Affordable Housing: What City Attorneys (and Cities) Need to Know

Introduction

The landscape of affordable housing development is everchanging. Cities will be involved through their land use approval process, providing financing to affordable housing projects, supplying land for the project, and receipt of public input.

This paper will touch on considerations when the city is the lender, timelines to be aware of when permitting a housing development project, and how cities can be proactive with respect to affordable housing. In an environment where the State has enacted laws that remove local discretion in the approval of housing, particularly affordable housing, cities still have room to innovate and take charge of affordable housing in their communities.

Financing and Timelines

It is difficult to pay for affordable housing. The construction of affordable housing is certainly not cheaper than market-rate housing. In fact, with the need for several "layers" of financing and potential prevailing wage requirements, it may be *more expensive* to build affordable housing rather than market-rate housing. Yet affordable housing cannot rely on market-rate pricing or rents.

The end of redevelopment agencies in 2011 created a significant challenge to affordable housing in California. While the history of redevelopment agencies deserves criticism, no other State funding is set aside exclusively for affordable housing. Notably, since 2000, redevelopment agencies annually funded approximately 300 units of affordable housing in Los Angeles and 370 units in San José.[1] Despite these successes, no State-level set-aside for affordable housing is on the horizon.

Low-Income Housing Tax Credits (LIHTCs) are the most common source of financing for affordable housing. Created by Congress in 1986, LIHTCs are tradeable credits that offset potential income tax liability, once affordable housing projects are completed. Under federal law, each State receives a separate allotment of LIHTCs that they may distribute. Per this system, affordable housing developers apply for LIHTCs from the State (the California Tax Credit Allocation Committee, within the State Treasurer's Office). Because of the tax benefits that they offer, LIHTCs can be sold by affordable housing developers on the open market to investors, thus providing initial capital and funding for an affordable

[1] Redevelopment Agencies in California: History, Benefits, Excesses, and Closure

housing project. But note that there is competition for LIHTCs allocations from the state, with the number of applicants regularly exceeding supply.[2]

While LIHTCs are often employed for affordable housing projects, they are rarely the only source of funding for projects. Thus, it is often necessary to "layer" or "stack" financing for projects, using a combination of local, State, and federal funding. A 2021 study conducted by the Terner Center found that affordable housing developers layered an average of 3.5 permanent sources to finance developments built between 2000 and 2018. One in four layered at least five – and in some cases as many as eleven – sources of financing, and over time, the number of financing sources has only increased.[3]

The assembly of financing can be complex and time-consuming, taking up to 2-4 years. Potential financing from a variety of sources often has different application timelines and cycles. Funding sources often include: private financing in the form of conventional "hard" debt; public agency financing such as federal, state, and local funds often in the form of "soft" debt; equity tax credit investment; bonds; deferred developer fees; and property tax exemptions. "Hard" debt typically incurs interest and requires fixed payments. "Soft" debt may or may not include interest, payments are not required until maturity, and payments can be made from cash flow (allowing for fluctuation in debt payment amounts).

Developers will take a fee for the work they have put into creating and developing the affordable housing project. But payment of this fee will often be deferred or paid from cash flows over time. Many affordable housing projects also rely on public subsidies, such as project-based vouchers, for which there is also competition and dwindling resources.

Compiling financing for affordable housing takes time – and time results in higher costs. Delay in starting affordable housing projects can result in higher interest rates. It also often results in higher labor and material costs, as well as potential carrying costs for real property.

In short, the assembly of financing is time-consuming and once the financing is fully put together, affordable housing developers will want to move forward as quickly as possible – often placing demands on cities and city attorneys.

Parties Involved and the City's Role(s) and Responsibilities

There may be many parties involved in an affordable housing project – the developer, tax credit investor, and lenders. The affordable housing developer will lead the

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[2] To the surprise of many, the recently enacted H.R. 1 – the One Big Beautiful Bill Act – will increase the amount of available tax credits in the coming years.
[3] The Complexity of Financing Low-Income Housing Tax Credit Housing in the United States (April 2021)

predevelopment, entitlement, and financing process. The developer's team will include architects, engineers, financial consultants, attorneys, etc. Additionally, in a tax credit project, a different legal entity formed by the developer will own and operate the project going forward. The type of legal entity and its structure will depend on the project investor and lender requirements.

If the city is providing a loan or other financing to an affordable housing project, it should also consider who will comprise its project team. This may include a staff planner overseeing the entitlement process, a housing specialist overseeing the loan process and documents, and city attorney or consulting attorney. Additionally, the city may consider having a financial consultant on board to help the city understand the financial nuances of the transaction and how the city's financial assistance will contribute to the overall project. There may also be requests from the developer team that would benefit from analysis by a financial consultant. Cities will also want to rely on their legal team to ensure the affordability and other commitments are secure and enforceable.

A city may expect that funding is the extent of its involvement. However, it is important for the city team to be involved in the entire transaction, not just the city's portion, to understand the finances of the project to ensure the city-contributed funds will be well-spent or to anticipate a request for additional funds down the road. Of course, the city should make sure the affordable housing "pencils" before committing funds. But it is also important that the city understand the project operating costs after it is developed and how those ongoing costs will be funded.

The city should also familiarize itself with the property title report and understand where in the recording order its documents may fall. It is common for the city's deed of trust to be recorded towards the bottom of the recording order. However, if there is a regulatory agreement associated with land use approvals, the city should ensure that is recorded in the most senior position. Most lenders are now accustomed to this approach, and it should not pose a significant challenge for the land use regulatory agreement, which often includes the long-term affordability commitments, to hold a senior recording position.

The city should also monitor closing calls and, in a tax credit project, the large number of parties involved and (consequently) the large volume of emails the city will soon receive. While the city may only have one loan in the transaction, it may receive comments on its document from the developer, other lenders, and investors. The city will need a system to collect and track all of the comments it receives and determine – ideally, ahead of time – which changes it is willing to make and who will be making the final decision regarding such changes.

Lastly, the city should make sure to identify any restrictions or requirements tied to the type of funding it will put towards the affordable housing project. For example, monies from the city's general fund will have significantly different restrictions than a fund that holds inclusionary housing in lieu fees.

Projects Change – the Need for Potential Flexibility

The parameters of affordable housing projects often change over time, primarily due to the involvement of additional parties to the transaction. While an affordable housing project may have begun with the selection of a developer, a tax credit investor and lender often later become a part of the project. And those investors and lenders may have different needs and priorities that were not addressed in the initial selection of a developer.

Because projects can change over time, cities should bear the need for flexibility in mind. For example, there may be changes to project milestones and timelines. The city may have negotiated agreements with the affordable housing developer, but once an investor or lender is identified and brought in, they may require changes to these documents. Similarly, if the city is providing a loan, the exact amount or structure of the loan, may need to change as the project gets closer to closing.

Given the fluid nature of projects, city councils should consider delegating future discretion over changes to city managers and other city staff. It will be a balancing act to ensure sufficient discretion is delegated to city staff and ensuring the city council is comfortable with what authority to change documents is provided to staff. It will also be important to help the developer team understand exactly what authority city staff have to modify documents, what will require city council approval, and the timelines involved.

Commonly Encountered Issues

Impact fees are one of the most common issues that cities may need to explore with affordable housing developers. Affordable housing projects are not presumptively exempt from development impact fees, such as fees charged to support school districts, parks, transportation or other types of infrastructure. In some projects, impact fees can be up to 10-20% of a project's total cost, which may present a challenge to affordable housing developers.

Cities may want to explore flexibility around impact fees for affordable housing projects, such as potential waivers or deferral of those fees. Further, as recent case law indicates, cities should also review whether all fees should apply to all projects.

Cities – and affordable housing developers – should seek to strike a balance on impact fees. While cities wish to encourage affordable housing, residents of those projects do place demands on public services and infrastructure. And developers may not necessarily wish to shirk those responsibilities, as they may want their future tenants to have public facilities available to them as well. There may also be questions on whether waivers or deferrals of impact fees could trigger prevailing wages requirements and how that may impact the project.

Other common issues that may require further discussion include:

- If the project is using city-owned land, any reverter or option to purchase clause for the property (that would potentially result in "reversion" of site control or ownership back to the city in the event the project is not completed or affordability covenants are violated).
- Similarly, if the project is using city-owned land, will the city be selling or leasing the land to the developer?
- The term (length) of any ground lease for the property. The length will need to be long enough to extend at least for the duration of financing, loan, and affordability covenant terms.
- If the city is ground leasing the property, the city will need to consider what it may permit to be recorded on the fee interest and what will be recorded on the leasehold interest.
- Structure and terms of a loan agreement from the City to help finance the affordable housing project.
- Potential flexibility on regulatory restrictions (affordability restrictions).
- Potential subordination to lender.
- Whether certain design or use requests should be incorporated into the project.
- Whether the community has certain needs regarding the population that will be housed by the project (e.g., low-income special needs individuals, supportive housing, etc.)

<u>City Attorney Punchlist</u>

The development of standardized checklists for different project types ensures consistency and more timely review. While such checklists and punchlists are not explicit "streamlining" policies, they can be just as instrumental in moving affordable housing projects forward.

Such checklists should be paired with internal tracking systems to monitor deadlines and flag potential delays as early as possible.

Recommended punchlist items are:

1. Assess Pre-Application or Application Type

- Project description?
- Affordability Levels and Unit Type
- Any requests for city financial assistance or other direct city support? E.g., free or reduced value land, infrastructure, financing?
- Applicant's proposed project type – e.g., SB 35, Density Bonus, Local/Special Housing Zoning, AB 2011/SB 6, or other?

2. Confirm and Calendar Deadlines Stemming from Application Type

- Under Permit Streamlining Act, the city must respond to any application submittal, or resubmittal, within 30 days as complete or incomplete.[4]
- Once a city deems a housing development application complete, the city has 30 or 60 days to determine if the application is consistent with applicable code requirements.[5] Note that the Housing Accountability Act applies to a code consistency determination.
- Under SB 330, the city is not required to issue a completeness determination for a pre-application. The applicant has 180 days to file a complete application, and after submission of the application, application completeness determination and code consistency determination requirements would apply.
- Project deadlines for action after the code consistency determination turn on whether the project is exempt from CEQA or requires further analysis. Typically, the city has 180 days to act if an EIR is prepared[6], 60 days if a Negative Declaration is prepared, or 60 days if the project is exempt from CEQA. Exceptions and shorter timelines exist for certain special project categories.

3. Assemble Project Team

Depending on the project's scope, the city will want to identify and put in place the project team, often including a designated planner, attorney, public works personnel, and consultants, such as CEQA, planning, financial, and resource specific consultants, if applicable.

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[4] Government Code Section 64943.

[5] Government Code Section 65589.5 (30 days if project has 150 or fewer units and 60 days if project has more than 150 units).

[6] Unless the housing project is at least 49% affordable to lower income households, in which case it is 60 days.

4. Consider Need for Initial Policy Direction

Depending on the project and realities on the ground, some cities will want to ensure early policy direction from the city council – mindful of the limits imposed by the Housing Accountability Act. Some projects are nearly certain to result in litigation, and identifying that possibility early, and discussing, as permitted by applicable law, potential resolutions and project adjustments toward resolution can facilitate a better outcome for the city and the applicant.

5. Evaluate Key Project Issues and Potential Pitfalls & Opportunities

- Every project is unique, and it is critical to identify key potential issues early, so they can be addressed. This includes identifying the issues, daylighting the issues to the city project team, and as appropriate, in conversation with the applicant team, and ensuring the right people and information are in place to resolve them.
- Recognize that affordable housing developers operate under different financial constraints than market-rate developers. Early engagement can identify potential deal-breakers before significant resources are invested.

6. Consider Establishing Regular Coordination Meetings with City and Developer Teams

- For larger or complex projects, it is important to establish regular contact, such as standing meetings, with the city and developer teams. This ensures regular, early information exchange, ensuring potential problems surface earlier, hopefully also resolving more successfully. This also helps in project planning and timeline management, as it allows the city to plan for what will be coming from the applicant.
- Structure these meetings to provide clear guidance on applicable housing laws, CEQA requirements, and local standards. Document key discussion points to avoid later disputes.

7. Map Out Project Path

Successful housing project processing begins before formal application submission. City attorneys should encourage planning staff to engage with developers early to identify potential issues and solutions. Once the city team has an initial handle on the project, it is helpful to map out the project's likely path, potential pitfalls or deviations, then plan out the processing timeline and plan. Typically, once this is determined, it is then shared with the applicant too, allowing the applicant to know the processing plan and timeline. For example, a project may require Planning Commission approval, but has a landmark on site, so it may also require review by the Historic Preservation Commission (creating multiple potential appeals to city council). Another, simpler project might only be subject to Community Development Director decision, with appeal to the Planning Commission. From the developer perspective, certainty in timeline and processing path is critical, so identifying the path early helps all.

<u>Potential Pitfalls</u>

Many projects can be fairly straightforward – a flat four-acre site, proposed for 80 units, all affordable, at 20 units/acre, with inconsistency with applicable zoning resolved by density bonus incentives and concessions. Other projects have pitfalls at every corner.

Potential pitfalls to look out for, and if present, evaluate are:

- **Affordability Compliance.** For projects claiming affordable housing benefits, it is critical to establish clear monitoring and enforcement mechanisms to ensure long-term compliance with affordability requirements. This can also create positive community support, as the public can see that the promised affordable units will truly be affordable 55+ years out.
- **General Plan and Zoning Consistency.** In addition to assessing the applicable base density, and any applicable special affordable or housing overlay zoning, most affordable housing projects will also qualify for a density bonus.
- **Landmark and Historic Properties.** Typically, a project that requires the demolition of a federal, state, or local registered historic site or landmark is not subject to streamlined state housing laws or exempt from CEQA. Projects that are consistent with the Secretary of the Interior's Standards for the Treatment of Historic Properties may be exempt from CEQA review.
- **Coastal Zone.** Most, but not all, newer state housing streamlining laws do not apply to the Coastal Zone, or portions thereof.
- **Wetlands.** Most, but not all, newer state housing streamlining laws exempt sites with mapped, jurisdictional wetlands.
- **Hazardous Waste Sites** that are not yet remediated and cleared by EPA and/or DTSC are typically not eligible for streamlining.
- **Earthquake Fault Zones** and **Floodways** are typically exempt from streamlining, unless certain safety requirements can be met.

- **Replacement Housing Requirements.** Three state laws require new housing developments to not reduce the total number of existing housing units, nor to displace, without replacement, existing lower income units: the Density Bonus Law, the Housing Element Law, and the Housing Crisis Act of 2019 for jurisdictions that are an "affected city" or "affected county" per HCD determinations under SB 330. Some cities also have stronger, local tenant protection and replacement housing laws. From a project processing perspective, this means the developer and the city need to determine if any protected units exist on site or existed but were demolished within the past five years, or ten years if the unit was withdrawn from the rental market under the Ellis Act; and if yes, the plan for ensuring their replacement as required. Some tenants may also qualify for relocation benefits. The city's application checklist may also include a requirement to provide information about existing tenant and their household income. This helps ensure the information is gathered at the start of the process to help inform the city on what requirements may be necessary with respect to existing units and tenants. The city should also consider bringing on a relocation consultant to help it navigate these requirements and ensure existing tenants receive the assistance required by law.
- **CEQA.** Most affordable housing projects are exempt from CEQA, either via housing streamlining laws, e.g. SB 35, SB 375, AB 2011/SB 6, or via CEQA Guidelines Sections 15194 or 15195, or the standard categorical exemptions, e.g. Class 32 Infill Projects, AB 130/SB 131, or because a ministerial approval process was followed. If not exempt, the city will need to assess CEQA compliance.
- **Learning the Changing Laws.** In the current context of annual changes and updates to state housing laws, it is important to stay up to date on these changes. Educating planning staff on state housing laws is crucial. Developers look very closely for tools to expedite entitlement processing and reduce CEQA review, and city staff should try to anticipate those questions as much as possible. Providing city staff with the resources to be knowledgeable and able to quickly respond and address project applicant proposals is important.
- **Managing Mixed-Use Complexity.** Mixed-use projects combining residential and commercial elements present unique challenges under both CEQA and housing laws. If a mixed-use project is proposed, the city will want to determine early whether the project qualifies for housing law protections when it includes substantial non-residential components. For example, density bonus projects can be mixed use in any proportion to qualify, but SB 35 projects must have at least two-thirds of the square footage designated for residential use to qualify. The Housing Accountability Act protections also require that at least two-thirds of the square footage be designated for housing for its protections to apply to the project.

- **Inadequate Public Participation.** Streamlined approval processes can reduce traditional public input opportunities, leading to community frustration and potential legal challenges. But cities can maintain meaningful public engagement within streamlined frameworks. Use early community meetings, design review processes, and clear communication about project benefits to maintain public support. Some of these meetings can be initiated and held by the developer team to share information and solicit community feedback.
- **Financial Feasibility.** Affordable housing projects operate on thin margins. Excessive conditions or fees can render projects financially infeasible, potentially triggering challenges under the Housing Accountability Act or leaving a project desired by the City and community unable to work. The solution can be to conduct feasibility analysis for significant conditions or fee requirements. Cities can even consider fee deferrals, reductions, or alternative compliance mechanisms for affordable housing projects – incentivizing desired projects.

Working collaboratively with the developer to identify, and resolve, these and other potential project pitfalls helps cities achieve affordable housing. In addition, cities can use this process to identify opportunities for the city, if desired, to support a project more directly, and to evaluate applicant requests, with city funding or land.

Local Streamlining and Policy Innovations

Over the past few years, cities have faced an onslaught of State legislation that seeks to facilitate or "streamline" affordable housing, through amendments to CEQA and other housing laws. These one-size-fits-all statues may have pros and cons. But cities are still free to innovate and develop their own policies to further affordable housing. Some cities have explored this policy areas, such as:

- Local streamlining processes for affordable housing, such as local density bonus programs.
- Local transit-oriented development.
- Objective development standards (e.g., avoiding subjective terms like "compatible with neighborhood character" in favor of specific height, setback, and design requirements)

In addition to such classic land use policies, cities can explore other ways in which to support affordable housing, such as:

- Implementing "gentle density" design standards, which provide multi-family housing but through a mix of different housing types.

- Inclusionary housing fees – don't be afraid to start small!
- Donation of land, or assistance with the consolidation of lots to create more potential sites.
- Programs that allow for cash flow flexibility, so that revenue from affordable housing projects with good cash flow can support other projects.

Smaller Steps

Apart from the type of larger policy decisions, there are more targeted – and potentially less demanding – ways that cities can support affordable housing projects.

- Seek HCD pro-housing designation. (This can help support a tax credit application and opens up the potential of other funding sources and state programs.)
- If your city is a utility provider, ensure that the local utility is on-time with utility hookups. (Developers may also need some help coordinating or establishing contact with PG&E, So Cal Edison, or SDG&E.)
- Be flexible with zoning changes that facilitate affordable housing projects. Small adjustments or changes may allow an entire project to move forward.
- Brainstorm with affordable housing project applicants on how best to process their applications so that the process is efficient and less costly and help present their project to gain community support (city staff will best know the political climate in the community).
- Support federal earmarks for affordable housing. Developers may want to partner with local elected officials, in seeking direct federal funding for projects.
- Collaborate with the local housing authority to determine what public subsidies may be available in your jurisdiction and when they may become available.
- Certain state funding applications require demonstration that the project has obtained land use entitlements or is eligible for a streamlined ministerial approval process. Cooperating with the developer on this aspect of the application can provide assistance and competitiveness to the developer in the funding application.
- Consider HCD requests for technical assistance.

Lastly, in speaking with persons in the affordable housing sector, cities – city managers and councilmembers – should be proactive in reaching out to their local affordable housing developers and asking about their concerns and challenges. Managing affordable housing properties is challenging work, and many tenants of such projects are facing financial challenges – such as the impending loss of Medicare and SNAP benefits. Keeping the "lights on" is more difficult than ever.

Such communication is also an opportunity for the city to express any concerns it may have with how a project is managed and work collaboratively to address issues. Public image and reputation are important and if the community sees poorly managed affordable housing projects, they may not be supportive of investing city funds into future projects.

Conclusion

Notwithstanding the plethora of State laws regarding affordable housing, cities (and other local agencies) still have room to be proactive regarding such projects in their communities. To be active participants, cities should prepare themselves – by learning about how affordable housing projects operate, considering local affordable housing policies, and preparing for the review and processing of such projects. As we all know, the need for affordable housing in California will be present for the foreseeable future.