



Affordable Housing Covenants: Ensuring Continued Affordability

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INTRODUCTION

Developers who provide even small amounts of affordable housing (as little as five percent for a density bonus project, or 10 percent for an SB 35 project) may be entitled to numerous regulatory incentives through density bonus law (Gov't Code § 65915¹), so-called “streamlined” SB 35 review (§ 65913.4), and “by right” approval (§ 65583.2(h), (i)). In addition, many cities have their own inclusionary ordinances that require various percentages of affordable housing at various income levels, and the replacement housing provisions of the Housing Crisis Act have their own requirements (§ 66300(d)). Finally, cities often provide loans and grants for affordable housing projects, and affordable projects typically have numerous funding sources.

Each of these programs has its own requirements for level of affordability (typically very low, low, or moderate income) and for how rents and sales prices are calculated. Often the same affordable unit will be used to satisfy the requirements of more than one program (one unit could theoretically satisfy all of the programs listed above). Cities also need to ensure that the affordable units are actually constructed and that they remain affordable and occupied by eligible households at affordable rents and sales prices over the long term.

State law (§ 27281.5) requires that cities record a covenant if they impose a restriction that restricts the ability of the owner to convey the property. Since affordability requirements restrict the ability of owners to convey the property, they must be enforced through a recorded restriction.²

This paper attempts to provide a reference guide for city attorneys who are tasked with drafting or reviewing these covenants. The discussion is divided as follows:

- **Affordability Requirements of State Land Use Programs**, containing an outline of the affordability requirements of various affordable housing programs enforced by cities, primarily in the land use context. It does not include the requirements of state and federal funding programs, nor of low income housing tax credits.
- **Common Issues that Arise in Drafting Covenants**, including Article 34 of the State Constitution, prevailing wages, and the fair housing issues that arise with local preferences.
- **Checklist of Key Provisions to Include in Recorded Covenants**, and a discussion of the documents needed for each type of affordable housing.
- **Summary of Best Practices.**

Despite the importance the state has given to resolving homelessness and lowering housing costs, there is little uniformity in the state's incentive programs, creating significant difficulties in implementation. Our purpose here is to provide city attorneys and city staff tasked with implementing

¹ All future references are to the Government Code unless otherwise stated.

² If the affordability requirement is tied to a land use approval, it can also be argued that the condition is enforceable notwithstanding a failure to record the restriction, but that would open the restriction to challenge, particularly by a subsequent buyer.

housing policies and programs with some guidance when negotiating with applicants and trying to resolve the issues they may encounter.

1. REQUIREMENTS OF SPECIFIC AFFORDABLE HOUSING PROGRAMS

Table 1 beginning on the next page summarizes the affordability requirements for four state programs:

- **State density bonus law** (§§ 65915 et seq.) which grants density increases, parking reductions, “concessions,” and waivers of development standards in exchange for various amounts of affordable housing.
- **SB 35** (§ 65913.4) which provides streamlined review exempt from the California Environmental Quality Act (CEQA) for projects that meet certain standards, including the inclusion of affordable housing.
- **‘By right’ zoning for housing element sites** (§ 65583.2(h), (i)), which provides rental housing with 20 percent lower income housing with an exemption from CEQA and a requirement that local review be limited to review for compliance with objective design review standards.
- **Affordable housing provisions in the Housing Accountability Act** (§ 65589.5), which provides that cities must make additional findings to deny or make infeasible a project for very low, low, or moderate-income households.

Table 1 also lists typical provisions in local inclusionary ordinances, but these vary widely by city. A city wanting to use this table should enter its local provisions in the last column.

To comply with state law, each covenant needs to include:

- The required number of affordable units;
- The required income level of those units (usually very low, low, or moderate);
- How qualifying income is calculated;
- How affordable rents or sales prices are calculated; and
- The term during which the unit must be affordable.

As can be seen in Table 1, these provisions vary from program to program and are not uniform; in some cases, key provisions are not defined (such as “20% lower income” for by-right approval). The general rule is that if an affordable unit is intended to meet the requirements of more than one program (say, a unit that meets a city’s inclusionary requirements and qualifies the project for both a density bonus and SB 35 processing), it must meet the most restrictive of the three requirements. If density bonus law and SB 35 require 55-year affordability, but the local inclusionary ordinance requires affordability in perpetuity, the unit must provide affordability in perpetuity to meet all three requirements.

Table 1: Summary of Program Requirements for Affordable Units

	Density Bonus § 65915	SB 35 § 65913.4	‘By Right’ Zoning § 65583.2(h), (i)³	HAA Affordable Housing Provisions §65589.5(h)(3)	Inclusionary (Local municipal code)
Affordability Requirement	Minimum 5% very low, 10% lower, 10% moderate; or senior housing (§ 65915(b))	10% or 50% lower ⁴ (§65913.4(a)(4)(B))	20% lower (§ 65583.2(h))	20% low or 100% moderate or middle income (§65589.5(h)(3))	Varies; typically 15 – 20%
How % Is Calculated	On base density only ⁵ (§ 65915(b), (o)(6))	Statute: on “total units” ((§65913.4(a)(4)(B)); HCD ⁶ Guidelines: on base density only (§ 402)	Not specified; HCD Site Inventory Guidebook says “total units” (page 38) ⁷	On “total units” (§65589.5(h)(3))	Commonly on base density only
Maximum Income for Household	HCD’s income table by household size for each income level (65915(b); Health & Safety Code §§ 50079.5, 50093, 50105; 25 CCR § 6932)	80% of median in HCD’s income table by household size (§65913.4(a)(4)(B); 25 CCR § 6932)	Not specified in statute; city could specify	HCD’s income table by household size for lower and moderate; 150% of median for middle income (§65589.5(h)(3)); HSC §§ 50079.5, 50093; §65008(c); 25 CCR § 6932	Often use either HCD or HUD income tables
Affordable Rent⁸	Very low: 1/12 of 30% of 50% of median Low: 1/12 of 30% of 60% of median ⁹ (§65915(c)(1)(B); HSC § 50053; 25 CCR § 6918)	1/12 of 30% of 60% of median (§65913.4(k)(2)(A); HSC § 50053; 25 CCR § 6918)	Not specified in statute; city could specify	Low: 1/12 of 30% of 60% of median Moderate: 1/12 of 30% of 100% of median Middle: not specified (§65589.5(h)(3); 25 CCR § 6918)	Often use either HCD or HUD rent calculations

³ ‘By right’ approval is also required for supportive housing (§§ 65650 et seq.) and low barrier navigation centers (§§ 65660 et seq.), meeting specific requirements contained in those Government Code sections.

⁴ In the Bay Area, 20% moderate can substitute for 10% lower. See § 65913.4(a)(4)(B)(i).

⁵Base density’ means density without a density bonus.

⁶ California Department of Housing and Community Development.

⁷ The statements on this page in the Guidebook are inconsistent with HCD’s SB 35 Guidelines.

⁸ All rents and affordable sales prices are adjusted for assumed household size: 1 person in a studio, 2 persons in a one-bedroom, 3 persons in a two-bedroom, etc.

⁹ Complicated provisions apply to a 100% affordable project (§ 65915(b)(1)(G), (c)(1)(B)(ii).) In particular, rents for 80% of the units may be set at those established for tax-credit projects. Moderate-income rental units are not eligible for a density bonus.

	Density Bonus § 65915	SB 35 § 65913.4	‘By Right’ Zoning under Housing Element § 65583.2(h), (i)	HAA Affordable Housing Provisions §65589.5(h)(3)	Inclusionary (Local municipal code)
Affordable Sales Price¹⁰	Very low: 1/12 of 30% of 50% of median Low: 1/12 of 30% of 70% of median Moderate: 1/12 of 35% of 110% of median (§65915(c)(20(A)(i); HSC § 50052.5; 25 CCR § 6920)	1/12 of 30% of 70% of median (§65913.4(k)(1); HSC § 50052.5; 25 CCR § 6920)	To be eligible for ‘by right’ approval, subdivision cannot be required; only rental housing qualifies (§ 65583.2(i))	Low: 1/12 of 30% of 60% of median Moderate: 1/12 of 30% of 100% of median Middle: not specified (§65589.5(h)(3); 25 CCR § 6920)	Often use either HCD or HUD price calculations
Term of Rental Restrictions	55 years (§ 65915(c)(1)(A))	55 years (§65913.4(a)(3)(A))	Not specified in statute; city could specify	Not specified	Typically 55 years or perpetuity
Term of Ownership Restrictions	Equity-sharing at first sale unless local ordinance requires longer term (§ 65915(c)(2)(C))	45 years (§65913.4(a)(3)(A))	Not specified in statute; city could specify	Not specified	Typically 45 years or perpetuity
Prevailing Wages¹¹	Not required	Required; “skilled and trained workforce” may also be required (§ 65913.4(a)(8))	Not required	Not required	Not required
CEQA	May be required	Exempt as a ministerial project	Exempt (§ 65583.2(i))	May be required	May be required

a. Oddities in Calculation of Incomes, Rents, and Sales Prices.

The statutes define very low income households as those whose incomes are 50% or less of median income (Health & Safety Code § 50105); low income households as those whose incomes are between 50% and 80% of median income (Health & Safety Code § 50079.5)¹²; and moderate income households as those whose incomes are between 80% and 120% of median income (Health & Safety Code § 50093). But, HCD adjusts these numbers for a variety of factors.¹³ In high-cost areas, HCD’s tables used to determine income limits can show very low and low incomes far exceeding 50% and 80% of median income. For instance, in Table 2 showing HCD income limits in Los Angeles County, “low” income limits are 105% of median income, not 80%, and very low incomes are 65% of median

¹⁰ Affordable sales price is calculated after determining a reasonable down payment, with monthly costs, including mortgage, property taxes, homeowners association fees, mortgage and homeowners insurance, and reasonable allowances for utilities and maintenance not exceeding the maximum percentages. 25 CCR § 6920.

¹¹ Prevailing wages may be required under any of these programs if public funding or fee waivers are provided.

¹² “Lower” income households include both low income and very low income households. (Health & Safety Code §50079.5.)

¹³ An explanation is available at: <http://www.hcd.ca.gov/grants-funding/income-limits/state-and-federal-income-limits.shtml>

income, not 50%. Conversely, in other areas, HCD’s adjustments result in low income limits being *less* than 80% of median –only 71% of median in Shasta County, and 76% of median in Alameda and Contra Costa Counties.

Table 2: Los Angeles County 2022 Income Limits¹⁴				
	Household Size			
	1	2	3	4
Very Low	\$41,700	\$47,650	\$53,600	\$59,550
Low	\$66,750	\$76,250	\$85,800	\$95,300
Median	\$63,750	\$72,900	\$82,000	\$91,100
Moderate	\$76,500	\$87,450	\$98,350	\$109,300

The income limits in Table 2 would apply to a density bonus project, but not to an SB 35 project. For an SB 35 project, maximum incomes for the affordable units are, in fact, limited to 80% of median. So, a family of four in Los Angeles County could have an income as high as \$95,300 to qualify for a low-income unit in a density bonus project, but its income would be limited to 80% of \$91,100, or \$72,880, to live in a low income unit in an SB 35 project. In both cases, however, the rents would be limited to 1/12 of 30% of 60% of median income, or \$1,366/month, including utilities.¹⁵

Given these varying provisions, cities need to be aware of the distinct requirements for determining maximum incomes, rents, and sales prices attached to each program and draft accordingly.

b. Recommendations for Implementing Ordinances

Draft a Density Bonus Ordinance to Ensure Long-Term Affordability. If for-sale units are used to qualify a project for a density bonus, the statute requires only that there must be an equity share agreement in place. Although the unit is initially sold at an affordable price, when the unit is sold for the first time, it may be sold at market rate in the future. The seller retains the value of any improvements made to the property, the initial down payment, and a “proportionate” share of appreciation; the city retains only its initial subsidy and a proportionate share of appreciation, which it must then expend within five years. (§ 65915(c)(2)(C).)

The city’s share of the proceeds is rarely adequate for it to purchase another home at the same income level, and so the unit is lost at the first resale. However, the statute allows the city to impose long-term affordability restrictions if an equity-sharing agreement is in conflict with a “law” or public funding. (§ 65915(c)(2)(C).) Cities desiring to require long-term affordability of these for-sale units should include this requirement in their density bonus ordinances, so that they are not required to use an equity-sharing agreement. Providing funds such as down payment assistance would also allow a city to require long-term affordability, but nothing would require the homebuyer to take advantage of such a program.

¹⁴ 25 CCR § 6932.

¹⁵ Health & Safety Code § 50053 allows landlords to charge tenants whose income exceeds 60% of median 30% of actual income. However, this requires frequent adjustments as tenant incomes change and is difficult to monitor, so most agencies simply set the rents at 1/12 of 30% of 60% of median.

Define ‘Lower Income Units’ in a ‘By Right’ Approval Ordinance. To implement their housing elements, many cities are required to rezone sites to allow ‘by right’ approvals. Cities must zone for ‘by right’ when they wish to designate a site for lower income housing that was designated for housing in a previous element or elements (§ 65583.2(c)); or, under an HCD interpretation, if zoning needed for sites designated for lower income housing is adopted after the housing element due date. If a site is zoned to permit ‘by right’ development, a project with 20 percent lower income housing and no subdivision is exempt from review under the California Environmental Quality Act (CEQA) and may only be subject to design review based on objective standards.

As shown in Table 1, the housing element statute contains no standards for how income limits, rents, or sales prices are to be calculated, nor for the required length of affordability. Cities that must amend their zoning ordinances to allow ‘by right’ approvals may wish to specify those requirements, perhaps using density bonus law as a model. That will enable the city to specify the rents, sales prices, and length of affordability in the agreement to be recorded against the property.

Use State Law Definitions in Local Inclusionary Housing Ordinances. A city can establish its own policies for income levels, affordable rents and sales prices, and length of affordability in its local inclusionary ordinance and program guidelines. Local policies most frequently determine the percentage of affordable units required, the level of affordability (percentage of very low, low, and moderate-income units) and the term of affordability (often increased to 99 years or perpetuity). However, it is much easier to draft agreements and administer the affordable units if tenant qualifications and calculations of rent and affordable home prices are consistent with the calculations used in density bonus law, especially as more and more developers use inclusionary units to qualify for the many benefits available under state density bonus law.

2. COMMON LEGAL ISSUES THAT ARISE IN DRAFTING COVENANTS

This section provides an overview of legal issues that we have frequently encountered in drafting covenants and that need to be considered by practitioners as they are requested to draft affordable housing covenants.

a. Local Preferences and Fair Housing Laws

Preferences for local residents or those who work in the community are commonly included in city regulatory agreements. However, prioritizing residents for housing opportunities over non-residents provides a housing benefit to one subset of the market (residents and local workers) to the detriment of another subset of the market (non-residents and other workers). If the preference exacerbates patterns of residential segregation or creates a disparate impact on a protected class, it may have a discriminatory effect in violation of fair housing laws and may conflict with the duty of cities to affirmatively further fair housing.

The California Fair Employment and Housing Act (FEHA), a city’s obligation to affirmatively further fair housing (AFFH), and Government Code Section 65008 all contain provisions that may affect a city’s ability to adopt local preferences.

FEHA. FEHA is the California equivalent of the federal Fair Housing Act (FHA). FEHA expands the scope of “protected classes” beyond the classes addressed under the FHA. Under FEHA, protected classes include race, color, religion, sex, gender, gender identity, gender expression, sexual

orientation, marital status, national origin, ancestry, familial status, source of income, disability, veteran or military status, and genetic information.

If a neutral policy has a discriminatory effect against a protected class, it is said to have a "disparate impact." A policy creating a disparate impact is prohibited under FEHA regardless of an agency's intent unless the city can demonstrate that there is a legally sufficient justification for the local preference. Under regulations adopted in the past few years by the state's Fair Employment and Housing Council, to demonstrate a "legally sufficient justification," the city must present evidence to establish a) that the policy was necessary to achieve one or more substantial, legitimate, nondiscriminatory purposes; b) the policy carried out the identified purpose; c) the identified purpose was sufficiently compelling to override the discriminatory effect; and d) there is no feasible, less discriminatory alternative that would equally or better accomplish the identified purpose.¹⁶ Being required to prove that there is no feasible, less discriminatory alternative that would equally or better accomplish the identified purpose creates a barrier very difficult to overcome if there is evidence of a disparate impact due to a local preference.

AFFH. "Affirmatively furthering fair housing means taking meaningful actions, in addition to combatting discrimination, that overcome patterns of segregation and foster inclusive communities free from barriers that restrict access to opportunity based on protected characteristics."¹⁷ Government Code section 8899.50 imposes the requirement to affirmatively further fair housing on cities when administering programs and activities related to housing and community development. Housing element law similarly imposes that requirement on local housing elements, and HCD has questioned local preferences in its review of housing elements.¹⁸ At a minimum, the AFFH obligation requires a city contemplating a local preference to consider whether it will create barriers to replacing segregated living patterns with integrated living patterns or barriers to transforming concentrated areas of poverty into areas of opportunity.

Government Code Section 65008. Section 65008 requires that cities not discriminate against the protected classes listed in FEHA in implementing planning and zoning laws. It adds to the list of protected classes a prohibition against discrimination based on "lawful occupation," which could make questionable any planning condition giving preference to certain occupational groups such as teachers and first responders.¹⁹ However, it allows favorable treatment of farmworker housing, emergency shelters, and affordable housing.²⁰

Ensuring Compliance with Fair Housing Laws. Local preferences are not inherently discriminatory, but a city must tailor the policy to minimize discriminatory effects. If desiring to adopt a local preference (most typically a preference for those who either live or work in the community), a city must first identify a substantial and legitimate goal. Examples include providing affordable housing opportunities near places of employment to reduce road congestion and vehicles miles traveled; preventing displacement of local residents; reducing overcrowding in existing units; housing the local unhoused population; or implementing goals contained in the housing element.

¹⁶ 2 CCR § 12062.

¹⁷ 24 CFR § 5.152; Cal. Gov. Code § 8899.50(a)(1).

¹⁸ Government Code § 65583.

¹⁹ Government Code §§ 65008(a)(1)(A), (d)(2).

²⁰ Government Code § 65008(e)(2).

The policy is best structured to reduce the risk of a disparate impact. The larger the geographic area, the less likely the disparate impact. At a minimum, a preference should cover the entire city.²¹ An even broader preference area, such as the entire county or entire market area, would further reduce the risk of a disparate impact. Another way to reduce the risk of the preference is to apply the preference to only some of the affordable units, perhaps for a limited period of time. A durational requirement (a requirement that an applicant live or work for a specified period of time in the city) should not be an element of the preference; a durational requirement could be subject to challenge under the Equal Protection Clause and the Privileges and Immunities Clause with regards to the fundamental right to travel.²²

Finally, there may be requirements imposed by project funders that conflict with local preferences. Language should be included in the regulatory agreement stating that the local preferences will be imposed to the extent that they are not in conflict with fair housing laws.

b. Article 34 of the California Constitution.

Adopted in 1950, in opposition to the creation of public housing, Article XXXIV, § 1 of the California Constitution (Article 34) provides in part:

No low rent housing project shall hereafter be developed, constructed, or acquired in any manner by any state public body [including cities] until, a majority of the qualified electors of the city, town or county, as the case may be, in which it is proposed to develop, construct, or acquire the same, voting upon such issue, approve such project by voting in favor thereof at an election to be held for that purpose, or at any general or special election.

As interpreted by the Legislature, Article 34 generally does not allow cities to restrict more than 49% of units in a project to lower income households without a public vote. So long as a city is restricting fewer than 49% of the units to lower income households, it does not need to consider Article 34 when drafting regulatory agreements.

There are two elements in determining whether a city's covenant makes the project subject to Article 34: first, whether the project is a "low rent housing project;" and, second, whether the city is "developing, constructing, or acquiring" the project. Unless both of those elements are met, the city's actions will not trigger Article 34.

What Is and Is Not "Low Rent Housing." Article 34 defines "low rent housing project" as:

any development composed of urban or rural dwellings, apartments or other living accommodations for persons of low income, financed in whole or in part by the Federal Government or a state public body or to which the Federal Government or a

²¹ UMR § 8305. HCD also allows a preference for areas as small as neighborhoods when targeting residents who have been or are at risk of displacement so long as the preference also complies with fair housing laws.

²² See *Saenz v. Roe* (1999) 526 U.S. 489 which discusses "the right of the newly arrived citizen to the same privileges and immunities enjoyed by other citizens of the same State."

state public body extends assistance by supplying all or part of the labor, by guaranteeing the payment of liens, or otherwise.²³

However, not all affordable housing projects are considered "low rent housing projects." Statutory and case law identifies types of affordable housing development that will not be characterized as a "low rent housing project," and thus will not require Article 34 voter authorization. For example, to clarify the requirements of Article 34, the Legislature has enacted the Public Housing Election Implementation Law (Health & Safety Code § 37000 et seq.). This law specifically defines the term "low rent housing project" to exempt several types of developments from the requirement for voter approval, including particular projects developed by a privately owned entity (including private nonprofit entity) receiving no ad valorem property tax exemption (other than under Rev & Tax Code Section 214(g)) and in which not more than 49% of the units are designated for occupancy by lower income households; ownership housing; and replacement of housing occupied by lower income households.²⁴

What Is and What Is Not "To Develop, Construct, or Acquire." Even if a project is a low rent housing project, it will not be subject to Article 34 unless the city's involvement extends beyond that of a regulator or lender and into the realm of a developer.

Health and Safety Code section 37001.5 provides what city activities fall outside of the scope of "developed, constructed, or acquired." For example, a city providing assistance to a low rent housing project and monitoring the project's compliance with the conditions of the assistance is not considered developing, constructing, or acquiring low rent housing projects if the city is: (a) carrying out routine governmental functions; (b) performing conventional activities of a lender; or (c) imposing constitutionally mandated or statutorily authorized conditions accepted by a grantee of assistance. Consequently, local enforcement of the affordability restrictions mandated by SB 35 and density bonus law do not trigger a need for Article 34 approval, even when they restrict more than 49% of the units.

It is also possible to enter into a loan agreement where the city funds a low rent housing project, so long as the city's actions do not exceed the conventional activities of a lender. Examples of conventional activities of a lender include conducting due diligence on the financial state of the borrower and securing the financing through a deed of trust. Activities that are helpful in ensuring affordability of the housing, such as regulating the marketing and tenant selection programs adopted by the borrower, are not conventional lender activities.²⁵ Thus, if a city elected to fund a low rent housing project and engage in activities that ensure the affordability of the units, it would need Article 34 authority.

Article 34 Election. The courts have upheld that an Article 34 election can authorize a certain number of units in a city without designating sites,²⁶ and that a countywide Article 34 election can be applicable

²³ California Constitution Article XXXIV, § 1.

²⁴ The California Supreme Court upheld the Legislature's general authority to adopt definitions applicable under Article 34 in *California Housing Finance Agency v. Patitucci* (1978) 22 Cal. 3d 171.

²⁵ See *Id.* at 590 "The Agency's duties and interests as financier, while extending perhaps to the construction of safe housing developments [] may not reasonably be said to encompass its extensive additional supervisory and regulatory responsibilities. They do not extend, for example, to insuring that tenants are sufficiently needy to qualify for the program, that undue concentration of racial or economic groups are avoided, or that certain eviction or grievance procedures are followed."

²⁶ *Davis v. City of Berkeley* (1990) 51 Cal. 3d 227.

to all cities in the county.²⁷ Regardless of whether the project has units that were authorized by an Article 34 election or if the project is exempt from the requirements of Article 34, if the project receives certain state funds, HCD will require a letter from the developer's counsel on whether the project complies with Article 34.²⁸ If a city has Article 34 authority, the city may be asked to confirm the Article 34 authority and the city should monitor the number of units applied towards the Article 34 authority. Note that there is a relatively short 60-day limitations period to challenge an action based on a violation of Article 34.²⁹

c. Prevailing Wages

Affordable housing projects may be subject to prevailing wage. The triggers for prevailing wages are based on sources of funds and statutory requirements.

Federal. Certain federally assisted programs trigger federal prevailing wage requirements under the Davis-Bacon Act.³⁰ These funds may be provided to a city who, in turn, provide the funds to an affordable housing project. Thus, a city should analyze the applicability of Davis-Bacon, which differs with each federal program, when using federal funds.

California. The California Labor Code also imposes prevailing wage requirements on "public works" contracts, which includes "work done under contract and paid for in or in part out of public funds."³¹ This includes private residential and commercial projects that receive public funds. The development work done under contract and "paid for in whole or in part out of public funds" is broadly defined to include the following actions by the state or political subdivision (including cities): (a) the payment of money or equivalent of money; (b) performance of construction work; (c) transfer of an asset of value for less than fair market price; (d) reduction, waiver, forgiveness, or payment of fees, costs, rents, insurance/bond premiums, loans, interest rates, or other obligations that would normally be required in execution of the contract; (e) making of loans where repayment is contingent; or (f) crediting the income received from things such as sales tax generated by the development against the developer's repayment obligations.³²

Some projects are statutorily excluded from prevailing wage requirements. Examples of such exceptions are provided in Labor Code section 1720(c). On the other hand, there are some statutes that expressly impose prevailing wage requirements. For example, Government Code section 65913.4 (known as SB 35) provides opportunities for certain developments to apply for local review under a streamlined, ministerial process, but the development work performed for these projects is subject to prevailing wage.³³ Additionally, some local jurisdictions impose their own prevailing wages requirements when assisting a project which are not preempted by state prevailing wages law if assisting a housing project.³⁴

²⁷ *Housing Authority of Kings County v. Peden* (1963) 212 Cal.App.2d 276.

²⁸ HCD Legal Affairs Division, California Constitution Article XXXIV Guidance, November 3, 2004.

²⁹ Health and Safety Code § 36005.

³⁰ 40 U.S.C. 3141 et seq.

³¹ Labor Code § 1720.

³² Labor Code § 1720(b).

³³ Government Code § 65913.4(a)(8).

³⁴ Labor Code § 1720(h).

d. Rental of Affordable Units in a For-Sale Density Bonus Project.

State density bonus law provides that the city shall ensure that a for-sale affordable unit is offered at affordable cost and “is initially *occupied*” by an eligible household, subject to an equity sharing agreement (unless in conflict with a public funding source or law); or sold to a “qualified non-profit housing corporation” (generally modeled on Habitat for Humanity). (§ 65915(c)(2)A); emphasis added.) This language is ambiguous regarding whether units in a for-sale project must actually be sold to an eligible buyer (or eligible non-profit), or just *occupied* by an eligible household. In some cases, developers have sold the units to for-profit or non-profit organizations, which then rent the units to eligible households at affordable cost. Because developers have the option under density bonus law to offer the affordable units for either sale or rent, it appears consistent with the statute to do this so long as the rents are limited to those allowed by the statute, and the units remain affordable for the 55-year period applicable to rental units.

3. CHECKLISTS OF KEY PROVISIONS TO INCLUDE IN AFFORDABLE HOUSING COVENANTS

The way to ensure continued affordability discussed thus far, is through covenants recorded on the housing development's property. Typically, affordable housing covenants are recorded as follows:

- An initial master developer agreement, which may also be termed an affordable housing agreement, with the project developer specifying construction phasing and outlining the affordability requirements, marketing, and initial sale and rental of the units. This is recorded against the entire development to ensure that the affordable units will be built concurrently with the market-rate units and is released against the market-rate units as the affordable units are constructed, and the document is replaced by either the rent regulatory agreement or homebuyer documents.
- A rent regulatory agreement recorded against affordable rental units. For a single-phase rental project, only one agreement may be needed, combining the development provisions with the long-term operational provisions, rather than a master developer agreement followed by rent regulatory agreement.
- A suite of homebuyer documents, including a resale restriction recorded against affordable for-sale units at the time of sale.

This section provides a checklist of key terms to include in each of these agreements.

a. Master Developer Agreements.

Affordable units by themselves in a market-rate project likely lose money for the developer, and so the developer may have a powerful incentive to avoid building them. Cities need to use points of leverage in the development process—such as the ability to withhold issuance of a building permit or certificate of occupancy for noncompliance with project conditions of approval—to ensure that the affordable units are actually built as contemplated.

The affordable units are most likely to be built if the developer needs to do so in order to construct and occupy the market-rate units in the project. A typical concurrency condition requires that the affordable units be constructed and made ready for occupancy at the same rate as the market-rate units. If 10% of the units in the project are affordable, then a building permit must be issued for one affordable unit for every nine market-rate units. Similarly, an occupancy permit must be issued, or final inspection completed, for one affordable unit for every nine occupancy permits approved for market-rate units. If the affordable percentage is 15%, then the ratio would be approximately one in seven.

Cities should require applicants to propose a schedule for construction of the affordable units during project approval, and the agreed-upon schedule should be made a condition of approval and included in the master developer agreement. Conditions of approval frequently require that certain actions be taken before a building permit can be issued, and a condition requiring concurrent issuance of permits for market-rate and affordable units to meet requirements of state and local law should certainly be enforceable.

Agencies should also impose a condition of approval requiring that the master affordable housing agreement be recorded against the entire property – not just the affordable units -- before any final or parcel map can be recorded and before any building permit can be issued. Requiring recordation of the master agreement against all of the units ensures that future buyers are on notice of the phasing requirements and will be bound by them.

Master Developer Agreement Checklist
<ul style="list-style-type: none"> • Recitals regarding approvals and legal bases for the affordability requirements • Legal description of the entire property • Development schedule in relation to the affordable and market-rate units; implementation of concurrency requirements • Type and location of affordable units (single family, condominium, townhouse, apartments, etc.)³⁵ • Number of bedrooms and square footage • Affordable unit design and appearance • Level of affordability and length of affordability • [If ownership] Provisions for recording restrictions against individual units as the affordable units are sold and resold in the future • [If rental] Provisions for recording rent regulatory agreement (may be combined with master agreement if one phase) • Procedures for setting initial affordable sales prices or rents

³⁵ The Legislature in 2021 enacted Health & Safety Code § 17929, requiring that in mixed-income buildings the occupants of the affordable housing units shall have the same access to the common entrances and to the common areas and amenities of the project as the occupants of the market rate units. The affordable housing units may not be isolated to a specific floor or to an area on a specific floor.

Master Developer Agreement Checklist

- Procedures for city approval of marketing plan
- [If ownership] Procedures for selecting initial buyers and verifying incomes
- If applicable, procedures for payment of in-lieu fees, dedication of land, or contribution to off-site construction of affordable units
- Provisions for minor and substantive amendments
- Remedies in the event of default
- Mechanism for terminating the master developer agreement once homebuyer restrictions are recorded, or rent regulatory agreement is recorded

The specific terms will depend on the source of the affordability restrictions, the design and phasing of the project, and local administrative practices.

b. Rent Regulatory Agreements.

A rent regulatory agreement is recorded against the property for the term of the affordability restrictions and includes long-term affordability, monitoring, and maintenance requirements. If the proposed project is a single phase multifamily rental project, the master developer agreement and the rent regulatory agreement can be one document that includes both the construction requirements and the long-term affordability requirements.

Some of the key provisions included in a rent regulatory agreement are the following:

Determination of Tenant Eligibility. The regulatory agreement will specify tenant eligibility and who will determine that a household is eligible to occupy a unit. Tenants need to be income-certified annually. For market-rate projects with a small percentage of affordable units, it is usually preferable for the city or its designee to determine income eligibility and then provide the names of eligible applicants to the property owner, but in some communities, the property manager makes that determination. Affordable housing projects typically have management staff that is experienced in determining tenant incomes and eligibility for an array of funders, and will select eligible tenants themselves.

Treatment of Over-Income Tenants. The income of a tenant may increase so that the tenant is no longer eligible to live in that unit. Cities' policies vary widely, from providing 90 days notice to vacate to allowing the tenant to remain with no rent increase. A common option is to increase the rent to 30% of the tenant's income until the tenant's income exceeds moderate income, at which time the tenant must either vacate the unit, or, if a replacement affordable unit can be found, pay market rent. Addressing over-income tenants is a policy decision for the city, potentially with input from the project developer. When a project is entirely affordable, some of the funding sources may prescribe how over-income tenants must be treated.

Rent. The agreement must describe how rents will be determined and how rent increases will be approved. In some agreements, cities will notify the developer of increased permitted rents when income limits are published by HCD; in other cases, the developer seeks approval from the city. Cities

often do not monitor rents, and when this occurs, it is not uncommon to find that building owners are calculating rent improperly.

Record Keeping. Regulatory agreements include requirements for record keeping to verify that the tenants occupying the affordable units are eligible and that appropriate rents are charged.

Potential Conversion to Ownership Units. Owners of condominium projects may decide to rent the units rather than sell them but retain the ability to sell the units if the market is favorable. In that case, the agreement should include provisions for notification to the city and affected tenants, tenant relocation benefits, right of first refusal, compliance with the Subdivision Map Act, and requirements for buyers of the affordable units (discussed below). If the developer received density bonus incentives or other benefits based on a certain level of affordability, the same level of affordability must be maintained in the for-sale affordable units.

Subordination of Regulatory Agreements. Project funding sources may request that a city subordinate its regulatory agreements to other loans; HCD demands this in many cases in exchange for its funds. Typically, it is expected that cities will subordinate their regulatory agreements associated with city loans. However, where the regulatory agreement is based on the housing development project having utilized density bonus, SB 35 approval, ‘by right’ approval, or compliance with an inclusionary zoning ordinance, the regulatory agreement is based on a land use approval, which must remain in effect for the term. To ensure these restrictions remain, cities should not agree to subordinate these agreements. If the city is restricting affordable units under both land use mechanisms and because it is providing funding, it is a good practice to provide separate regulatory agreements for land use requirements and financing requirements to facilitate subordination of the loan agreements, if requested and the city desires to do so. Issues regarding subordination of documents are a chief source of dispute and negotiation when an affordable housing development is approved.

Rent Regulatory Agreement Checklist
<ul style="list-style-type: none">• Recitals regarding approvals and legal bases for the affordability requirements• Legal description of the entire property• Location of the affordable units³⁶• Number of bedrooms and square footage• Level of affordability and duration of affordability• Calculation of affordable rents and mechanisms for city approval of annual rent increases• Determination of tenant eligibility and annual certification of incomes• Policies for over-income tenants• Procedures for marketing of vacant units• Required lease terms• Property management and maintenance

³⁶ See previous note regarding requirements of Health & Safety Code § 17929.

Rent Regulatory Agreement Checklist

- Required record-keeping
- If building is a condominium: provisions for conversion to ownership and tenant relocation and other benefits
- Term and requirements for tenant notification when term expires
- Provisions for minor and substantive amendments
- Remedies in the event of default

The specific terms will depend on the source of the affordability restrictions and local administrative practices.

c. Affordable Ownership Restrictions

During the Great Recession, many affordable ownership units were lost. Some homes were lost because, for a time, title companies seemed to ignore documents recorded on title except deeds of trust. In other cases, affordability restrictions were attached to grant deeds and so did not show up in title reports because they were not recorded separately.

To prevent these problems, cities would best prepare these five documents to ensure that their controls on ownership units are enforced³⁷:

1. Resale Restriction and Option to Purchase Agreement (recorded)
2. Promissory Note (not recorded)
3. Deed of Trust (recorded)
4. Request for Notice of Default or Sale (recorded)
5. Disclosure to Buyers (not recorded).

Resale Restriction and Option to Purchase Agreement. The resale restriction and option to purchase agreement is the key document in a homebuyer's purchase of an affordable home. It allows the city to purchase the affordable home when the owner is ready to sell it, explains how to calculate the restricted resale price, and also includes all of the substantive provisions to be applied to the property as a condition of any governmental subsidy or purchase at below fair-market value. Usually the city can assign its option to purchase to another income-eligible homebuyer or nonprofit organization that provides affordable housing, so that the city never actually takes title to the home.

The city can also exercise its option to purchase if there is a default by the homeowner or foreclosure is threatened, which is not necessarily the case if the city has only a right of first refusal. This allows both the homeowner and the city to avoid foreclosure proceedings and can force a sale where the

³⁷ In 2006 we collaborated with the Institute for Local Government to prepare a paper on 'Ensuring Continued Affordability in Homeownership Programs.' Most of that material is still relevant today. It can be obtained at: <https://goldfarbblipman.com/ensuring-continued-affordability-in-homeownership-programs/>

homeowner is not complying with the terms of the resale restriction (such as the owner-occupancy requirement). However, it does require that the city have funds available to be used to purchase a home in the event that foreclosure is threatened.

As an alternative to a resale restriction, some cities prefer to capture an equity share when the unit is sold at fair market value. However, it is rare that the city's share enables it to purchase another affordable unit at the same affordability level.

CHECKLIST OF TERMS TO BE INCLUDED IN THE OPTION TO PURCHASE AND REALE RESTRICTION AGREEMENT	
<p>When the Resale Price Is Restricted</p> <ol style="list-style-type: none"> 1. Required length of affordability and affordability level (very low, low, or moderate-income) 2. Means of calculating the resale price 3. Entity (usually the public agency) entitled to the difference between the sales price and the restricted resale price if a qualified buyer cannot be found 	<ol style="list-style-type: none"> 5. Requirements for owner-occupancy and annual certification 6. Procedures for property transfer. Usually, the agency has an option to purchase at an agreed-upon price within a set period of time when the owner decides to sell. Depending on the terms of the agreement, this may be at either the restricted resale price or at fair market value. 7. Treatment of involuntary sale or transfer: inheritance, divorce, etc.
<p>When the Resale Price Is Not Restricted:</p> <ol style="list-style-type: none"> 1. Provisions for repayment of the initial subsidy (or for rolling over the subsidy to a new buyer at resale) 2. Provisions for sharing of equity or appreciation 3. Term (in years) of the required repayment 	<ol style="list-style-type: none"> 8. Addition of parties to title by marriage or domestic partnership 9. Requirements for hazard insurance and payment of property taxes 10. Provisions refinancing, and home equity loans 11. Buyer's consent to the option to purchase
<p>For All Agreements</p> <ol style="list-style-type: none"> 1. Protections for buyer if price of home declines (often included because homebuyer's potential for appreciation is limited)³⁸ 2. Treatment of capital improvements at resale 3. Treatment of deferred maintenance at resale 4. Provisions for repayment of any secondary financing benefiting a public agency 	<ol style="list-style-type: none"> 12. Default events that trigger the Option to Purchase or foreclosure. These typically include a lender's declaration of default, the owner's failure to occupy the home as its principal residence, failure to pay property taxes, and a sale or transfer in violation of the restrictions.

Promissory Note and Deed of Trust. Cities should require promissory notes and deeds of trust even when the city has not provided financial assistance to the homebuyer, to secure an equity share, to ensure that the city receives any excess proceeds if the home is sold above the affordable price, or simply to ensure performance under the resale agreement and option to purchase. The promissory

³⁸ FHA requires that the homeowner be allowed to recover at least the original purchase price, real estate commission, and cost of capital improvements.

note specifies the required performance or loan. The note is not recorded on title to the property. The deed of trust secures the note and is recorded.

Performance deeds of trust are authorized by California law.³⁹ The enforceability of a performance deed of trust in the context of a first-time homebuyer program was upheld by the Court of Appeal in 2005 in *Dieckmeyer v. Redevelopment Agency*.⁴⁰

Request for Notice of Default or Sale. A request for a notice of default or sale is a recorded document that requires notice be given whenever the holder of a deed of trust declares a default or when the property is sold due to a default. The benefit of this document is the city will be notified more quickly of a default than they will be under a deed of trust. This document should be recorded at the time of sale.

Disclosure to Homebuyer. Cities should prepare a separate disclosure that explains the terms of the resale restriction, promissory note, and deed of trust in plain language. Typically, the disclosure will include calculations showing the homebuyers how much equity they will receive in various situations and the resale price of their home given certain assumptions. The disclosure will also explain the other terms. The buyer acknowledges reading and understanding the documents by signing the disclosure. Many communities also require first-time homebuyers to participate in homeowner education programs that explain maintenance requirements, homeowner responsibilities, predatory lending, and other issues that homeowners may encounter.

d. City Financing and 100% Affordable Projects.

Cities may impose affordability restrictions by providing a loan or grant to an affordable housing project. If the funds come from the city's general fund or a city affordable housing fund, the city typically has great flexibility on how those funds are spent and what requirements are imposed in terms of tenant qualifications, affordable rent, duration of restrictions, and the like. If sources of funding such as Community Development Block Grants are used, those sources of funding will dictate the requirements to be included in the city's loan or grant documents.

Loans, Not Grants. Generally, it is advantageous for both the city and the developer to structure city assistance as a deferred or residual receipts loan, rather than as a grant. This is because the city has more leverage to enforce its long-term affordability and maintenance requirements if it is a project lender with a deed of trust securing its debt recorded against the project. If the project owner fails to comply with city regulatory requirements (rent or occupancy restrictions, for instance), the city can call a default under the loan documents, accelerate the debt, and proceed to foreclosure under the deed of trust. If the city provides a grant to the project, the city's only remedy or enforcement mechanism in the event of non-compliance with city requirements is to sue to enforce the developer's covenant or contractual agreement, which is a longer, more expensive, and legally riskier task than foreclosure.

³⁹ Civil Code section 2920(a) (a deed of trust is security "for the performance of an act."). The courts have upheld use of a deed of trust to secure the performance of a contract. *See Stub v. Belmont*, 20 Cal. 2d 208, 213-14 (1942).

⁴⁰ 127 Cal. App 4th 248 (2005).

A ground lease, where the city retains ownership of land and leases it to the developer for a 60- to 99-year term, with the developer building, owning, and operating the project on the leased land, is another popular tool to enhance long-term city control over a project.

Prevailing Wages. If the city provides the affordable housing project, for example, a grant, property (in the form of fee title or ground lease) below fair market price, fee waivers or reductions, or below market loans, prevailing wages may be triggered. From the developer's point of view, these transactions often can be structured in such a way to avoid prevailing wage requirements.

However, when a situation arises that triggers prevailing wages the city needs to require the developer (or the party the city is entering into an agreement with) to cause the work to be performed as a public work and, if required under law, to maintain bonds to secure the payment of contractors.⁴¹ Failure to include such statement in an agreement puts the city at risk of having to pay the contractor's increased costs that are a result of the prevailing wage requirements.⁴²

Demands of Funders. A 100% affordable project will most likely come with many different funding sources and utilize various land use tools to achieve their desired development (e.g. density bonus to receive waivers of development standards or SB 35 streamlined approvals), which will all come with their own affordability restrictions and requirements. Other sources of financing from other local public agencies, the state, the federal government, private banks, non-profit lenders, foundations, and the use of low income housing tax credits, will all affect the structure and content of the city's assistance documents, as well as the business terms of the city's assistance. Project sponsors typically turn to the city to modify its restrictions to be consistent with the other financing restrictions and requirements and to meet the demands of lenders. If the restriction is based on state statute or local ordinance, those requirements must remain. For other provisions, either standard loan agreements and policies, adopted underwriting criteria, or experienced consultants, should be used to avoid making unnecessary concessions.

e. Enforcement of Agreements

The provisions included in the agreements and documents described above are key to enforcement and ensuring continued affordability. At the development stage, a master or affordable housing agreement will ensure affordable units are built and, if they are not, a city can require those units be constructed before future building permits or occupancy certificates are issued. In rental regulatory agreement and homeowner resale restriction agreements, provisions to require record keeping and information be provided regularly to the city will assist in monitoring continued affordability. It will be important for city staff to insist the information (such as tenant income certification and homeowner certification of continued occupancy of a dwelling unit) is provided when specified in the agreement.

If a breach of an agreement discussed above is identified, the first step is to provide a notice of default and what is expected to cure the default. Many times the developer or property owner will come into compliance once notified. However, this is not always the case and additional measures may need to be taken to bring an enforcement suit to obtain specific performance under the agreement or other remedies identified. As discussed above, if the city is a lender to the affordable housing project, it

⁴¹ Labor Code § 1781(a)(2).

⁴² Labor Code § 1781(a)(1).

may accelerate the debt and proceed to foreclosure under the deed of trust. In a homeowner resale restriction agreement, the city may take advantage of the option to purchase upon default provision. If the city is the property owner and the project has a ground lease, termination of the lease is a potential remedy.

4. A SUMMARY OF BEST PRACTICES

Affordable housing covenants, at a minimum, must ensure that the units that provided developers with significant benefits, get constructed and continue to be operated in compliance with state and local law.

Some of the key provisions to include in those covenants are:

- Draft recitals that clearly lay out the legal bases for the covenants; understand the requirements of each program imposed on, or used by, the developer.
- Specify the required level of affordability, eligible tenants and buyers, calculations of affordable rents and sales prices, and the term of affordability.
- If adopting local preferences, design the policy to minimize potential disparate impact.
- Consider Article 34 if the occupancy of more than 49% of the units is restricted to lower income households.
- Record a master developer agreement for each project, and either a rent regulatory agreement or homebuyer documents, as applicable, when the units are built. Adopt conditions of approval to ensure that the affordable units are built concurrently with the market-rate units.
- Provide loans, not grants, to affordable housing developments; consider a ground lease, not sale of the fee, when making land available.

As the Legislature adopts more and more laws to incentivize the construction of affordable housing, and the development community becomes more familiar with those laws, even cities without inclusionary programs (and without programs to monitor affordable units or operate an affordable housing program) will be required to draft or review affordable housing covenants. This paper provides some key considerations for these documents to ensure that the housing remains affordable and available for their intended users.

5. CONCLUSION

California cities have been implementing affordable housing programs for many years. Lessons learned over the years lead to improved ordinances, agreements, and documents. There are two general scenarios where affordability must be incorporated into a housing development project: (1) due to land use requirements and opportunities, such as inclusionary zoning ordinances, density bonuses, and streamlined ministerial approval processes; and (2) when the city provides funding to the project. Key to ensuring continued affordability in both these scenarios are the covenants recorded on the properties that create a mechanism to ensure affordability and remedies when the negotiated affordability is not adequately provided. Those covenants come both at the development stage and after occupancy is achieved. The agreements used, which vary based on the whether a project is rental or for sale, lay out the expectations of the city on affordability requirements, rent or ownership costs, and duration of affordability. With these expectations laid out clearly, the agreements can be enforced to ensure the affordability continues for both current and future tenants and homeowners.