

Information and Discussion re: Draft Declaration of Restrictive Covenant for the 1025 Waimanu Street Parcel (Artspace) to be Encumbered as Affordable Housing in Perpetuity

Staff Report
October 7, 2015

Background: The Authority approved a Development Permit for the Ola Ka ‘Ilima Artspace Lofts project (“Project”) on January 15, 2015 (Exhibit A). On November 25, 2014, the Authority also approved ground lease terms and authorized the Executive Director to enter into a ground lease for the land parcel owned by the Hawaii Community Development Authority (“HCDA”) at 1025 Waimanu Street (Lot 40, Tax Map Key: 2-3-003: 040) for construction of the Project (Exhibit B). On June 24, 2015, there were brief presentations made by Kathleen Kelly, Deputy Corporation Counsel for the City and County of Honolulu, and Gary Nakata, City Director of Community Services, before the Authority met in Executive Session to discuss possible affordable housing covenant on land intended for the Project.

The Project proposes to provide 84 rental units affordable to households earning between 30% and 60% of the Area Median Income (“AMI”) for 65 years, and with a preference for residents participating in the arts.

EAH Housing, a non-profit corporation will manage the Project. Some of the ground floor commercial space is reserved for the PA‘I Foundation and will serve as a classroom space for traditional Hawaiian practices.

Discussion: Ola Ka ‘Ilima Lofts, Limited Liability Limited Partnership (“LLLP”) is the entity that will develop the Project. At the time of approval of a Development Permit, the Project was estimated to cost approximately \$39 million. Artspace Projects, Inc. (“Artspace”) is assembling a financing stack of grants, low-income housing tax credits, and loans for construction of the Project. It was previously presented through a letter dated June 15, 2015, (Exhibit C) that the City and County of Honolulu (“City”) had appropriated \$7,202,000.00 from the City’s Affordable Housing Fund (“Fund”) for development, construction and maintenance of the Project. It was indicated at that time that amount would be sufficient to complete financing and allow the LLLP to proceed with construction. An appropriated amount of \$1.1 million may have lapsed due to funds not being encumbered by June 30, 2015. Subsequent information submitted on September 29, 2015 (Exhibit D) includes a letter to Artspace from the Office of the Mayor dated August 10, 2015 which describes that \$4,400,000.00 has been appropriated for the Fund and specifies that there is no guarantee for those funds to be awarded to the Project. At this point it is not clear what amount of funding is still necessary to complete financing for the Project.

As described in Exhibit D, in order to secure monies from the Fund, the LLLP would need to respond to a Request for Proposals (“RFP”) and would need to demonstrate that the Project will be used for affordable housing in perpetuity. At this time, there is no information about the timing or criteria for responding to a future RFP for the Fund.

In anticipation of such a RFP process, the LLLP is requesting that the HCDA “take action to approve the placement of a perpetual affordability covenant against the fee simple interest of the property” (Exhibit D). Currently by statute, the HCDA can only offer a 65-year lease. However, it appears that there is no restriction on placing covenants or encumbrances on fee simple property owned by the HCDA.

A draft of such a restrictive covenant (“Covenant”) has been prepared by the City’s Corporation Counsel and is being circulated among certain City agencies for consideration, including the HCDA (Exhibit D). The draft Covenant does not include conditional language that would be dependent on the LLLP’s favorable awarding of a RFP for the Fund; instead, the draft Covenant is framed to be executed after a specific appropriation has been awarded through established terms and conditions provided in an ensuing Grant Agreement. Consequently, decision-making by the HCDA for restricting the Project parcel for affordable housing in perpetuity would need to be made prior to the LLLP submitting to a RFP and not based on approving the draft Covenant (except in form only). Action by the HCDA could offer particular conditions for allowing such a restrictive covenant, and would subsequently be included in the LLLP submitting to a RFP. For example, it is not described in the draft Covenant, but it is staff’s opinion, that the HCDA, as property owner, should be party to any Grant Agreement awarding funding to the LLLP.

The draft Covenant requires a minimum affordability of less than 50% AMI to be provided in perpetuity for a prescribed number of units to be established by the amount provided by the Fund. From the 84 units proposed by the Project, 42 units are proposed to be priced for individuals earning less than 50% AMI. So the restriction for perpetual affordability would be proportionally limited to some fraction of 42 units and would be based on initial unit type composition. Because the amount of funding that would be requested or provided is not specified at this time, it is not possible to estimate the proportional unit requirement for restricting affordability in perpetuity.

The draft Covenant indicates that default on the perpetuity commitment would obligate repayment of the entire award amount to the City. There is no consideration in the draft Covenant for the HCDA (described as “Declarant”) to defer obligation for repayment to the LLLP during the initial 65-year ground lease should the LLLP fail to maintain the affordability covenant. There is no provision provided in the draft Covenant to terminate restrictive covenant on the Project parcel after repayment of award amount to the City following failure to maintain perpetuity commitment (by either the LLLP, a subsequent leaseholder, or the HCDA). Conceivably, one scenario might entail the LLLP failing to maintain affordability and not being able or obligated to make required repayment, where the HCDA would bear the repayment cost and the property would continue to be encumbered by restrictive covenant.

There has been no commitment by the LLLP to provide a financial guarantee to the HCDA for an award amount from the Fund.

Attachments: Exhibit A – Findings of Fact, Conclusion of Law, Decision and Order
Exhibit B – Approved Ground Lease Terms
Exhibit C – Letter from Carlsmith Ball LLP, dated June 15, 2015
Exhibit D – Letter from Carlsmith Ball LLP, dated September 29, 2015,
Draft Declaration of Restrictive Covenant for Affordable
Housing