

**DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
DIVISION OF HOUSING POLICY DEVELOPMENT**

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September 21, 2022

Jennifer Gates, Planning Manager
Development Services Department
City of Encinitas
505 S. Vulcan Avenue
Encinitas, CA 92024

RE: Letter of Technical Assistance Regarding Replacement Units and Right of First Refusal Laws

Dear Jennifer Gates:

The California Department of Housing and Community Development (HCD) is responding to a request for information regarding the intersection of requirements to provide replacement units pursuant to State Density Bonus Law (SDBL)¹ and the Housing Crisis Act (HCA)² with the Right of First Refusal as required by the HCA.³ The request was initiated by D. Wayne Brechtel of Worden Williams, LLP, who is representing Brian Staver of Torrey Pacific (Developer) regarding the Torrey Crest Project (Project). When HCD reached out to the City of Encinitas (City), City staff expressed an interest in receiving technical assistance from HCD.

The Project consists of 30 detached single-family homes. Twenty-seven of the homes are market-rate and three of the homes will be affordable to very low-income (VLI) households. The three VLI units qualify the Project to receive a 50-percent increase in density.⁴ Six existing single-family homes will be demolished, all of which require replacement. Two of the homes being demolished qualify as protected units⁵ under the HCA. One of the protected units is occupied by a low-income (LI) household⁶ and one of the protected units is occupied by a VLI household.⁷ There is no disagreement between the City and the developer as to the number or affordability level of the units being demolished.

This technical assistance addresses how the requirements for the replacement units pursuant to SDBL and HCA reconcile with the requirements for the Right of First

¹ Gov. Code, § 65915, subd. (c)(3).

² Gov. Code, § 66300, subd. (d).

³ Gov. Code, § 66300, subd. (d)(2)(D).

⁴ Gov. Code, § 65915, subd. (b).

⁵ Gov. Code, § 66300, subd. (d)(2)(F)(vi).

⁶ Health and Safety Code, § 50079.5.

⁷ Health and Safety Code, § 50105.

Refusal in the HCA when the Project involves multiple households with a mix of income levels that qualify for benefits under the Right of First Refusal provision.

It is helpful to begin by distinguishing the difference between the goal of replacement unit requirements and the goal of the Right of First Refusal requirement. The goal of replacement unit requirements is to ensure a proposed housing development project does not result in a reduction to the number of housing units available, including the number of affordable housing units. The goal of the Right of First Refusal requirement is to provide housing opportunities to the households who are being displaced due to the housing development project. In short, replacement requirements address housing units while the Right of First Refusal addresses people.

SDBL and Replacement Unit Requirements Under SDBL and HCA

The HCA and SDBL harmonize regarding replacement units as the HCA⁸ specifically refers to SDBL statute:

“Replace” shall have the same meaning as subparagraphs (B) and (C) of paragraph (3) of subdivision (c) of 65915.”

SDBL⁹ states:

“...the proposed housing development shall provide at least the same number of units of equivalent size [bedroom count]¹⁰ to be made available at affordable rent or affordable housing cost to, and occupied by, persons and families *in the same or lower income category* as those households in occupancy...” (Emphasis added.)

SDBL clearly provides an option to provide greater affordability with the replacement unit(s) than was available with the unit(s) requiring replacement. It is important to note that neither the concept of Right of First Refusal nor the use of the term “protected unit” are included within SDBL.

Right of First Refusal Requirements Under HCA

The HCA defines protected units by establishing multiple criteria that qualify units as protected.¹¹ In the case of the Project, the two units in question are protected because they are rented by income-qualifying households. One household qualifies in the LI category and one household qualifies in the VLI category.

⁸ Gov. Code, § 66300, subd. (d)(2)(F)(vii)(I).

⁹ Gov. Code, § 65915, subd. (c)(3)(b)(i).

¹⁰ Gov. Code, § 65915, subd. (c)(3)(D).

¹¹ Gov. Code, § 66300, subd. (d)(2)(F)(vii).

The HCA seeks to provide additional benefits to lower-income households residing in protected units who will be displaced by development of a new housing project. Developers must provide the lower-income households with both relocation benefits and a right of first refusal for a *comparable unit* in the new housing development at an affordable rent or an affordable housing cost.¹²

The HCA defines a comparable unit¹³ as:

“...if one or more single-family homes that qualify as protected units are being replaced in a development project that consists of two or more units, ‘comparable unit’ means either of the following, as applicable:

“A unit containing the same number of bedrooms if the single-family home contains three or fewer bedrooms.”

“A unit containing three bedrooms if the single-family home contains four or more bedrooms. For purposes of this clause, a comparable unit is not required to have the same or similar square footage or the same number of total rooms.”

It is important to note that the term the HCA uses in its Right of First Refusal requirement is “comparable unit,” not “replacement unit.” While replacement units must be deed-restricted, there is no such requirement for comparable units to be deed-restricted.

Options Presented by the Developer and the City

The City and Developer agree that six units must be replaced and that two of them qualify as protected units – one for a LI household and one for a VLI household. The disagreement is regarding the specific criteria and characteristics required of units to satisfy both the replacement unit requirements and the Right of First Refusal requirements while simultaneously allowing the Project to receive a 50-percent increase in density under the SDBL.

Two Developer-Suggested Options:

Both of the developer’s options assume utilization of very low-income units to qualify for SDBL.¹⁴

¹² Gov. Code, § 66300, subd. (d)(2)(D).

¹³ Gov. Code, § 66300, subd. (d)(2)(D)(iii).

¹⁴ Gov. Code, § 65915, subd. (f)(1).

- As replacement units may be provided at the same or a lower income category, offer one of the VLI units to the LI household at the VLI rate.
 - HCD does not support this option as the LI household does not qualify as a VLI household. This may present a fair housing violation as it prevents a qualifying VLI household access to an affordable unit.
- Give the LI household the Right of First Refusal to rent an unrestricted market-rate unit at an affordable rent or purchase the unit at an affordable cost. When that specific household, the household qualifying for the Right of First Refusal, no longer occupies the unit, or if the household chooses not to accept occupancy in the unit (declines the Right of First Refusal), the unit can be immediately made available at market-rate because it is not deed-restricted.
 - HCD agrees that this is a valid option that satisfies all legal requirements: the replacement units are deed-restricted and satisfy the required affordability levels and both the LI household and the VLI household are offered comparable units at an affordable rent or cost. Units being offered for the Right of First Refusal are not required to be deed restricted.

Three City-Suggested Options:

The first two of the City's options assume utilization of VLI units to qualify for SDBL.¹⁵ The third option assumes utilization of LI units to qualify for SDBL.¹⁶

- Convert one of the three VLI units to a LI unit. This option reduces the bonus allowed under SDBL to less than the 50 percent requested by the developer.
 - HCD agrees this approach would reduce the bonus units to less than the 50 percent requested by the developer while accommodating the Right of First Refusal to both the LI and VLI households.
- Offer one deed-restricted unit at LI in addition to the three VLI units. This option retains the 50-percent bonus requested by the developer under SDBL.
 - HCD agrees this approach allows a 50-percent density bonus and accommodates the Right of First Refusal to both the LI and VLI households.
- Use the LI¹⁷ option of SDBL as opposed to the VLI¹⁸ option. This would require the developer provide four LI units and one VLI unit. (The VLI unit counts toward the LI total and accommodates the Right of First Refusal for the VLI household.¹⁹)

¹⁵ Gov. Code, § 65915, subd. (f)(2).

¹⁶ Gov. Code, § 65915, subd. (f)(1).

¹⁷ Gov. Code, § 65915, subd. (f)(1).

¹⁸ Gov. Code, § 65915, subd. (f)(2).

¹⁹ Gov. Code, § 65915, subd. (b)(1)(A).

- HCD agrees this approach allows a 50-percent density bonus and accommodates the Right of First Refusal to both the LI and VLI households.

Conclusion

HCD recognizes the complexities that arise when satisfying the many laws applicable to housing development projects. HCD appreciates the opportunity to provide technical assistance when conflicts appear and questions arise.

In this instance, there are multiple options that would satisfy both the replacement unit requirements of SDBL and the HCA and the Right of First Refusal required by the HCA. HCD encourages both the developer and the City to be flexible and work together to determine which of the acceptable options provides the best opportunity for project feasibility while supplying much-needed housing at all income levels for Californians.

If you have any questions regarding the content of this letter or need additional assistance, please contact Robin Huntley at Robin.Huntley@hcd.ca.gov.

Sincerely,

A handwritten signature in black ink that reads "Shannan West". The signature is written in a cursive, flowing style.

Shannan West
Housing Accountability Unit Chief

cc: D. Wayne Brechtel, Worden Williams, LLP