Institute for Community Economics

CLT Financing in California
Working Paper #2



California Redevelopment Law

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This is one in a series of working papers designed to assist Community Land Trusts (CLTs) in California in accessing statewide financing resources to produce permanently affordable homeownership opportunities for low and moderate income families. CLTs are community based nonprofit organizations that hold title to land as a means to stabilize communities and preserve investment in affordable housing for the benefit of future generations. CLTs generally sell the homes that sit on the land to eligible homebuyers and enter into long term ground leases which offer the residents the benefits traditionally associated with homeownership while limiting the resale price of the home so that it remains affordable to future low or moderate income buyers.

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I. California Redevelopment Law

California's 400 plus community redevelopment agencies[1] generate more housing subsidies than any other group in California. Redevelopment agencies reported that they deposited nearly $1.1 billion into their housing set-aside funds during Fiscal Year 2002-3.[2] At the end of the year, the total equity in the RDA housing funds exceeded $2.2 billion.

RDA housing funds may be used in a variety of ways to support and assist the development, improvement and preservation of affordable housing. These funds may be used to acquire housing development sites, structures that will be converted to housing or existing housing units. The funds may be used to develop or rehabilitate housing. They may also be used for long-term project financing or to provide down payment assistance for individual home buyers. They may also be used as grants.

In addition to being used directly for these purposes, RDA funds may be used in a number of creative ways. Redevelopment agencies can borrow against future income and repay the loans or bonds with annual tax increments. RDA funds can be used as loan guarantees. The guarantees can cover monthly short-falls, loan payoffs or the performance of a developer.

Clearly redevelopment agencies are an important housing resource that community land trusts and other affordable housing developers should investigate.

California Redevelopment Law requires local redevelopment agencies to preserve the affordability of homes built with redevelopment housing set-aside funds over the long term and encourages the use of the type of resale price restrictions that Community Land Trusts commonly use as a means for meeting this requirement. However, the details of redevelopment law make it difficult to implement resale restrictions that fairly balance the interests of homeowners and the need for long term affordability. In spite of the challenges described below,

[1] California redevelopment law begins with Section 33000 of the Health and Safety Code.
[2] Redevelopment agencies are required to make annual reports on their housing funds and activities to the California Department of Housing and Community Development (HCD). The data from individual agencies is compiled into annual reports that can be viewed or downloaded from: http://www.hcd.ca.gov/rda/.

redevelopment funds can be made to work as a source for CLT funding and are likely to be the single most important source of public subsidy for new CLT projects in California.

Background and History

California first authorized cities and counties to create redevelopment agencies in 1945 as a vehicle for addressing blight and economic distress. One of the main tools of redevelopment is tax increment financing. Under tax increment financing, the property taxes that existing taxing authorities –cities, counties, schools and special districts – receive from within redevelopment project areas are capped and most of the future tax increases – the tax increment – go to the redevelopment agency. The tax increments are used by the redevelopment agency to finance infrastructure improvements, site acquisition, real estate development and rehabilitation projects and other activities that support the revitalization of the redevelopment project area.

Since 1979, redevelopment agencies have been required to set aside at least 20% of their tax increment funds for low and moderate income housing.[3] The use of RDA housing funds has become increasingly restricted and targeted over the years. In addition, agencies that extend projects beyond their original life are now required to place 30% of their tax increment in their housing set-aside fund.[4]

Redevelopment funds can generally only be used within redevelopment project areas in the city or unincorporated county in which they are generated. Housing set-aside funds, however, may be used anywhere within the city or unincorporated county in which the redevelopment agency is located. The redevelopment agency simply needs to make a finding that providing affordable housing outside of the project area supports the project area. This should be a relatively easy finding for all redevelopment agencies to make.

RDA Housing Requirements

State law places numerous housing requirements on redevelopment agencies. In addition to requiring that funds be set-aside for housing, redevelopment agencies must adopt a housing implementation plan and are required to meet certain housing production goals. Implementation plans are required to be updated on a ten-year cycle.

Two targeting requirements that must be addressed in these plans were added to redevelopment law. First, RDAs must distribute housing funds among very low, low, and moderate-income households in proportion to the housing needs of these groups as identified in the local housing element. Second, RDAs may not use more housing funds to assist senior housing than the percentage of seniors in the community.

Maintaining Affordability:
All housing assisted with redevelopment housing set-aside funds or counted towards an agency's housing production goals must have long-term affordability restrictions. Rental housing must be affordable to, and occupied by, the target income group (very low, low or moderate income) for a period of at least 55 years. Ownership housing must be restricted for at least 45 years.

[3] Health and Safety Code Section 33334.2
[4] Health and Safety Code Section 33333.10 (g) (1)

However, redevelopment law allows ownership housing to be released from the restrictions if the agency's assistance is repaid and the lost unit is replaced by another affordable unit.

Inclusionary housing requirement:
Few people realize it, but all redevelopment agencies in California are subject to inclusionary housing requirements. Under state law, at least 15% of the housing developed within redevelopment project areas must be affordable to low or moderate income households. The affordability and occupancy of these units must also be regulated in the same manor as housing that is assisted with RDA housing funds. Affordable housing that is created outside of the redevelopment project area may be counted towards an agency's inclusionary requirement on a 2 for 1 basis. Two affordable units produced outside of the project area count as one produced within the project area.

RDA Affordability Standards[5]

Affordability standards for RDA-assisted ownership and rental housing are in California Health and Safety Code Sections 50052.5 and 50053, respectively. These codes, plus Section 6920 of Title 25 of the California Code of Regulations, set the maximum housing costs for units that are affordable to very low, low, and moderate income households based upon the number of bedrooms in the units.

Like virtually every other source of public subsidy for affordable homeownership, California Redevelopment Law provides a definition of "affordability" which limits the price that can be charged for homes that have benefited from redevelopment subsidies. The State, understandably, wants to insure that subsidized homes are not only sold to low or moderate-income buyers but that they are sold at an affordable price. Redevelopment law achieves this goal by specifying a maximum percentage of monthly household income a family should be expected to pay for their housing costs. This is known as the "Affordable Housing Cost." The maximum sales price for a subsidized home is then calculated as the price that results in monthly payments that don't push the family's total housing costs above the Affordable Housing Cost limit. While this is a common approach for evaluating initial affordability, California Redevelopment Law's application of this concept is unique in two ways. First, redevelopment law includes in this calculation a number of housing costs such as utilities and repairs which are typically not included; and, second, it expects the same calculation to be performed at the time that an assisted unit resells.

Adding additional factors into the affordable housing cost calculation has the inevitable result of lowering the maximum price that a given unit can sell for, which generally means that additional subsidy will be required to make the same home affordable to the same income group.

[5] The housing affordability standards in Health and Safety Code Sections 50052.5 and 50053, and California Code of Regulations 6920 apply to various other state housing programs in addition to RDA housing set-aside funds.

	CA Redevelopment Law
Affordability Ratio *Housing is considered affordable if it costs less than this percentage of household income.*	30% to 35% depending on income level
Housing Costs *The total of these elements must be less than the specified percentage of monthly income.*	• Mortgage payments (principal and interest plus mortgage insurance) • Property Taxes • Fire and casualty insurance • Homeowner association fees • Ground rent • A reasonable allowance for utilities, including garbage collection, sewer, water, electricity, gas, and other heating, cooking, and refrigeration fuels • Property maintenance and repairs

To be affordable, the housing costs listed above must total less than the results of the following affordability formulas for very low, low, and moderate-income households.

Income Level	Affordability Formulas
Very Low Income	30% of 50% of Median Income
Low Income	30% of 70% of Median Income
Moderate Income	35% of 110% of Median Income[6]

To complicate these formulas, the median income figures that are used in these formulas must be "adjusted for family size appropriate to the unit."[7] State law presumes that the following number of peoples will occupy homes with the following number of bedrooms.

Bedrooms in Unit	Presumed Household Size[8]
0 bedrooms (studio)	1 Person
1 Bedroom	2 Persons
2 Bedrooms	3 Persons
3 Bedrooms	4 Persons
4 Bedrooms	5 Persons

[6] State law also includes a minimum housing cost for moderate income households to prevent home buyers from being over subsidized. That minimum is 28% of their actual income.
[7] Health & Safety Code Section 50052.5(h).
[8] Note that these household sizes are only used for calculating the affordable housing cost for homes with different numbers of bedrooms. Buyers may have more or less members in their household without effecting their ability to buy a home or the price they must pay.

Redevelopment agencies and housing sponsors take the affordable housing costs that are calculated using the formulas and factors described above and calculate how much homebuyers can afford to pay for a home.

The following table shows the affordable housing costs for a three bedroom home in a county that has a median household income of $100,000. It also includes the maximum affordable sales prices for the same home assuming various housing costs, a 6.0% mortgage interest rate and a 5% down payment. The details of these calculations are included in the Example.

Income Level	Affordable Housing Costs	Affordable Sales Prices[9]
Very Low Income	$1,250 per month	$153,624
Low Income	$1,750 per month	$223,852
Moderate Income	$3,208 per month	$435,999

The Affordable Sales Prices are only affordable if home buyers can buy the homes without paying more than the higher of the affordable housing costs or either 30% of their income if low income or 35% of their income if moderate income. If a buyer pays more than the higher of these amounts to own the home, they are either ineligible to buy the home or they must receive additional assistance to lower their housing costs.

While the affordability standard is often referred to as 30% or 35% of income, it can be far more than these percentages for households who are at the lower range of an income group. For example, a household that earns 81% of median income is moderate income. The RDA formula allows them to pay 35% of 110% for housing. While the affordable housing cost is 35% of the income of a household that earns 110% of median income, it is 47.5% of the income of a household that earns only 81% of the median.

With the RDA affordability standards, the cost of financing has the biggest influence on what homebuyers can afford to pay for a home. When interest rates are low, buyers can afford to pay more for a home. When interest rates are high, they can afford less. In addition, households that receive assistance to buy their home can afford to pay more than those who do not.

In times of dropping interest rates, the RDA affordability formula can cause affordable sales prices to increase significantly. When interest rates increase, the RDA affordability formula causes affordable sales prices to drop. Using the figures for a low income household from the example, an increase in the interest rate from 6% to 7% will reduce the affordable purchase price by 10%. An increase from 6% to 8% will reduce the affordable price by 18%.

RDA Funds and CLT Homes

Redevelopment law is generally consistent with the structure and operations of community land trusts. RDA-assisted housing must be affordable to and occupied by low or moderate income households for at least 45 or 55 years. RDA-assisted ownership housing must be owner-occupied. When RDA-assisted ownership housing is sold, the buyer must be income-eligible and their costs of ownership must be affordable.

[9] The Maximum Purchase Prices assume a 5% cash down payments and 6.0% mortgage interest rate.

CLTs may use RDA funds either to help finance a housing project or to assist individual homebuyers or both. If RDA funds are used to finance a project, a regulatory agreement is recorded against the project to restrict the occupancy and affordability of some or all of the homes in the project. If RDA funds are used to assist individual homebuyers, the occupancy and affordability of the assisted units is regulated. Like a number of other government funds, it is also possible to initially use RDA funds for project development and then roll it into individual assistance.

Using RDA funds to assist a project has many advantages, including lowering land acquisition, development and holding costs. Lowering these costs allows the sales prices for individual homes to be reduced. It also keeps the subsidy in the project for future homebuyers. There are also advantages to using RDA funds to assist individual homebuyers. These include having more flexibility in marketing the homes and being able to adjust the amount of assistance that each buyer receives. CLTs that receive project financing can also tailor the RDA assistance to the needs of individual buyers by adjusting their monthly lease payments.

CLTs need to understand the implications of the RDA long-term affordability requirements when applying for funds and structuring deals with redevelopment agencies. There can be problems if the interaction between the RDA affordability standards and CLT's resale restrictions and formula are not addressed. This is especially true if the CLT's resale formula allows for higher sales prices than are allowed under the RDA affordability standards.

CLTs also face a potentially significant risk when using RDA funds. That risk is that the RDA affordability standards may result in affordable sales prices that are lower than what some homeowners paid for their units. It is even possible for the formula to establish an affordable resale price that is lower than the current owner's debt on the property.

In order to limit the impacts of these risks, CLTs that use RDA funds for project financing should insist that their regulatory agreements include provisions for releasing individual homes from the affordability standards if the formula results in the affordable resale price for a home being less than what the current owner paid for the unit. Not all redevelopment agencies allow homes to be released from their agreements because they have an obligation under state law to create a replacement unit. The CLT may also wish to allow homes to be released from the RDA agreement if their affordable resale prices are significantly lower than what the CLT's resale formula allows.

Of course, releasing a home from the regulatory agreement will require the unit's RDA subsidy to be repaid and this will probably make the home even less affordable for future buyers. To minimize the financial impact of releasing a home, the CLT should negotiate with the RDA to base the repayment on the change in the value of the home or their subsidy since the home was last purchased, rather than since the home was originally sold.

To reduce the risk that homes will have to be released from an RDA agreement, CLTs should try to set their initial homes sales price as far as possible below the maximum allowed under the RDA formula. CLTs should also refrain from basing their initial sales price on what buyers can afford with RDA and other down payment assistance. In addition, they should try to get commitments from the RDA and other down payment assistance programs to keep their money in the project for future homebuyers.

CLTs that use RDA funds should also consider setting up internal subsidy programs to mitigate the impact of higher interest rates on future homebuyers. Examples of such programs include providing down payment assistance loans with no payments until the buyers can afford payments, or allowing temporarily reduced lease fees to make homes more affordable to future buyers. The lease fees could increase over time as the owners' incomes increase, or perhaps become liens against the property that are repaid when the homes sell.

Resources for Learning Information

Additional information on redevelopment law and redevelopment agencies is available from a variety of sources including a number that are online. Some of these sources include:

California Department of Housing and Community Development – Redevelopment agencies must submit annual reports on their housing set-aside funds and housing activities to HCD. This information is compiled into reports that are available at: www.hcd.ca.gov/rda/

California Redevelopment Association – CRA is the statewide association of redevelopment agencies. Information on the association's publications and workshops is available online at www.calredevelop.org

California Redevelopment Law – You can review and search the California Codes at the state legislature's website – www.leginfo.ca.gov. Redevelopment law begins with Section 33000 of the California Health & Safety Code.

Goldfarb and Lipman – this law firm represents many redevelopment agencies throughout California and has articles on various redevelopment issues posted on its website at www.goldfarblipman.com/articles.html

Solano Press – Solano Press – www.solano.com – publishes the definitive guide to both the law and the practice of redevelopment. This book – Redevelopment in California can be purchased for $60.00.

Your City or County – Every redevelopment agency is required to adopt both a Redevelopment Plan and an Implementation Plan. These are public documents that must be available for the public to review, copy or buy. In addition, redevelopment agency budgets are included in the budgets for the city or county in which the agency is located. Many of these budgets are online.