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AFFORDABLE HOUSING TRANSACTIONS:

BACKGROUND AND STRATEGIES FOR LOCAL GOVERNMENT ATTORNEYS

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I. YOUR CLIENT'S GOAL: MAXIMUM AFFORDABILITY AND LONG-TERM FINANCIAL FEASIBILITY

YOUR TASK: GET THE FINANCING CLOSED AND THE HOUSING BUILT NO MATTER WHAT

It is crucial for a public agency attorney handling an affordable housing transaction to remember the city's[1] goals for the transaction. The city is providing land and/or funds to the project because the city wants to see the project built and occupied, providing much-needed housing for low income households and much- needed housing element and redevelopment housing credit for the city. Your primary task as the city's attorney is to assist in getting the land transaction and project financing closed and the housing under construction, while protecting the city as much as possible under the circumstances. Along the way, you must ensure that both the city and the housing developer are complying with the myriad of regulatory restrictions that accompany the various sources of funds used by the city to assist the housing development.

Affordable housing projects are fraught with peril. Each transaction resembles a bar exam question where you must spot the seventy-nine issues that can cause the project to come tumbling down. If the city's attorney sees his or her role to be the identification of all the risks the city is taking and all the reasons the city should not do the deal (and there will be hundreds such risks and reasons), then the deal will never close. To be a deal "closer" rather than a deal "killer," you must decide at the beginning that the deal will close and that you (perhaps alone!) will make it close, and you had better not spot any risks or issues that you yourself cannot creatively mitigate or solve for your client.

II. UNDERSTANDING AND STRUCTURING THE TRANSACTION; ENFORCEMENT TOOLS AND REMEDIES

Most cities today approach affordable housing projects with the goal of maximizing affordability, while ensuring that the project is financially feasible over the long term. Most cities want to leverage their funds with other public and private funding sources, so that city affordable housing dollars are available to assist as many different projects as possible. The city is generally not investing in a project to receive a return on its funds, but to ensure long-term affordability and long-term maintenance of the project. No city wants to encourage NIMBY elements by assisting a project that is underfunded and will be poorly maintained or poorly managed, increasing burdens on already over-burdened city services.

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[1] For convenience, this paper refers often to a "city" and "city attorney." In most instances, such references also apply to counties and redevelopment agencies and their legal counsel as well.

Hopefully, city housing staff will be skilled in the financial analysis necessary to screen projects for financial feasibility, leaving you with the job of structuring and documenting the transaction to ensure the city's goals continue to be met over time. If city housing staff is weak in this area, encourage staff to contract with a financial consultant to analyze the developer's economic projections. Make sure city staff understand that no amount of legal documentation can turn an economically infeasible project into a feasible project – no contract can prevent or prohibit a default. And the city will lose big if a project does goes into default: the initial city funds will be lost; the city will likely have to put more funds into the project that may also be at risk; the city will face bad publicity; the affordability may well disappear; and the low income residents could lose their homes. There is no substitute for good financial analysis on the part of the city, and it is part of the city attorney's job to make sure someone other than the city attorney is doing it.

Your first step as the city's attorney is to understand the transaction. First, who is the developer? Are they non-profit or for-profit? Are they experienced in affordable housing transactions? What are their goals and motivations? Generally, a non-profit developer and a city will have similar goals for a project, resulting in more of a team approach to a project. A nonprofit developer will be more likely to admit a project's weaknesses and ask for city assistance in addressing problems. A for-profit developer may be more likely to hide or obscure project problems, gambling that the city will have no choice but to continue with a project once the initial city investment is made. Both non-profit and for-profit developers can be expected to return to the city to ask for more financial assistance if there is a financing gap before or after closing.

Before you start drafting documents for the city, be sure you understand the proposed structure of the transaction, particularly <u>all</u> proposed sources of financing. The sources of funding for the city's assistance will dictate the requirements to be included in the city's loan or grant documents (see discussion in Part III below). But other sources of financing from other local public agencies, the state, the federal government, private banks, non-profit lenders, foundations, and the anticipated 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. For example, if a project will receive funding from the California Department of Housing and Community Development ("HCD") under the Multifamily Housing Program (Proposition 46 funds), HCD requires that 50% of the project residual receipts be shared between the State and local government funders in proportion to each entity's investment. The California Housing Finance Agency ("CalHFA"), on the other hand, is a first mortgage lender with hard debt service payments, leaving all project residual receipts to be utilized as negotiated between the developer and the city. CalHFA permits the city to require 100% of residual receipts be utilized to repay city loans – although they will never pre-approve such repayment in their loan documents.

Low income housing tax credits always raise special issues for local governments. For example, if a project has received an allocation of 9% low income housing tax credits, the city generally cannot fund its assistance with tax-exempt bond proceeds or as a grant (or such assistance must be very carefully structured so as not to disqualify the project for the 9% credits or decrease the value of the credits). While tax credits bring substantial equity into a deal,

decreasing the amount of local government assistance that is needed, the equity comes from investors who are traditionally very demanding, arrogant, and fond of last minute requirements for changes in city documents that are, allegedly, required by obscure provisions of tax law, as interpreted by their New York or D.C. tax attorneys. Ideally, the attorney representing the city should have access to tax counsel who can verify Internal Revenue Code requirements, confirm whether particular tax law interpretations are within the mainstream, and suggest alternative approaches, if necessary. This is an instance where experienced outside counsel can by very helpful.

A. City Loans, Not Grants

Generally, it is always advantageous for the city 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. Revocable grants or forgivable loans, if secured by deeds of trust, are other options that provide the city with the additional enforcement leverage that comes with a deed of trust.

Public agency lenders generally document their loans with the following documents: (1) a loan agreement, governing disbursement of funds; (2) a promissory note, evidencing the obligation to repay; (3) a regulatory agreement and declaration or restrictions, setting forth the ongoing rent, occupancy, and maintenance obligations imposed by the city on the project; and (4) a deed of trust, securing all the other documents. The regulatory agreement, which is recorded against the project, should include all ongoing city requirements that are intended to run with the land, including the affordability requirements required by city funding programs, as well as other city policies that may be more project specific, including occupancy preferences, tenant selection procedures, management plans, city rights to require changes in project management, maintenance requirements, and special maintenance remedies (for example, city rights to enter the project and cure maintenance problems and obtain reimbursement from the project owner).

If a city provides a loan to a project, it will usually be a "subordinate lender," meaning that it must subordinate both its deed of trust and regulatory agreement to other project lenders. Subordination of local government interests is required by State of California lenders, HUD, and private lenders, with the exception of private banks providing loans under the Federal Home Loan Bank's Affordable Housing Program ("AHP"). Subordination to other local public agencies (cities, counties, housing authorities, and redevelopment agencies) is a matter of negotiation on a project-by-project basis. The negotiation of subordination agreements with other project lenders is one of the more tedious tasks of the affordable housing attorney. It is good practice for the subordinating public agency lender (and required by law for redevelopment agencies) to require written notice of defaults under the senior loan and the right to cure such

defaults (in order to save a project). Most senior lenders, including private banks, HCD and CalHFA, but not including HUD, will provide notice and cure rights to subordinating local agencies, but the city attorney needs to know to ask for notice and cure rights – they almost never appear in the first draft of the subordination agreement sent by the senior lender, no matter how many times the city has requested this in prior deals!

B. Ground Leases

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. The main advantage to the city of a ground lease is, again, that it provides an efficient enforcement mechanism. City regulatory requirements are included as covenants of the ground lease. If the developer violates a covenant, the city can terminate the lease and evict the developer. The threat of lease termination is a far more effective enforcement mechanism than the threat of a lawsuit to specifically enforce an affordability or maintenance covenant.

The main drawback to public agency ground leases is the complication they add to the deal. Although a 60-year (or longer) term should provide adequate security for most lenders, many lenders will attempt to require subordination of the public agency's fee interest in the land (meaning they will ask the city to sign a deed of trust pledging the fee interest in the land as security for the developer's loan). Many cities are able to resist subordination of their fee interest, but instead negotiate special lease riders with lenders granting them various protections, notices, and cure rights intended to forestall lease termination by the city.

The ground lease structure requires some extra work and planning on the part of the city. The developer may already own the project site when it approaches the city for assistance, in which event the city must require the developer to convey the property to the city and then lease it back. If the developer holds an option to purchase a project site, the city can require an assignment of the option to the city and itself purchase the land and then lease it to the developer.

III. SOURCES OF CITY FUNDING

The source of the city funds used to assist a project will dictate many of the requirements to be included in city loan, grant, or ground lease documents. The following are the most common sources of funds used by local agencies to assist affordable housing projects and some of the special requirements that go with each source:

A. Redevelopment Low and Moderate Income Housing Funds (20% Housing Set-Aside Funds)

These funds are allocated to redevelopment agencies and governed by Health and Safety Code Section 33334.2 et seq. The funds are required to be used to increase, improve, or preserve housing available at affordable housing cost to low and moderate income households. If the funds are used to assist new or substantially rehabilitated housing, the law requires recorded affordability covenants, with a 45-year term for ownership housing and a 55-year term for rental

housing. The funds may be utilized for projects anywhere within the territorial jurisdiction of the redevelopment agency (city or county), but if the funds are utilized outside of a redevelopment project area, the legislative body (Board of Supervisors or City Council) and the redevelopment agency board must make special findings that the expenditure of funds benefits the project area. A wide variety of project costs are eligible for funding with redevelopment low and moderate income housing funds, but special findings are required if the funds are used to pay the cost of offsite improvements or if the funds are supporting more than 50% of the cost of the development. Special findings are also required to subordinate affordability covenants to other lenders' deeds of trust.

B. Community Development Block Grant (CDBG) Funds

CDBG Funds are federal funds made available by HUD to cities, counties, and states pursuant to Title I of the Housing and Community Development Act of 1974, as amended. CDBG Regulations are published at 24 CFR 570 et seq. In general, CDBG funds must be expended to benefit lower income households, but there are no ongoing affordability and occupancy requirements required for a specified term of years. CDBG regulations impose various limitations on the types of entities that can utilize CDBG funds for particular uses, so local agency attorneys should verify that the proposed borrower is an eligible recipient of CDBG funds for the intended use. For example, for-profit entities like limited partnerships cannot utilize CDBG funds for acquisition of land or new construction of projects. Use of CDBG funds requires imposition of numerous federal requirements, including payment of Davis-Bacon prevailing wages in many instances.

C. HOME Investment Partnership Program (HOME) Funds

HOME funds are made available to local jurisdictions by HUD pursuant to the Cranston Gonzales National Housing Act of 1990. HOME regulations are published at 24 CFR92 et seq. HOME funds can be loaned to non-profit or for-profit borrowers and require the imposition of recorded affordability covenants for specified time periods, depending on the amount of subsidy provided per assisted unit. HOME funds also engender numerous federal requirements, including payment of Davis-Bacon prevailing wages for projects with more than 11 HOME-assisted units.

D. Housing Opportunities for People with AIDS (HOPWA) Funds

HOPWA funds are made available to local jurisdictions by HUD pursuant to AIDS Housing Act, as amended by the Housing and Community Development Act of 1992. HOPWA regulations are published at 24 CFR 574 et seq. HOPWA funds must be used to assist units that will be restricted for occupancy by persons with AIDS and their families, and cities loaning or granting such funds into projects must require that the owner ensure specialized services are made available to HOPWA unit tenants.

E. Local Housing Trust Funds

Many cities and counties have established Housing Trust Funds, into which a variety of locally-generated funds are deposited. Sources of funds include inclusionary housing in lieu fees, impact fees, transfer tax revenues, hotel tax revenue, and any other local source dedicated to affordable housing use. Housing Trust Fund monies are governed only by local ordinances and practices; consequently these funds may usually be used more flexibly than funds subject to state or federal regulations.

F. Local Bond Issue Funds

Cities, counties and redevelopment agencies have the authority to issue taxable and tax-exempt revenue and general obligation bonds and to use the proceeds to assist affordable housing projects. Numerous rules apply to the expenditure of bond funds. Tax-exempt bond proceeds are subject to Internal Revenue Code restrictions that severely restrict the use of the funds for affordable housing loans, unless the jurisdiction has obtained a multifamily bond allocation.

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The remainder of this paper discusses threshold legal issues that must be considered on nearly every city-assisted affordable housing project.

IV. CEQA AND NEPA

A. California Environmental Quality Act ("CEQA") [Public Resources Code Section 21000-21177; 14 CCR 15000-15387]

One of the first questions to ask about an affordable housing development that the city intends to assist is whether the project has undergone review under CEQA. Activities financed by public agencies are considered "projects" under CEQA. Consequently, a public agency should not approve or provide financial assistance to a development before the development has undergone environmental review, unless the development or the financial assistance is for some reason exempt under CEQA.

If a development is not exempt from CEQA, environmental review of the proposed city financing should ideally occur simultaneously with the environmental review conducted for the development's planning approvals. The proposed city loan or grant should be listed in the "project description" section of the Negative Declaration or Environmental Impact Report, and the loan or grant can be studied or reviewed along with the proposed rezoning, conditional use, or other discretionary planning approval. If the city financial assistance was not included as part of a prior "project" review process, the city council should make findings explaining the method of CEQA compliance, which might include findings pursuant to CEQA Guideline 15162, that the environmental documentation prepared for the prior approval is adequate to cover the approval of the financial assistance as well.

A number of CEQA statutory and categorical exemptions may apply to affordable housing projects or local agency assistance to such projects. Relevant exemptions include: (1) statutory exemption for feasibility and planning studies, (see Public Resources Code Section 21102), which may be applicable if a city is providing only predevelopment funding for a project; (2) categorical exemption for in-fill developments (see CEQA Guideline 15332); (3) statutory exemption for affordable low income housing (see Public Resources Code Section 21159.23); and (4) statutory exemption for farmworker housing (see Public Resources Code Section 21159.2). Various strategic and legal considerations apply to the decision to seek an exemption rather than proceed with environmental review, and consultation with city land use attorneys is essential.

B. National Environmental Quality Act ("NEPA") [42 USC 4321 et seq.; 40 CFR Parts 1500-1508 and 24 CFR Part 58]

If a project receives federal funding, NEPA (in addition to CEQA) will apply. NEPA requires the performance of an environmental assessment prior to the commitment of federal funds by a local agency. NEPA documents include a Finding of No Significant Impact ("FONSI"), which is similar to a negative declaration under CEQA, and an Environmental Impact Statement ("EIS"), which is similar to an environmental impact report under CEQA.

Developers and city/agency staff who may not be familiar with NEPA should be mindful of the timing issues that can arise. HUD regulations require the responsible agency to publish a notice of its intent to issue a FONSI and a Request for Release of Funds ("RROF") at least 15 days, and in some cases 30 days, prior to issuance of the FONSI/RROF to allow for public comments. Following issuance of the FONSI/RROF, NEPA provides for an additional 15-day period before HUD will approve the documents.

An agency may not commit HUD assistance funds (like CDBG, HOME, or HOPWA funds) for an activity or project prior to completion of NEPA review. In addition, an agency may not commit non-HUD funds for such a project or activity prior to NEPA review if the project or activity "would have an adverse environmental impact or limit the choice of reasonable alternatives" [24 CFR 58.22]. HUD takes the position that land acquisition is a "choice-limiting activity," consequently, the safest course for a city or a developer is to not acquire land for a project which will be receiving federal funding prior to completion of NEPA review. Where such delay is infeasible, there may be alternative arguments or strategies to win HUD's blessing. For example, some cities have argued successfully that land was acquired for land-banking purposes, before it was known that federal funds would be involved in the project, or before the project was sufficiently formulated for meaningful environmental review to occur. Alternatively, in some instances property acquisition may be deferred and the parties may instead enter into an option agreement with a due diligence period of sufficient length for NEPA review to occur prior to exercise of the option. Needless to say, the earlier NEPA (and CEQA) issues are considered, the better.

V. PREVAILING WAGES

A. Federal Davis-Bacon Act

Federal prevailing wage requirements are included in the Davis-Bacon Act 40 USC 3141 et seq.). The Davis-Bacon Act, however, does not itself impose prevailing wage requirements on all federally-assisted projects. Rather, each federal funding program specifies when the Davis-Bacon Act will apply to activities funded under the program. Consequently, if a city utilizes federal funds like HOME or CDBG to assist an affordable housing project, it must analyze the applicability of the Davis-Bacon Act under the rules of the particular funding program.

When CDBG funds are utilized, the application of Davis-Bacon depends on the particular use of the CDBG funds. Generally, if CDBG funds are used for hard construction costs, Davis-Bacon wages must be paid for the entire construction project, although there is an exception for hard construction costs on rehabilitation projects of fewer than eight units. If CDBG funds are used for soft costs (studies and other predevelopment costs), Davis-Bacon wages may not be triggered. Volunteer labor on CDBG-funded projects is exempt from Davis-Bacon requirements.

When HOME funds are utilized, Davis-Bacon requirements will apply if more than eleven units are assisted with HOME funds. Volunteer labor is exempt.

If Davis-Bacon requirements apply, the developer must pay federal prevailing wage rates on the entire construction project. A certified payroll is required and the local agency is obligated to monitor Davis-Bacon compliance by the contractor.

B. State Labor Code

California Labor Code Section 1720 defines a "public work" subject to prevailing wage requirements as work done under contract and "paid for in whole or in part with public funds." Recent legislation (effective January 1, 2002) further defined "paid for in whole or part out of public funds" broadly so as to reach private projects that have public agency assistance. Under Labor Code Section 1720(b), the following types of assistance trigger prevailing wages for private projects: (1) public agency payments to a private project developer; (2) public agency construction of improvements for or related to the private project; (3) public agency transfer of an asset to a private developer for less than "fair market price"; (4) public agency payment of or waiver of development fees or permit processing fees; (5) public agency loans made at less than "fair market value"; (6) public agency loans or advances where repayment is contingent or repayment will be forgiven based on the developer's performance; and (7) arrangements where payments or repayments to the public agency are reduced by credits for income the public agency receives (e.g., credits for the sales tax or tax increment generation of the private development).

Consequently, unless an exception described below applies, the Labor Code requires payment of prevailing wages for most private projects that are constructed under an agreement with a local public agency providing for some form of public agency assistance for the project. Public agency loans and grants to private or nonprofit developers, regardless of the source of funds, will trigger state prevailing wage requirements, unless a statutory exception applies. If a

local agency utilizes federal funds to provide assistance to a project, both state and federal prevailing wage laws may apply, so that the project must be analyzed under both the California Labor Code and applicable federal law and regulations to determine if one or both of state prevailing wage law and the federal Davis-Bacon Act apply. It is important to note, for example, that a HOME-funded project may be structured to avoid application of federal prevailing wage law, but that state prevailing wage requirements may still apply to the project. In addition, a project may be subject to both Davis-Bacon and state prevailing wage requirements, requiring dual compliance – Davis-Bacon does not pre-empt state prevailing wage law except in the narrow circumstance of public housing constructed by a public housing authority.

City attorneys should be aware that, in a relatively recent income coverage determination letter, the California Department of Industrial Relations (the "DIR") stated without analysis that tax credit equity funds are "public" funds (Public Works Case No. 2002-070, 1010 Pacific Apartments, City of Santa Cruz), which presumably will trigger the requirement to pay prevailing wages. This interpretation is considered flawed by many; however, predictions that the Schwarzenegger administration will reject it have not yet proved true, although several cases raising this issue are currently pending before the DIR.

As a result of legislative efforts by several interests, there are a number of exceptions to the requirements to pay prevailing wages under the Labor Code. The exceptions relevant to affordable housing are outlined below.

1. Below Market Rate Interest Loans (Section 1720(6)(E). This exception is for residential projects in which the public funding participation is a below market interest rate loan for projects in which at least 40% of the units are restricted, by deed or regulatory agreement, for at least 20 years to households whose incomes do not exceed the low income level (80% of area median income). This exemption has broad applicability to many affordable housing projects. However, the exemption does not apply if there are government grants or other non-loan assistance to the project, nor does the exemption apply if there are several government loans, but not all of them meet the requirements of the exemption. Consequently, care should be taken to structure all public assistance as loans meeting the criteria outlined above.

2. Redevelopment Agency Affordable Housing Expenditures (Labor Code Section 1720(c)(4). This exception applies to redevelopment agency assistance for construction or rehabilitation of affordable housing if the assistance is from the agency's low and moderate income housing fund, so long as the only other source of funding for the project is private funds. This exception does not apply if an affordable housing project has any other source of government funding in addition to redevelopment housing fund money. For example, a city grant from its housing impact fee fund would trigger prevailing wages, as would assistance from the local housing authority. Larger housing projects almost always involve funding from multiple government agency sources, making the redevelopment affordable housing exception much narrower in scope than it appears.

The redevelopment affordable housing fund exception is most useful for smaller programs that do not involve multiple sources of government funding. For example, a single-family housing rehabilitation program involving loans to individual homeowners may be funded solely from housing fund tax increment and private funds.

3. Residential Projects With No Agreement (Labor Code Section 1720(c)(1)). A residential development on private property that is built without any agreement with a state agency, redevelopment agency or housing authority is not subject to prevailing wage obligations. This exception permits a redevelopment agency, city, or other public agency to construct infrastructure that will spur private residential development so long as there is no agreement between the developers of the private development and the redevelopment agency. This exception would also allow an agreement between a residential developer and a city (such as development agreements or subdivision agreements) whereby the city agrees to construct public infrastructure for the private project. In such a scenario, the public infrastructure would be constructed with prevailing wages but the private improvements could be built without prevailing wages.

4. Public Infrastructure Without Proprietary Interest (Section 1720(c)(2)). This exception allows the state or local government to pay for public infrastructure needed for a private project without triggering prevailing wages for the private project so long as the public infrastructure is required as a condition of the approval for the private project, the government construction is limited to the cost of the public infrastructure, prevailing wages are paid for construction of the public infrastructure, and the government "maintains no proprietary interest in the overall project." The "proprietary interest" requirement is the wildcard in this exception. This is a vague concept that could be interpreted in any number of different ways by DIR and the courts. To date, the DIR has found that an easement in favor of a government agency is not a proprietary interest.

5. De Minimis Assistance (Labor Code Section 1720(c)(3)). Government assistance to a private project that "is de minimis in the context of the project" will not trigger prevailing wages for the private project. This exception is undefined and vague and will require extensive DIR and/or court guidance before public agencies will be comfortable in relying on it. Labor Code Section 1771 already exempts projects of $1,000 or less. Thus, a private project including $1,000 of work (i.e., small rehabilitation) would be exempt from prevailing wages even if it had $500 in government assistance.

6. Reimbursement for Normal Public Costs (Labor Code Section 1720(c)(3)). This exception may be useful in situations that commonly occur where, as an accommodation to the local government, a developer undertakes work that the local government could not ordinarily compel the private developer to do, and the government reimburses the developer for the costs. It may also be useful in situations where there is government policy to bear certain costs for all similarly situated projects. For example, if a redevelopment agency has a policy of reimbursing all developers in a project area for public sidewalk construction costs, that reimbursement arguably is for a cost normally borne by the public. Likewise, a city policy to waive application fees for all affordable housing developments would arguably constitute reimbursement for costs normally borne by the city.

7. Tax-Exempt Bond and Low Income Housing Tax Credit Exception (Section 1720(d)) [expired]. Section 1720(d) provided an exception for affordable housing projects financed with mortgage revenue bonds, affordable housing projects receiving mortgage credit certificates or state or federal low income housing tax credits so long as the project received an allocation of bond capacity, mortgage credit or tax credits prior to December 31,

2003. This exception has for most purposes now expired, as most project receiving bond and tax credit allocations in 2003 have completed, or nearly completed, construction. As mentioned above, the DIR currently takes the position that tax credit equity funds are "public funds," requiring the payment of prevailing wages on low income housing tax credit projects, which makes the expiration of the bond and tax-credit exemption especially significant.

8. Self Help Housing (Labor Code Section 1720(6)(A). This exception is for self-help housing project in which at least 500 hours of construction work is performed by homebuyers. This exemption is very useful to self-help projects which typically rely on skilled labor for portions of the construction. This exemption does not cover projects using volunteer labor, unless the project also has 500 hours of homebuyer construction work.

9. Small Homeless Housing Projects (Labor Code Section 1720(6)(B). This exception is for privately-owned projects that consist of rehabilitation or expansion work of temporary or transitional homeless housing operated on a not-for-profit basis if the work costs less than $25,000. This exemption is of limited application.

10. Primarily Privately Funded Transitional Housing Projects (Labor Code Section 1720(6)(D). This provision exempts new construction, rehabilitation or expansion work of emergency or transitional housing, and ancillary services and assistance, for homeless adults and children developed by a nonprofit organization and operated on a not-for-profit basis. The nonprofit must provide, at no profit, at least 50% of the total project costs from nonpublic sources. In calculating costs, the value of donated private labor, materials, architectural and engineering services may be included as a cost the nonprofit provides from nonpublic sources. The cost of land for the project is not included in determining if the 50% threshold has been met. This exemption also has limited applicability.

11. Homeowner Assistance (Section 1720(6)(E). This exception applies where public assistance is provided to a household as mortgage assistance, down payment assistance or for the rehabilitation of a single-family home. This exemption applies to many local agency programs to assist individual homeowners. Although it is not entirely clear in the legislation, this exception probably applies to assistance to owner-occupants and to assistance to the owner of a single family home who rents the unit to third parties.

Three additional points on prevailing wage requirements should be noted. First, if a project receives funding under a program with an explicit statutory prevailing wage requirement outside of the Labor Code (as is found, for example, in the statute governing the state's Multifamily Housing Program), the project will be subject to the state prevailing wages, even if one or more Labor Code exceptions apply.

Second, Labor Code Section 1720(e) provides that the various Labor Code exceptions do not preempt local prevailing wages ordinances. This is important to note because some local prevailing wages ordinances, particularly older ordinances adopted before the various Labor Code prevailing wage exceptions were enacted, actually require the payment of prevailing wages in more circumstances than does state law. Local government attorneys should always check to assess if additional prevailing wage requirements are imposed under local ordinances.

Third, expansive new legislation (SB 966), effective January 1, 2004, imposed liability for payment of prevailing wages on local governments under certain circumstances. Under prior law, the contractors and subcontractors who actually undertook construction of "public works" were the parties who were responsible for assuring that prevailing wages are paid as required by the prevailing wage provisions of the Labor Code. A public agency that entered into a contract with the contractor or subcontractor providing for construction of the facility that is a " work" generally was not liable for prevailing wages if the contractor or subcontractor was required but failed to pay prevailing wages to the workers building the project. The public agency was liable only if the agency engaged in a fraud or intentional misrepresentation.

Under the new law, a contractor may bring an action to recover from the "awarding body" or the "body otherwise undertaking the public work" (in the affordable housing context, this body would be the city or other local agency providing the financial assistance that gives rise to the prevailing wage requirement) any increased costs (differential in wages and penalties) as a result of any decision by the body, the DIR or a court that classifies the work as a prevailing wage job after the time at which the body accepts the contractor's bid or awards the contract. Liability would arise if the public agency fails to include in bid or contract documents a statement that the construction contemplated by the bid or contract documents is a "public work" subject to prevailing wages. As a result of SB 966, a public agency has potential liability for unpaid prevailing wages and penalties even it has a good faith belief that the project in question is not a "public work" subject to prevailing wages. To avoid this potential liability, public agencies are now inclined to require in contracts and/or bid documents that the contractor or developer treat the project as a "public work" and pay prevailing wages, even though the application of the prevailing wage requirement to the particular situation may be subject to considerable doubt.

VI. ARTICLE 34 OF THE CALIFORNIA CONSTITUTION

Article XXXIV of the California Constitution ("Article 34") requires that voter approval be obtained before any "state public body" develops, constructs or acquires a "low rent housing project." Cities, counties, housing authorities and agencies are all "state public bodies" for purposes of Article 34. As a result, if any of these entities participates in development of a "low rent housing project" and that participation rises to the level of development, construction, or acquisition of the project by the agency, approval by the local electorate pursuant to Article 34 is required for the project.

A. Definition of "Low Rent Housing Project."

Not all low-and moderate-income housing is a "low rent housing project." Statutory and case law permits development of many kinds of low-and moderate-income housing that will not be characterized as a "low rent housing project," and thus will not require Article 34 voter authorization.

To clarify the requirements of Article 34, the Legislature has enacted the Public Housing Election Implementation Law (Section 37000 et seq.). This law specifically exempts each of the following types of developments from the requirement of voter approval:

1. Privately owned housing which is not exempt from property taxation (unless fully reimbursed to all taxing entities) or is exempt from property taxation pursuant to the provisions of Revenue and Taxation Code 214(f) or (g) (applicable to specified housing developments operated by nonprofit entities), and in which not more than 49% of the units are required by the state public body to be occupied by low-income persons;

2. Privately owned housing which is not exempt from property taxation by reason of any public ownership and is not financed with direct long-term financing from a public body;

3. Housing that is intended for owner-occupancy (which may include cooperative or condominium ownership) rather than rental occupancy;

4. Housing consisting of newly constructed, privately owned, one-to-four family dwellings not located on adjoining sites;

5. Housing that consists of existing units leased by a state public body from a private owner;

6. Rehabilitation, reconstruction or replacement of an existing low rent housing project, or a project previously or currently occupied by lower-income households; and

7. Acquisition, rehabilitation, reconstruction or improvement of a low rent housing development subject to a contract for federal or state public body assistance for the purpose of providing affordable housing if the development maintains or enters into a contract for federal or state public body assistance for the purpose of providing affordable housing.

The California Supreme Court upheld the Legislature's general authority to adopt definitions applicable under Article 34 in California Housing Finance Agency v. Patitucci, 22 Cal. 3d 171 (1978). Because only a portion of the provisions listed above had then been enacted in the present form, only that portion of the listed provisions bears the Supreme Court's direct seal of approval.

Other types of locally-assisted housing developments, although not statutorily exempted from the voter approval requirement, may still be exempt depending on their particular circumstances, such as the nature of the housing, the type and income mix of tenants, the nature of public agency assistance, the degree of public agency control over the development, and other factors.

B. Definition of "Develop, Construct or Acquire."

Not all local agency activities in connection with a "low rent housing project" can be characterized as development, construction, or acquisition of a low rent housing project. If a local agency were to construct housing directly, of course, its action would constitute development, construction, or acquisition. In addition, if an agency loans money for a project and the loan is conditioned on typical government agency requirements such as review and approval of plans, project financing, operation and maintenance standards and occupancy, the

agency quite possibly will be deemed to have developed or constructed the project. See California Housing Finance Agency v. Elliott, 17 Cal. 3d 575 (1976), in which the California Supreme Court concluded that CalHFA activities in the course of making a loan for a project constituted "development" by a public body.

The Legislature has undertaken to define specific exclusions from the meaning of "develop, construct or acquire," although the California Supreme Court has not ruled on the validity of those sections. Pursuant to such legislation, the words "develop, construct or acquire" do not apply if the agency's activity is limited to any of the following: (1) the agency provides financing secured by a deed of trust, or obtains title temporarily through foreclosure or a deed in lieu with the intent to resell to a private owner; (2) the agency acquires land or makes improvements to land which it anticipates will be ground leased to a private owner prior to its development so long as the land and improvements are not exempt from property taxation by reason of public ownership for more than five years after agency acquisition or after five years the agency fully reimburses the affected taxing entities; (3) the agency leases units from a private owner provided that the lease does not result in a decrease of property tax; (4) the agency provides assistance to a private owner or occupant of existing housing which enables the occupant to live in decent, safe and sanitary housing at a rent he or she can afford; (5) the agency provides assistance to a development prior to its becoming a low rent housing project without intending or expecting that the development will become a low rent housing project; or (6) the agency provides assistance and monitors construction and compliance with the conditions of assistance to the extent of carrying out routine governmental functions, performing conventional activities of a lender, or imposing constitutionally mandated or statutorily authorized conditions accepted by the recipient of the assistance. The last category listed is potentially the most widely applicable, but legally open to the greatest doubt.

This list is not exhaustive and does not authoritatively define development, construction or acquisition. In each individual case the local agency must examine its role and the extent of its involvement to determine if those actions fall inside or outside the definition.

C. Nature of Article 34 Election.

Where elections are held, local agencies usually seek general authority from the electorate to develop low income housing prior to identification of a specific project. For example, a typical Article 34 election might authorize construction of 500 units of "low rent housing" anywhere in the jurisdiction by the city (or county), its housing authority, its redevelopment agency, or other state public bodies.

The California Supreme Court has upheld this practice of "unit banking" in Davis v. City of Berkeley, 51 Cal. 3d 227 (1990). In that case, the plaintiffs challenged as too vague and indefinite the general authorization approach, but the court upheld the adequacy of two contested Berkeley ballot measures which authorized 200 and 300 units of housing, respectively, without identifying its location, occupants, physical characteristics or dates of construction. The practical effect of the Davis decision is to confirm that obtaining Article 34 ballot approval may be eased by holding elections before making commitments to individual sites, projects or funding.

D. Limitation of Time For Article 34 Challenge.

Health and Safety Code Section 36005 et seq., requires that an Article 34-based challenge to a local or state agency's approval of (or funding commitment for) a housing development be brought within 60 days of the date of approval (or funding commitment). Given the questions about how specific fact situations may be affected by Article 34, this provides an important assurance, particularly where no election is held. Moreover, the Supreme Court in Davis appeared to recognize the Legislature's right to establish this statute of limitations period. This does not necessarily mean, however, that communities can completely ignore Article 34 and then rely on the 60-day statute of limitations with impunity.

E. Practical Issues of Structuring to Avoid Article 34 Election.

Most cities that have not held Article 34 elections will structure their assistance so that the assisted project will not qualify as a "low rent housing project." The most typical approaches taken by cities include:

1. The city will itself restrict only 49% of the units in a new construction project to low or very low income occupancy. If multiple public agencies are providing assistance, care must be taken to ensure that all agencies are restricting the same 49% of the units. It is the general consensus that a tax credit restriction on 100% of the units will not itself cause a project to qualify as a "low rent housing project."

2. The assisted project is inclusionary housing which is part of a larger master development project (as defined in applicable land use approvals), such that the restricted units comprise less than 49% of the total master development project units.

3. The city will provide assistance for the acquisition and rehabilitation of an existing project in which all or the majority of existing residents are low income.

4. The city will provide assistance to an ownership project.

Both HCD and CalHFA require legal opinions from either city attorneys or developer attorneys regarding Article 34 compliance or exception. However, these legal opinions may not be required until project construction is underway or has been completed. Consequently, it is often up to the local agency attorney to recognize and raise Article 34 issues early in the process so that the project may be properly structured from the outset to either meet or avoid Article 34 election requirements.

VII. CONCLUSION

Above all, public agency attorneys involved in affordable housing transactions must keep a healthy perspective. Most of the other parties involved in the transaction (developers, banks, state and federal housing agencies, investors, and all of their attorneys) spend all their days on the same kinds of transactions. They speak in shorthand and acronyms, threaten constant deadlines that will reputedly kill the project, and rarely are willing to recognize past agreements

reached between the parties on similar issues in prior deals. For the city attorney, on the other hand, affordable housing transactions may occur only infrequently and your time may be precious enough that you don't wish to renegotiate the same issue over and over again on each successive project. You, too, may be the only attorney involved in the project that has to bear, or has a client that will bear, the political consequences of the particular way the project is structured and financed.

To protect your client and yourself, it is very useful to know what is "standard in the industry" – what other cities and counties and redevelopment agencies are agreeing to under similar circumstances. Although you may dismiss this advice as self-serving, outside counsel can help you establish and retain the proper perspective. Even if you keep the drafting of documents in-house, experienced outside counsel, who also do these deals on a daily basis but are on your side, can help you structure a deal and can be your reality check on developer, lender, and state and federal agency demands and deadlines. A good sense of humor helps, too.