Purchase of Easements CDBG Program

October 7, 1988

MEMORANDUM FOR: Robert J. De Monte, Regional Administrator - Regional Housing Commissioner San Francisco Regional Office, 9S

FROM: Jack R. Stokvis, Assistant Secretary for Community Planning and Development, C

SUBJECT:Purchase of Easements Community Development Block Grant (CDBG) Program Program Number: B-87-UC-06-0505

This is in response to your request for guidance concerning a program which the County of Los Angeles proposes to undertake involving the purchase of easements. The easements would be funded under the County's CDBG program and would be used to reserve a certain percentage of units in newly constructed rental housing projects for occupancy by low and moderate income persons at rents affordable to this income group.

According to the information accompanying your request, the easements would be for a 15 year period, and thereafter, the property owner would have the option to repurchase them from the County, which would then treat the funds it gained from the sale as CDBG program income. If the property owner decided against the repurchase, the County would then have the option to require that the number of units made available to low and moderate income households be increased to 49 percent of the units in the project.

The County cites a project that it previously funded under its CDBG program as an illustration of how the proposed program would work. From the information in the enclosed project's easement deed and other information gained through a follow-up telephone call with your staff, we understand that this project, referred to as Sunrise Lancaster, received tax exempt financing. Consequently, under California State law, a minimum percentage of the project's units had to be made available to low and moderate income persons. In this case, 20 percent (or 31) of the project's 151 units were reserved for this income group through easements, which were paid for with CDBG funds, amounting to $491,000.00. Since the total cost of the project was $8,433,000.00, the CDBG contribution did not exceed 20 percent of that project's costs.

You ask whether the County would be precluded from using CDBG funds to acquire an easement if the project is financed with tax exempt financing or involves tax credits. The use of CDBG funds for easements could be eligible under section 105(a)(1) as an acquisition of an interest in real property. However, the Department has ruled in a previous case that this would only apply if the grantee's counsel opined that such easement constituted an interest in real property under State and local law, and if the amount paid for the easement did not exceed the bona fide value of the interest acquired.

If what the easements would require, however, is already required as a matter of law, any CDBG funds used to pay for such easements would be an unnecessary expenditure of CDBG funds, since the property interest being acquired would have no real value. However, there is one important exception to this and that is when it can be clearly documented that, despite the availability of the tax-exempt financing, a project would not be financially feasible if it were not for the addition of CDBG funds. For example in the case of the Sunrise Lancaster project, the CDBG payment of easements for the 31 (or 20 percent) of the project's units appears to have represented the same number of units that were required to be reserved for lower income households under State law. Therefore, for this project to be eligible, the County would have to document that the assisted housing would not have been built if it were not for CDBG assistance.

In the case of the proposed program, the County must be able to identify and clearly document the project(s) that, without CDBG funding, would not be built. For any project where the County is unable to do so, it would be limited to using CDBG funds to pay for that portion of the easement attributable to the number of units to be reserved for low and moderate income households that exceeds the number required under State law authorizing the tax exempt financing.

It is our understanding from information in that April 12 letter that the value of each easement would be determined through independent appraisal and would be set at the amount of property value reduction caused by the existence of the easement. Such a process appears to constitute a legitimate means for establishing a bona fide value for the proposed easements, so long as it takes into account the impact of the tax exempt financing restriction as discussed above.

The County also states in that letter that the CDBG funds spent on easement purchases would benefit low and very low-income persons. In response to that, it should be noted that, as an eligible acquisition activity, easements involving new construction, such as the Sunrise Lancaster projects and this proposed program, would have to meet national objectives under 570.208(a)(3)(i).
In meeting the requirements of this section, the number of units for low and moderate-income persons would have to represent at least 20 percent of the project's total number of units. However, this percentage would not have to be met exclusively through CDBG funded easements. For example, if the number of CDBG easements in the proposed project were less than 20 percent, the County would be allowed to also count those units for lower income persons that the project is required to provide under State law. Of course, the CDBG contribution could not represent a larger percentage of the project than the percentage of the total units that would be occupied by low and moderate income households following construction.

As noted above, the proposal provides that after a 15 year period the property owner would have the option to repurchase the easements from the County. We have attached an opinion from the Office of the Attorney General for the State of California which holds that the use of Federal funds by a city or county to purchase an interest which allows it to restrict the use of property to housing affordable low and moderate income persons comes within the terms of California Government code sections 65915 and 65916 as a "financial contribution" and "other incentive of equivalent financial value," thus triggering the 30-year use restriction required under these sections. The use of block grant funds to purchase the subject easements is clearly within the holding of the Attorney General's opinion. Consequently, a repurchase after the 15 year period would not serve to terminate the use restriction. Your letter should make it clear that the County must comply with state law in this regard.

Attachment