such conveyance is subject to this Declaration, provided, however, the covenants contained herein shall survive and be effective regardless of whether such contract, deed or other instrument hereafter executed conveying the Project or portion thereof provides that such conveyance is subject to this Declaration."

²⁰*Nordbye*, 2011 WL 5067104, at *10.

²¹*Id.*

SON THEREOF, THE OWNER IN CONSIDERATION FOR RECEIVING LOW-INCOME HOUSING TAX CREDITS FOR THIS PROJECT HEREBY AGREES AND CONSENTS THAT THE DEPARTMENT AND ANY INDIVIDUAL WHO MEETS THE INCOME LIMITATION APPLICABLE UNDER SECTION 42 (WHETHER PROSPECTIVE, PRESENT OR FORMER OCCUPANT) SHALL BE ENTITLED, FOR ANY BREACH OF THE PROVISIONS HEREOF, AND IN ADDITION TO ALL OTHER REMEDIES PROVIDED BY LAW OR IN EQUITY, TO ENFORCE SPECIFIC PERFORMANCE BY THE OWNER OF ITS OBLIGATIONS UNDER THIS DECLARATION IN A STATE COURT OF COMPETENT JURISDICTION."

¹³Under the framework established in *Chevron USA, Inc. v. Natural Res. Def. Council*, 467 U.S. 837 (1984).

¹⁴*Nordbye*, 2011 WL 5067104, at *5 (citing *Friends of Columbia Gorge v. Columbia River*, 213 P.3d 1164, 1172 (Or. 2009)).

¹⁵*Id.* (citing *Chevron USA, Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 843 (1984)).

¹⁶*Friends of Columbia Gorge*, 213 P.3d at 1164.

¹⁷*Nordbye*, 2011 WL 5067104, at *6 (citing *Orthopaedic Hosp. v. Belshe*, 103 F.3d 1491 (9th Cir. 1997)).

noncompliance could not legally support termination. As stated by NHLP, “in specifically prohibiting purposeful foreclosure from terminating an extended use period, Congress clearly articulated its intent to ensure compliance with long-term use requirements. Congress certainly did not intend to prohibit purposeful foreclosure while simultaneously allowing noncompliance with program requirements—which is also wholly within an owner’s control—to produce identical results.”²²

The court also agreed with NHLP that release of use restrictions upon a finding of noncompliance would create perverse incentives for the owner to evade those use restrictions by simply violating program requirements. The court noted that “once released from the obligation to maintain the property as low-income housing for the stated period, an owner would be free to charge market-rate rent or sell the project for a profit, thereby profiting from a public subsidy without fulfilling the conditions of that subsidy.”²³ Hitting the nail on the head, the court concluded, “In sum, permitting abrogation of LIHTC program-prescribed use restrictions—and, specifically, tenants’ rights to enforce those restrictions—by way of ‘releases’ between project owners and local housing agencies would subvert, and even invert, Congressional intent.”²⁴

The court therefore reversed the trial court’s decision granting judgment to the agency and the owner and denying the tenant’s cross-motion for summary judgment. After finding that the trial court erred in denying the tenant’s cross-motion for summary judgment, the court remanded the case so that the tenant may enforce the declaration’s use restrictions.

Conclusion

Nordbye underscores the challenges caused by the lack of clear federal rules and the hazards of ad hoc advice from IRS staff on major issues presented by one of the nation’s largest affordable housing programs. In crafting the LIHTC program, Congress established two exclusive termination conditions, to which state agencies and owners must adhere. Regulatory agencies must establish and execute effective monitoring programs that are faithful to the statutory scheme and take advantage of the third-party enforcement rights built into the program structure. Tenants should not pay the price of lax monitoring or owner noncompliance. The Rose City experience demonstrates that vigilance and persistent enforcement of use restrictions can ensure that taxpayer funds are well-utilized for their intended purpose—meeting community needs for decent and affordable rental housing. ■

²²*Id.*

²³*Id.* at *11.

²⁴*Id.*