



California Notice Provisions For At-Risk Properties: An Update for 2012

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Introduction - The Affordable Housing Preservation Challenge in California

As of November 2011, California has more than 438,000 apartments serving low income households earning less than 80% of area median income: 116,099 are subsidized and regulated by the US Department of Housing and Urban Development (HUD), 22,912 are subsidized by the US Department of Agriculture (USDA), 40,500 are public housing units, another 260,000 have received allocations of Low Income Housing Tax Credits (LIHTC) and an unknown number have received funding through local HOME, Community Development Block Grant (CDBG), redevelopment and other programs without relying on any of the above programs.

The termination of rental restrictions is a problem not only for the affected tenants, who face potential displacement and/or rent increases, but also for their communities, which will suffer a permanent loss of affordable homes. The impact of conversion is compounded by the scarcity of affordable rental housing in most parts of the state and the fact that it typically costs two to three times as much to replace an affordable apartment as to preserve it. In recognition of this impact, the federal government requires owners of these at-risk properties to provide notice to tenants and HUD. (Properties prepaying a HUD subsidized mortgage must also provide notices to state and local governments under federal law.)

Finding that the federal notice laws do not go far enough in providing advance warning to tenants and local governments or in encouraging preservation transfers, the State of California has passed its own State Notice Law (Government Code Section 65863.10-13), which has been amended several times to address a number of related issues. In 2010, Senate Bill 454 made the law permanent and added amendments that took effect January 1, 2011. The intent of the State Notice Law is to

give tenants sufficient time to understand and prepare for potential rent increases, as well as to provide local governments and potential preservation buyers with an opportunity to develop a plan to preserve the property. This plan typically consists of convincing the owner to either (a) retain the rental restrictions in exchange for additional financial incentives or (b) sell to a preservation buyer at fair market value. This Bulletin provides an overview of the current requirements of the State Notice Law, including those changes that took effect on January 1, 2011.

Properties Covered Under the Notice Law

Historically, the State Notice Law has applied to apartments subsidized through the following federal programs: 1) project-based Section 8 and USDA Section 521 rental assistance contracts; 2) mortgages financed through Section 221(d)(3) BMIR (Below Market Interest Rate) mortgage insurance, Section 236 IRP (Interest Reduction Payment) mortgage insurance, and Section 515 loans; 3) loans and capital grants through Sections 202 and 811 for housing the low income elderly and disabled; and 4) the LIHTC program (Section 42 of the Internal Revenue Code).

In 2005, the State Notice Law's coverage expanded to include a wide variety of properties with rental restrictions imposed under the terms of most other federal, state and local subsidy programs including the following: tax-exempt bond financing, HOME, CDBG, and McKinney homeless programs, grants or loans made by the state Department of Housing and Community Development (HCD), tax increment financing, housing trust funds, linkage funds, the sale or lease of public property at below market rates, or local land use incentives such as inclusionary zoning, parking variances and density bonuses. *It is important to note that owners who commit to maintaining or increasing the affordability of their properties for at least 30 years*

may be exempt from having to provide the required state notices if they meet specific conditions (see “Exemptions from the Notice Requirements”, below).

Required Notices to Tenants

Two notices to tenants are required: the first at twelve months prior to termination or expiration of the restrictions, and a second notice at six months. The twelve-month notice must state the owner’s intent to discontinue subsidies or that the rent restrictions will expire, the anticipated date of that event, the program involved, and information on the effect of removing the restrictions. The notice must also inform recipients whether other governmental assistance will be provided. For example, usually Section 8 vouchers are provided for HUD prepayments and Section 8 opt-outs, but not for USDA Section 515 or other properties facing expiring restrictions. For properties facing prepayment of HUD or USDA mortgages, or Section 8 opt-outs, the owner can satisfy this twelve-month state requirement by serving a copy of any legally sufficient federal notice.¹ The owner must also provide a copy of this notice to prospective tenants at the time of an eligibility interview occurring during the one-year notice period.

The six-month notice provides more specific information to all of the same entities that received the first notice. It must contain the following:

- Anticipated date of termination, prepayment, or expiration and identity of the program involved;

¹ This will usually work only for Section 8 opt-outs because federal notice periods for prepayments are shorter, and it’s often impractical for owners to serve them 12 months prior to expiration. Also, service of the federal notice does not fulfill the owner’s obligation under Section 65863.11 to serve a twelve-month notice of opportunity to make a purchase offer, as described below.

- Current rents and anticipated new rents;
- Statement that the notice is being sent to public agencies and that owner may still choose to keep project restricted or not increase rents;
- Statement of the owner’s intention to participate in any replacement subsidy program (e.g. Section 8 vouchers); and
- Names and phone numbers of the local government, public housing authority, and legal services organizations for tenants to contact about their rights and options and about the owner’s responsibilities.

If carefully drafted, this second six-month notice under state law can also satisfy all of the requirements of the federally required five-to- nine-month notice for prepayments of HUD-subsidized Section 236 and Section 221(d)(3) BMIR mortgages, permitting simultaneous compliance.

In addition, the second notice sent to public entities must provide additional specific information to enable assessment of the proposed impact on the community’s affordable housing stock. This information must include the:

- Number of affected tenants;
- Number of units assisted and type of assistance;
- Number of bedrooms in the assisted units;
- Number of unassisted units;
- Age and income of all affected tenants; and
- Description of owner’s plans, including:
 - Timetable of actions;

- Governmental action required;
- Reason for termination;
- Contacts being made with governmental agencies or others; and
- Copy of any federally required notice that was previously served.

Any time there is a significant change in the information required in the second notice, the owner must re-notify everyone again within seven business days of the change. Sample forms for these notices are posted on the HCD website (www.hcd.ca.gov/hpd/hrc/tech/presrv/) as well as on the CHPC website (www.chpc.net/preservation).

“Opportunity to Make a Purchase Offer” Notice Requirements

The purpose of the “opportunity to make a purchase offer” (Government Code Section 65863.11) is to provide organizations willing to preserve assisted housing development with an opportunity to purchase them prior to conversion.² It is important to note this is not an option to purchase, but an opportunity to make a purchase offer. The parties still have to agree on whether there will be a sale and all of the terms of sale. However, in the event the owner chooses to sell, the submission of a bona fide offer by a qualified entity does trigger a right of first refusal that provides the qualified entity with the right to match the terms of any other purchaser.

The owner must provide this notice to all qualified entities who register with HCD on their website (www.hcd.ca.gov/hpd/hrc/tech/presrv/) or

² Requiring owners to notify interested parties of the opportunity to make an offer does not apply to transfers to public agencies via eminent domain or negotiated purchase, or to foreclosure, gift or inheritance, or certified financial emergencies.

who contact the owner directly at least 12 months prior to the expiration of the restrictions or proposed transfer to another entity. *Owners proposing to sell or otherwise dispose of a covered property at any time during the five years prior to the expiration of restrictions must provide this notice at least 12 months in advance unless such sale or disposition would result in preserving the restrictions consistent with the requirements of Section 65863.13.*

Many organizations can qualify as entities entitled to notice, including the tenant association, local nonprofits and public agencies, regional or national nonprofits, and profit-motivated organizations and individuals. In order to qualify, an entity must meet the following criteria, which are self-certified later by those submitting bona fide offers:

- Be capable of managing the facility;
- Agree to maintain affordability for at least 30 years or the remaining term of assistance. The existing occupancy profile must be preserved and rents cannot exceed Tax Credit levels (30% of 50% or 60% of Area Median Income depending on the subsidy type).
- Cause these restrictions to be recorded in a regulatory agreement, binding on successors; and
- Agree to renew subsidies (project-based Section 8) if available and sufficient to maintain economic feasibility.

This notice must be sent by registered or certified mail, and must also be posted in the project.

Effective January 1, 2011, the initial notice of opportunity must include a statement addressing whether the owner intends to maintain the current number of affordable

units and level of affordability, whether the owner is interested in selling the property, and whether the owner has executed a long-term subsidy contract to maintain the property's affordability. This information is intended to give interested parties better information about owners' intentions. Additionally, unless 25% or less of the units on the property are subject to affordability restrictions or a rent or mortgage subsidy contract, the owner must state that it will provide additional financial information about the property to a qualified entity within 15 business days of a request. To assist a qualified entity in developing a bona fide offer, this information includes: terms of assumable financing and subsidies; proposed improvements, if any; monthly operating expenses; capital improvements made within the past two years; amount of project reserves; the two most recent financial and physical inspection reports and most recent rent roll and subsidy information; and vacancy rates for the past two years. The owner's notice must also state that qualified entities have the right to make a purchase offer. Finally, this notice must also state that all of the notice requirements under Section 65863.10 have been met, unless it is given before the other notices are required.

During the period immediately following this initial notice, the owner can accept offers only from qualified entities for the first 180 days. However, the owner has no obligation to accept any of the offers made. After the first 180 days, the owner can accept offers from anyone, but must give any qualified entity that submitted an offer in the first 180-day period an opportunity to match the accepted offer. A qualified entity must make an offer in the first period in order to be eligible to exercise this right of refusal.

If the owner accepts an offer from a non-qualified entity after the first 180-day period, all qualified entities that have made bona fide offers must be notified by registered or certified mail. They then have 30 days from

the date of notice to meet the accepted offer under the same terms and conditions. If the owner goes through this process and eventually sells to a non-qualified entity, the owner must certify that all provisions of this section have been met and record the certification.

Exemptions from the Notice Requirements

Under Section 65863.13, owners and purchasers seeking to change the financing and restrictions but still planning to preserve or increase the level of affordability can be exempt from the notice requirements of Section 65863.10 and the notice and opportunity to make offer requirements of Section 65863.11. In 2005, the exemption was broadened to cover the termination of other federal, state and local subsidies. Owners proposing to terminate their project-based Section 8 contract are not eligible for the exemption.

The purpose of the exemption from the state's notice and opportunity to make offer requirements is to further encourage owners to sell to buyers who will preserve the thousands of units at risk in California. This exemption for selling to a preservation buyer under these terms allows for a more expeditious transaction for sellers, while also facilitating preservation purchasers' compliance with the state's closing timelines for tax-exempt bonds and tax-credits. In addition to preservation transfers, the most common situation potentially meriting exemption will be refinancing by the existing owners that maintain or increase affordability.

Most projects that are being preserved utilize tax-exempt bonds and/or tax credits as part of their refinancing. The terms required to qualify for the exemption are generally consistent with the requirements of the California Debt Limit Allocation Committee (CDLAC) and the Tax Credit Allocation

Committee (TCAC) for obtaining a bond and/or credit allocation.

To qualify for an exemption from the notice requirements of Section 65863.10 and the notice and right of offer requirements of Section 65863.11, the owner must record a regulatory agreement containing the following restrictions:

- No low income tenant with restricted or subsidized rent shall be involuntarily displaced on a permanent basis as a result of the owner's action, absent a breach of lease;
- The owner must accept and fully use all renewals of project-based Section 8, if available, and if that assistance is sufficient to maintain the project's fiscal viability;
- The owner shall accept all enhanced Section 8 vouchers, if tenants receive them, and all other Section 8 vouchers for vacancies;
- The owner shall not terminate a tenancy of any low income tenant at the end of a lease term, except for breach of lease;
- In selecting applicants, the owner must consider all factors relevant to an applicant's ability to pay rent;
- For developments with only a portion of units assisted by one of the covered programs, the new regulatory agreement must restrict rents to levels at least as low as the restrictions under the prior regulatory agreement;
- For units with project-based Section 8 assistance at prepayment where any form of Section 8 later becomes unavailable (e.g. if Congress fails to appropriate funds), the underlying rents must be set no higher than 30% of 60%

of AMI so that tenants will never be asked to pay more than this amount even if Section 8 goes away. The owner must seek and accept any form of Section 8 that becomes available, and then abide by Section 8 rules.

- For units that are unassisted or do not have project-based Section 8 assistance at prepayment, rents must generally be set no higher than 30% of 50% of AMI. If the project has a Section 241(f) loan, rents can be set at the regulated rents under that loan (expressed as a percentage of AMI), if greater than 30% of 50% of AMI. The owner must seek and accept any form of Section 8 that becomes available, and then abide by Section 8 rules. Effectively, this means that "underwriting rents" for these units are limited to 30% of 50% of AMI.
- If a previously unassisted unit becomes assisted but is occupied by a non-low income household upon execution of the new regulatory agreement, the owner may charge rent no more than 30% of the household's gross income. Upon vacancy, the rent reverts to the level specified under the regulatory agreement.

All of these conditions must be contained in a regulatory agreement with a governmental agency that is recorded against the property to bind successors in interest and that runs for the greater of the term of the subsidy program being preserved or 30 years. No specific agency is identified in the law.

Enforcement

Enforcement of the provisions of Section 65863.10 is through court action for injunctive relief by any affected public entity (the locality, the local housing authority, HCD), as well as any tenant residing in the project at the time notice should have been provided. HCD currently lacks the staff to enforce these requirements, so it will fall to tenants and local agencies to insure that timely and legally sufficient notices are filed.

Violations of the requirements of Section 65863.11 are enforceable by qualified entities through judicial action seeking injunctive relief.