

ORIGINAL

**CARLSMITH BALL LLP**

A LIMITED LIABILITY LAW PARTNERSHIP

ASB TOWER, SUITE 2100  
1001 BISHOP STREET  
HONOLULU, HAWAII 96813  
TELEPHONE 808.523.2500 FAX 808.523.0842  
WWW.CARLSMITH.COM

RECEIVED

2015 JUN 15 PM 12 15

HAWAII COMMUNITY  
DEVELOPMENT  
AUTHORITY

DIRECT DIAL NO.  
808.523.2557

JLIM@CARLSMITH.COM

OUR REFERENCE NO.:  
067106-1

June 15, 2015

**Via Hand Delivery and  
Via E-Mail Tony@hcdaweb.org**

**Via Hand Delivery**

Mr. Anthony Ching  
Executive Director  
Hawaii Community Development Authority  
547 Queen St  
Honolulu, HI 96813

John Whalen, Chairperson  
and Members of the  
Hawaii Community Development Authority  
547 Queen St  
Honolulu, HI 96813

RE: Ola Ka 'Ilima Artspace Lofts, 1025 Waimanu Street, Kakaako  
Request for HCDA Covenant to Guarantee Affordability in Perpetuity

Dear Chair Whalen, Mr. Ching and Members of the Authority:

We represent Artspace Projects, Inc. ("**Artspace**"), a non-profit real estate developer specializing in creating, owning and operating affordable spaces for artists and creative businesses, and the applicant under Development Permit No. KAK 14-101 for the development of the Ola Ka 'Ilima Artspace Lofts project ("**Lofts Project**"). We also represent Ola Ka 'Ilima Lofts, Limited Liability Limited Partnership ("**LLLP**"), the entity that will develop the Lofts Project. The Lofts Project is a proposed mixed-use affordable rental housing and commercial project located within the Mauka Area of the Kakaako Community Development District, on land owned by the Hawaii Community Development Authority ("**HCDA**").

The Lofts Project will provide 84 residential rental units, 83 of which will be offered to rent to households earning between 30% to 60% of the area median income ("**AMI**") (1 unit will be set aside for a resident manager). These rental units will create affordable spaces for artists to live and work in Kakaako. There will be 50 one-bedroom units, 30 two-bedroom units and 4 three-bedroom units. Under the current HUD affordable rent guidelines,<sup>1</sup> the monthly rental amounts in Honolulu, inclusive of utilities, are as follows:

<sup>1</sup> The monthly rent levels in the following table represent gross rents, which include the cost of the following utilities: water, sanitary sewage services, electricity and gas (where applicable). These are HHFDC's current AMI rent levels, and are subject to change should AMI increase or decrease in future years.

<u>Percent of Median</u>	<u>one-bedroom</u>	<u>two-bedroom</u>	<u>three-bedroom</u>
30% AMI	\$539	\$647	\$747
50% AMI	\$898	\$1,078	\$1,245
60% AMI	\$1,078	\$1,294	\$1,494

The residential units will be between 792 to 1,483 square feet in size, and designed with high ceilings, large windows, durable surfaces and large doors and hallways to accommodate a variety of creative activities. The oversized doorways and halls will allow for easy ADA conversion of units for senior and disabled residents.

In addition to the homes, the Lofts Project will also include approximately 6,482 square feet of commercial space, approximately 94 parking stalls, and approximately 9,264 square feet of open/community space. The bulk of the commercial space (approximately 4,546 square feet) of the Lofts Project will be anchored by the PA'I Foundation, which will create a native Hawaiian cultural center, with classrooms, space of teaching and performing hula, music and other traditional practices.

The City & County of Honolulu ("C&C") has appropriated from the C&C's Affordable Housing Fund ("**Fund**") \$7,202,000.00 for the development, construction and maintenance of the Lofts Project. The estimated construction costs for the Lofts Project are \$39 million. Therefore, at over 18% of the total construction costs, this is an extremely generous and vital source of funding for the Lofts Project. The addition of \$5 million from the Fund in the 2015/2016 C&C budget represents what in essence will complete the financing package for the Lofts Project, and allow the LLLP to commence construction.

In order to access the monies from the Fund, Artspace/LLLP must demonstrate to the C&C that the Lofts Project will be used for affordable housing **in perpetuity**. HCDA, as the landowner, is the only party that has the authority to make that commitment to the C&C. Therefore, Artspace respectfully requests that HCDA impose an affordability covenant on the HCDA property underlying the Lofts Project, so that the C&C can release the monies from the Fund to be used at the Lofts Project.<sup>2</sup>

**A. THE CITY CHARTER & THE AFFORDABLE HOUSING FUND  
REQUIRE AFFORDABILITY IN PERPETUITY**

The C&C Fund was established under the 2006 General Election Charter Amendment Question No. 3, and codified in Ordinance No. 07-19. In relevant part, the Charter provides as follows:

---

<sup>2</sup> The Lofts Project has received various budget allocations from the C&C Fund. The initial allocation of \$1.1M **will lapse on June 30, 2015 if the funds are not encumbered**, i.e., if there is not a formal action taken by HCDA to approve placing a perpetual covenant on the property to maintain affordability.

Chairperson Whalen  
Mr. Anthony Ching  
June 15, 2015  
Page 3

Moneys in the Affordable Housing Fund shall be used to provide and maintain affordable housing for persons earning less than fifty percent of the median household income in the city for the following purposes: provision and expansion of affordable housing and suitable living environments principally for persons of low and moderate income through land acquisition, development, construction, and maintenance of affordable housing for sale or for rental, provided that the housing remains affordable in perpetuity.

Revised Charter of the City and County of Honolulu, Article XI, Chapter 2, Section 9-204; *see also* Revised Ordinances of Honolulu, Chapter 6, Article 63, Sec. 6-63.2.

Under the Charter there are two criteria that must be met and maintained in order for Fund monies to be used. First, the project must be "principally for persons of low and moderate income," meaning that more than 50% of the project must be for low and moderate income people. Second, the funds must be used for persons earning less than 50% of the median household income in Honolulu (which we understand to mean the AMI), and may be used for common areas in proportion to the occupancy by under-50% AMI households.

Further, we note that the C&C's pending award for the FY 2015/2016 C&C budget comes with the additional limitation that the 84 units within the Project must remain affordable in perpetuity for persons earning less than 50% AMI, that a minimum of 12 of the residential units must be dedicated for Housing First clients, and that \$1,000,000 of the funds may be used toward the Arts and Cultural center for native artists that is planned for the commercial portion of the Project.<sup>3</sup> As such, in order to access the Fund, the LLLP will require the Lofts Project to be operated with these additional limitations. Although the LLLP has the ability to impose strict affordability requirements on the Lofts Project during the term of the 65-year ground lease between HCDA and the LLLP, only HCDA has the authority to put the affordability covenant on its fee interest in the property.

To comply with the Charter's requirement that Fund-assisted affordable housing must remain affordable "in perpetuity," HCDA must allow a perpetual covenant to be recorded against the property upon which the Lofts Project will be built, so that affordability restrictions run with the land in perpetuity. That way, once the term of the ground lease is over and the LLLP returns the land, along with the completed Lofts Project (estimated to have construction costs of \$39,000,000) to HCDA, HCDA will need to ensure that any future use continues to comply with the covenant.

It is understood that if HCDA or the LLLP ever defaults on this commitment, or wishes to discharge this commitment to the C&C, all monies from the Fund that were provided for the Lofts Project must be returned to the C&C.

---

<sup>3</sup> This is based upon the language in the C&C's Executive Capital Budget for fiscal year July 1, 2015 to June 30, 2016. *See* Bill 14(2015), CD2, FD1. As of today, this Bill is awaiting signature of the Mayor.

**B. THE PERPETUITY REQUIREMENT UNDER THE AFFORDABLE HOUSING FUND CANNOT BE AMENDED WITHOUT A CHARTER AMENDMENT**

Without HCDA's cooperation, the perpetuity requirement under the Fund will preclude the use of the Fund at the Lofts Project. Because the perpetuity requirement was established by Charter amendment, amending that language would require another amendment to the City Charter. *See Fasi v. City Council of City and Cnty. of Honolulu*, 72 Haw. 513, 519, 823 P.2d 742, 744 (1992) ("A basic tenet of municipal corporation law is that an ordinance which conflicts with an express provision in a charter is invalid.") The process for amending the City Charter is difficult and time-consuming, and the voters of Honolulu have already spoken to say that the monies in the Fund should be used to support affordable housing in perpetuity.

**C. HCDA HAS THE AUTHORITY TO ENCUMBER ITS PROPERTY IN PERPETUITY, PARTICULARLY IF THE ENCUMBRANCE PROMOTES AFFORDABLE HOUSING**

We believe that HCDA has the authority to permit land under its jurisdiction to be designated for affordable housing purposes for perpetuity. We recognize that HCDA's authority to enter into ground leases for terms exceeding 65 years is limited by statute (HRS § 206E-31.6 requires HCDA to go to public auction should it wish to lease land for a term greater than 65 years). However, HCDA, as the fee owner of the Project land, has the authority to require the Project to be used as affordable housing in perpetuity.

The Legislature has granted HCDA uniquely broad powers over its lands and in the administration of the agency. HCDA has the power to:

(3) Make and execute contracts and all other instruments necessary or convenient for the exercise of its powers and functions under this chapter;

\* \* \*

(8) Acquire, reacquire, or contract to acquire or reacquire by grant or purchase real, personal, or mixed property or any interest therein; to own, hold, clear, improve, and rehabilitate, and to sell, assign, exchange, transfer, convey, lease, or otherwise dispose of **or encumber the same**;

\* \* \*

(10) By itself, or in partnership with qualified persons, acquire, reacquire, construct, reconstruct, rehabilitate, improve, alter, or repair or provide for the construction, reconstruction, improvement, alteration, or repair of any project; own, hold, sell, assign, transfer, convey, exchange, lease, or otherwise dispose of

**or encumber any project**, and in the case of the sale of any project, accept a purchase money mortgage in connection therewith; and repurchase or otherwise acquire any project that the authority has theretofore sold or otherwise conveyed, transferred, or disposed of;

\* \* \*

(17) Do any and all things necessary **to carry out its purposes** and exercise the powers given and granted in this chapter; and

HRS § 206E-4 (emphasis added).

With respect to subsection (17), HCDA's purpose includes the provision of affordable housing, especially in Kakaako. HCDA has all powers necessary to carry out its purpose of providing and encouraging the development of affordable housing. HCDA's purpose, as expressed in HRS § 206E-1, provides in relevant part:

The legislature further finds that there exists within the State vast, unmet community development needs. These include, but are not limited to, a lack of suitable affordable housing; insufficient commercial and industrial facilities for rent; residential areas which do not have facilities necessary for basic liveability, such as parks and open space; and areas which are planned for extensive land allocation to one, rather than mixed uses.

Specifically with respect to Kakaako, the legislative grant of authority to HCDA, and the creation of the Kakaako Community Development District, expressly contemplated the development of low-income housing. *See* HRS § 206E-31(2) ("[Kakaako] is relatively underdeveloped and has especially in view of its proximity to the urban core where the pressure for all land uses is strong the potential for increased growth and development that can alleviate community needs **such as low-income housing**, parks and open space, and commercial and industrial facilities.") (emphasis added).

As set forth in HRS § 206E-4(8), HCDA clearly has the power to encumber its land. HCDA also has the authority to encumber any "project", under § 206E-4(10).<sup>4</sup> Within Kakaako, HCDA is restricted in its ability to sell the fee interest in its land, but even that restriction is eliminated when the sale is of "reserved housing" (reserved housing is housing for households with low and moderate income), further demonstrating the Legislature's intention to empower HCDA to promote affordable housing in Kakaako.

---

<sup>4</sup> As defined under HRS § 206E-2, "Project" means "a specific work or improvement, including real and personal properties, or any interest therein, **acquired, owned**, constructed, reconstructed, rehabilitated, or improved by the authority, including a residential project, a redevelopment project, or a commercial project, all as defined herein, or any combination thereof, which combination shall hereinafter be called and known as a "multipurpose project". (emphasis added).

1. **THE LEGISLATURE GRANTED HCDA ADDITIONAL POWERS TO PROMOTE THE DEVELOPMENT OF AFFORDABLE HOUSING**

HRS § 206E-31.5 was enacted in 2006, and placed prohibitions on HCDA's authority to sell or otherwise assign the fee simple interest of its lands in the Kakaako community development district (however, HCDA does have authority to grant fee simple interest to any state or county department of agency). However, there is no prohibition under HRS § 206E-31.5 or elsewhere on HCDA's ability to encumber its lands with an affordability covenant. The affordability covenant required by the C&C is not a transfer of fee ownership of HCDA property and therefore is consistent with the limitations under HRS § 206E-31.5.

The Legislature's intention of maintaining HCDA's authority with respect to affordable housing is further demonstrated by the 2014 amendment to HRS § 206E-31.5, which exempted from the restrictions on fee simple sales "reserved housing" as defined in HRS § 206E-101 ("Reserved housing" means housing designated for residents in the low- or moderate-income ranges who meet such eligibility requirements as the authority may adopt by rule.")

In providing the exception for reserved housing, Senate Standing Committee Report No. 3056 (2014) acknowledged that "the Legislature established [HCDA] in 1976 as a public entity to plan new and innovative forms of urban redevelopment and renewal to meet certain community needs, especially the provision of low- and moderate-income housing located in residential and mixed-use areas with sufficient public facilities and services." Although the Lofts Project is not "reserved housing" it is clearly housing for households at a low income, which is a key group that HCDA is mandated to address.

2. **LEGISLATIVE ACTION IN 2012 WAS UNDERTAKEN TO ENHANCE HCDA'S ABILITY TO ATTRACT LONG-TERM INVESTORS IN KAKAAKO**

Even the Legislature's actions in 2012 to grant HCDA the authority to lease land in Kakaako without recourse to public action for terms not to exceed 65 years "upon such terms and conditions as may be approved by the authority" demonstrates the broad powers and authority that have been granted to HCDA. When enacting Act 323 (2012) (now found at HRS § 206E-31.6), the Legislature took note of the following:

Currently, section 206E-14, Hawaii Revised Statutes, allows the authority to sell or lease for a term not exceeding sixty-five years, all or any portion of its real or personal property constituting a redevelopment project if the authority finds that the sale or lease is in conformity with the community development plan. As defined in section 206E-2, Hawaii Revised Statutes, a redevelopment project may only be incidental in its commercial nature. The legislature finds that this limitation adversely impacts the

authority's ability to attract long-term investors and tenants who seek to develop or redevelop primarily commercial projects within the Kakaako community development district. This conflicts with the authority's commitment to implement longer lasting change in the Kakaako community development district.

2012 Haw. Sess. Laws Act 323, § 6.

Thus, the legislation was enacted for the purpose of supporting longer term investors and tenants in the Kakaako area. For the Lofts Project, HCDA, by authorizing the use of its property as affordable housing in perpetuity, will allow the LLLP to receive potentially over \$7.2 million from the C&C that can be used for the development of a mixed-use affordable housing project in Kakaako. An affordability encumbrance on HCDA's fee interest would support the long-term nature of the C&C Fund requirement for funding.

**D. THE AFFORDABILITY COVENANT WILL WORK LIKE OTHER FINANCIAL ENCUMBRANCES ON THE PROPERTY**

In order to construct and operate the Lofts Project, the LLLP will have loans and will place mortgages on its leasehold interest in the Lofts Project, but the LLLP will not place a mortgage on HCDA's fee interest in the land. In order for the LLLP to receive the monies from the Fund, HCDA, as the fee owner, must commit to the C&C that the property will remain affordable in perpetuity. If, upon reversion of the improved property to HCDA at the end of the LLLP's lease term, HCDA decided to that it wanted to release the Lofts Project from the affordability requirement, it would have to return all Fund monies to the C&C. We understand that there would be no penalty or interest due on the Fund monies. In effect, HCDA would pay the C&C to release the covenant. If HCDA decided to ignore the perpetuity commitment to the C&C and began using the Lofts Project as market housing or in other ways that are inconsistent with the Charter, the C&C would have the right to put a lien on the HCDA project and demand repayment of the monies or seek other legal recourse.<sup>5</sup>

In order to demonstrate to the C&C that compliance with Fund's Charter requirements will be secured by HCDA's commitment to retain the Lofts Project's affordability requirements

---

<sup>5</sup> Consistent with the concept of being able to return the C&C funds to release the property from the affordability requirements, the LLLP is exploring the possibility of securing those funds as a loan from the C&C, which funds would be repaid at the end of the lease term with HCDA. Our understanding is that the AHF monies would be repaid at zero interest, with payments beginning sometime during the 65-year term of the ground lease (most likely upon the expiration of the first mortgage for the Project), so that a final payment is made to the C&C at the same time that the ground lease is surrendered to HCDA. It is expected that this loan concept, which has not been utilized by the C&C in the past, would require HCDA to put a mortgage on its fee interest in the land so that the C&C would have adequate security to ensure repayment.

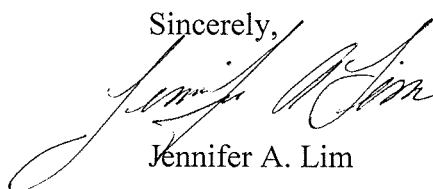
Chairperson Whalen  
Mr. Anthony Ching  
June 15, 2015  
Page 8

in perpetuity as required by the Fund, HCDA must take action prior to June 30, 2015,<sup>6</sup> to approve imposing an affordability covenant on HCDA's property. Formal action taken by HCDA will demonstrate to the C&C that HCDA will later execute a perpetual covenant, similar to the covenants that will be recorded against the property in connection with the low income housing tax credits that have been awarded by Hawaii Housing Finance and Development Corporation. HCDA is not required to execute a covenant in order for the C&C to deem the Fund monies "encumbered" but the covenant must be executed prior to any funds being released to the LLLP for the construction of the Lofts Project.

#### E. CONCLUSION

Artspace Projects, Inc. and Ola Ka 'Ilima Lofts, LLLP, respectfully request that HCDA take action to approve the placement of a perpetual affordability covenant against the fee simple interest of the property owned by HCDA at 1025 Waimanu Street. The Affordable Housing Funds appropriated by the City & County of Honolulu are critical to the advancement of the Ola Ka 'Ilima Artspace Lofts project, and at least some portion of those funds are about to lapse as of June 30, 2015, if HCDA does not act. HCDA, by extending the affordability commitments that Artspace is willing to make, such that the affordability commitments run beyond the term of the 65-year ground lease, and agreeing to encumber its fee simple interest in the land, will guarantee that the Lofts Project and this property remain affordable in perpetuity. Such a commitment from HCDA meets HCDA's objective to create permanently affordable housing within the Kakaako area.

We look forward to the opportunity to present this matter to the Authority at the meeting scheduled for June 24, 2015.

Sincerely,  
  
Jennifer A. Lim

JAB/jah

cc: Roy K. Amemiya, Jr., Managing Director  
Gary Nakata, Department of Community Services  
Greg Handberg, Artspace Projects, Inc./Ola Ka 'Ilima Lofts, LLLP

4824-8671-1844.2.067106-00001

---

<sup>6</sup> The Project has received various budget allocations from the AHF. The initial allocation of \$1.1M will lapse on June 30, 2015 if the funds are not encumbered, i.e., if there is not a formal action taken by HCDA to approve placing a perpetual covenant on the property to maintain affordability.