



Inclusionary Housing Requirements: Still Possible?

Friday, September 5, 2014 General Session; 10:15 a.m. – 12:00 p.m.

Andrew L. Faber, Berliner Cohen

DISCLAIMER: *This paper is not offered as or intended to be legal advice. Readers and conference attendees should seek the advice of an attorney when confronted with legal issues. Attorneys should perform an independent evaluation of the issues raised in these materials.*

Copyright © 2014, League of California Cities®. All rights reserved.

This paper, or parts thereof, may not be reproduced in any form without express written permission from the League of California Cities®. For further information, contact the League of California Cities at 1400 K Street, 4th Floor, Sacramento, CA 95814. Telephone: (916) 658-8200.

**LEAGUE OF CALIFORNIA CITIES
CITY ATTORNEYS' DEPARTMENT**

2014 Annual Conference

**INCLUSIONARY HOUSING
REQUIREMENTS: STILL POSSIBLE?**

By

**Andrew L. Faber, Esq.
Berliner Cohen
10 Almaden Boulevard, 11th Floor
San Jose, CA 95113
(408) 286-5800
alf@berliner.com
www.berliner.com**

**September 5, 2014
Los Angeles Convention Center
Los Angeles, CA**

Inclusionary Housing Requirements: Still Possible?

By Andrew L. Faber, Esq.

Why this paper?

A few years ago, it seemed that inclusionary housing was a concept that was straightforward in execution and pretty defensible. It had been the subject of a League City Attorneys paper every few years. About one-third of the cities in the State used some form of it to help produce affordable housing. But several events have altered the legal landscape:

- The demise of Redevelopment Agencies in 2012.
- The redefining of “exactions” by the California Supreme Court in Sterling Park.
- The granting of review by the California Supreme Court in the San Jose inclusionary housing case.
- The possible ramifications of the decision of the U.S. Supreme Court in the 2013 Koontz case.

So in light of these developments another look at this topic is warranted.

Has the need for affordable housing increased in recent years?

Yes it has. Many cities recognize the need for affordable housing, and, of course, there are many features of State law that mandate that awareness and recognition. For example the Housing Element Law requires that a city’s housing element identify sufficient sites that have appropriate zoning and are free from other physical and regulatory obstacles to be made available for affordable housing. *See* Govt. Code Section 65583.2(h). As another example, cities are required to give density bonuses and make other accommodations to projects that include appropriate affordable components. *See* Govt. Code Section 65915; Latinos Unidos Del Valle De Napa y Solano v. County of Napa (2013) 217 Cal.App.4th 1160 (density bonus is mandatory even if the project only includes affordable housing “involuntarily” to comply with a local ordinance).

And in the good old days of redevelopment, 15% of housing in redevelopment areas had to be affordable, and the Redevelopment Agencies had to devote 20% of their tax increment revenue to affordable housing.

The need has increased recently, particularly in parts of the State such as the San Francisco Bay Area, due to a confluence of several factors. First, the demise of redevelopment and a reduction in federal programs have led to a serious drop in funding available to affordable housing. For example, in Santa Clara County, it has been estimated that total funding available for affordable housing in 2008 (the last “normal” year) was approximately \$126 million. In 2013, the corresponding number was \$47 million. Assuming an average subsidy of \$150k per affordable unit, that would allow

the construction of a little over 300 affordable units per year. That number, in turn, is less than 20 percent of the Regional Housing Needs Assessment requirement (the RHNA number) for the current Housing Element cycle of 2014 to 2022, just for extremely low- and low-income housing.

The second factor has been the booming local economy. That has lowered the vacancy rate on rental housing, created a white hot real estate market for medium- to high-density multi-family housing, but, of course, also raised rents. According to economic surveys we have seen recently, rents in new construction in various Bay Area cities seem to average about \$3,000 per month (and more like \$3,600 in some cities). The average household income necessary to afford such rents is in the vicinity of one hundred thousand dollars per year, well above that of the average worker filling a new job in the retail sector generated by the new residents.

Even opponents of inclusionary housing or affordable housing fees concede the need for affordable housing. Generally speaking, they just don't think developers or landowners should have to foot the bill. The major opponents are builders' groups (e.g., California Building Industry Association) and the Pacific Legal Foundation, a property rights advocate.

How does all this relate to “inclusionary housing”?

What is called inclusionary housing is one particular way that some cities have tried to accommodate the need for affordable housing. The basic concept is to require developers to include affordable units in their projects. Typically, the affordable units must be interspersed among the market rate units, and must be of the same general design and appearance, though it is not uncommon to allow some downgrading of interior appointments in the interest of saving on construction costs.

There is a lively debate among affordable housing advocates over the desirability of using inclusionary housing. *Compare, e.g.,* Kautz, “In Defense of Inclusionary Zoning: Successfully Creating Affordable Housing,” 36 U.S.F. L. Rev. 971 (2002) *with* Floryan, “Cracking the Foundation: Highlighting and Criticizing the Shortcomings of Mandatory Inclusionary Zoning Practices,” 37 Pepp. L. Rev. 1039 (2010).

Generally speaking, dispersing affordable units among market rate units is seen as egalitarian and less stigmatizing, and is an approach that furthers integration of lower income households into the main fabric of a city. It also would tend to reduce neighborhood stratification of school-age children by economic class, and thus would further the goal of non-discriminatory public education. To the extent that economic status is correlated with race or ethnicity, it would also tend to reduce racial or ethnic geographic concentration.

On the other hand, an alternative of collecting an in lieu fee that would be applied to subsidize affordable housing projects also has supporters. For one thing, it should be a more efficient method, producing more affordable housing for the same investment.

One reason is that a 100% affordable project can be built to a more economical standard. In addition, many developers would prefer to simply pay a fee, which they can ascertain and include in project budgets without the further complications inherent in marketing and administering the affordable units.

Didn't the Napa case uphold inclusionary housing requirements under the city's police power?

The Napa case, Home Builders Assn of Northern California v. City of Napa (2001) 90 Cal.App.4th 188, did indeed uphold the city's inclusionary housing ordinance as against a facial challenge. The city's ordinance required a ten percent affordable component in any residential subdivision, or payment of an in lieu fee. The court upheld Napa's ordinance as a proper exercise of the city's police powers and rejected challenges based on a takings claim and a claimed violation of due process. In addition, the ordinance contained a provision for administrative relief that the court also saw as preventing a facial challenge:

When an ordinance contains provisions that allow for administrative relief, we must presume the implementing authorities will exercise their authority in conformity with the Constitution. (See Fisher v. City of Berkeley [1984 37 Cal.3d 644, 684].)

Here, as we have noted, City's ordinance includes a clause that allows city officials to reduce, modify or waive the requirements contained in the ordinance "based upon the absence of any reasonable relationship or nexus between the impact of the development and . . . the inclusionary requirement." Since City has the authority to completely waive a developer's obligations, a facial challenge under the due process clause must necessarily fail. 90 Cal.App.4th at 199.

A similar result was reached a few years later in the Santa Monica case of Action Apartments Assn v. City of Santa Monica (2008) 166 Cal.App.4th 456.

This law seemed to be so solidly fixed that a presenter of a paper at the League City Attorneys conference in 2011 stated that there was no way that San Jose could lose its inclusionary housing case, then pending in the trial court (she was accused by the writer of this paper of potentially jinxing the case).

Up to mid-2013, the outlook was still bright for inclusionary housing in the court system. Two published opinions were helpful. The first was Trinity Park, LP v. City of Sunnyvale (2011) 193 Cal.App.4th 1014. In that case, the question was: what is an "exaction" under the Mitigation Fee Act (the "MFA," Govt. Code Section 66001 *et seq.*) and more particularly Section 66020, which provides for a procedure to protest fees or exactions. In the published opinion, the Sixth District Court of Appeal held that an affordable housing requirement of the City of Sunnyvale was not an exaction under the MFA because it was not levied to help defray the costs of public infrastructure or facilities. A reasonable conclusion to be drawn from that opinion was that an affordable

housing requirement or in lieu fee could not be challenged for failure to meet the technical requirements of the Mitigation Fee Act.

Also, the City of San Jose had won its case in the same Sixth District Court of Appeal. The San Jose ordinance, which had not yet gone into effect on a city-wide basis (though a predecessor requirement had been in effect for years in redevelopment areas), had been enacted and was defended in court as a proper exercise of the police power. Although the ordinance contained recitals that the development of market rate housing created a need for affordable housing, the ordinance was not based upon a formal nexus study. It was a true inclusionary housing ordinance, requiring that any residential development containing more than 20 units provide 15 percent affordable units as part of the project. For-sale units could be sold to anyone earning no more than 120 percent of area median income. Like many such ordinances, it allowed for alternate performance at the developer's option, including land dedication or payment of an in lieu fee to be calculated as the cost of providing subsidies to allow the construction elsewhere of the affordable units not provided in the project.

The San Jose ordinance was challenged by the California Building Industry Association. The challenge was not based on State or Federal Constitutional grounds (including explicitly, the "takings" clause) or on Mitigation Fee Act grounds. The petitioner's primary objection was the lack of a nexus study, and the claim that as a result of that lack, the ordinance failed to meet the standard of San Remo Hotel v. City & County of San Francisco (2002) 27 Cal.4th 643, 671 (legislatively enacted fee "must bear a reasonable relationship, in both intended use and amount, to the deleterious public impact of the development").

The trial court, however, issued a permanent injunction against enforcement of the ordinance in this facial challenge, in a relatively incoherent opinion that rejected the City's police power justification. [Disclosure: the author of this paper is one of the attorneys of record for San Jose in this litigation.] On appeal, the Sixth District issued a published opinion upholding the ordinance as a valid exercise of the police power. *See California Building Industry Assn. v. City of San Jose* (Cal. App. 6th Dist. 2013) 2013 Cal. App. LEXIS 447, 2013 WL 2449204, *formerly published at* 216 Cal. App. 4th 1373.

Sounds good. Why the current worries?

Well, the California Supreme Court has stepped in with two actions that may change the legal landscape established in Napa. First, it took the opportunity to take a close look at the subject of exactions in the case of Sterling Park, L.P. v. City of Palo Alto (2013) 57 Cal.4th 1193, in the process explicitly criticizing and ultimately disapproving of the Sixth District's holding in Trinity Park regarding the meaning of "other exactions" under the MFA. Second, it granted review in the San Jose case, thus potentially signifying its intent to take a new look at the City's justification for the ordinance (and, of course, vacating that helpful appellate opinion).

Let's discuss Sterling Park first, as this is a major development in the whole area of exactions and impact fees.

The case arose in a dispute over a statute of limitations, but the Court used it as a springboard to clarify its interpretation of the scope of the "other exaction" language in the Mitigation Fee Act. The developer in this case was required under the Palo Alto inclusionary program to set aside ten units of its 96-unit for sale project as affordable, inclusionary units. The developer did not object when the project was approved, but did file a protest letter under the Mitigation Fee Act when it came time to make an in lieu payment to the City. The trial and appellate courts, following Trinity Park, held that the MFA did not apply to this fee, since it was not for the purpose of financing public improvements; thus, the "protest" was barred by the 90-day statute of limitation contained in the Subdivision Map Act, Govt. Code Section 66499.37.

The Supreme Court rejected this argument, however, holding instead that the timeliness of the protest would be governed by the protest procedure of the Mitigation Fee Act, Govt. Code Section 66020. The Court summarized the issue and the decision of the Appellate Court as follows:

The question concerning section 66020's applicability comes down to this: Are the requirements at issue "any fees, dedications, reservations, or other exactions" under section 66020, subdivision (a)? The Court of Appeal held that they are not.

Trinity Park, supra, 193 Cal.App.4th 1014, the case on which the Court of Appeal primarily relied in reaching its conclusion, supports the City's argument. *Trinity Park*, and the Court of Appeal here, interpreted the phrase "any fees, dedications, reservations, or other exactions" as being limited to fees as defined in section 66000, subdivision (b): "a monetary exaction ... that is charged by a local agency to the applicant in connection with approval of a development project *for the purpose of defraying all or a portion of the cost of public facilities related to the development project.*" (Italics added.) The Court of Appeal also held that the requirements at issue here were not imposed for the purpose of defraying the cost of facilities related to the proposed development. 57 Cal.4th at 1200-01.

The Supreme Court rejected the conclusion reached by the Sixth District, in part due to different interpretations of the maxim "ejusdem generis". Summarizing where it said the Sixth District went wrong, the Court said:

Trinity Park used the canon of *ejusdem generis* to conclude that section 66020's words "any fees, dedications, reservations, or other exactions" mean nothing more than fees as defined in section 66000, subdivision (b). But this view deprives the words "any" and "or other exactions" of all meaning. As we said in interpreting another statute within the Mitigation Fee Act, "[t]he use of the word 'any' and the inclusion of

several disjunctives to link essentially synonymous words all serve to *broaden* the applicability of the provision.” (*Utility Cost Management v. Indian Wells Valley Water Dist.* (2001) 26 Cal.4th 1185, 1191, italics added [referring to § 66022].) The words “any ... other exactions” must have some meaning to broaden the statute's reach beyond merely a specific definition of fees. 57 Cal.4th at 1203.

After discussing two other cases that had interpreted this language: Fogarty v. City of Chico (2007) 148 Cal.App.4th 537 (holding that a restriction on number of units in a project *was not* an “other exaction”) and Williams Communications LLC v. City of Riverside (2003) 114 Cal. App.4th 642 (holding that a license fee for installing fiber optic cable in the city streets *was* an “other exaction”), the Court stated its view that Fogarty and Williams had correctly interpreted the law, concluding with:

In combination, *Williams* and *Fogarty* indicate that the term “other exactions” under section 66020 at least includes actions that divest the developer of money or a possessory interest in property, but it does not include land use restrictions. This interpretation conforms to the statute's plain language far better than does *Trinity Park's* excessively narrow interpretation. Divesting the developer of money or a possessory interest is similar to imposing a fee, dedication, or reservation. This interpretation also conforms to the legislative purpose behind the statute. 57 Cal.4th at 1204.

Much of the oral argument in Sterling Park was devoted to debating fine points of real estate law, on the issue of whether when the city took an option to purchase an affordable unit (part of the city program to ensure continued affordability in the future), that constituted taking a possessory interest in real property.

The Court concluded that it did, and ended up with a prescient statement that could apply to the next case – the San Jose case now awaiting argument:

It may be, as the City argues, that under traditional property law, an option to purchase creates no estate in the land. But a purchase option is a sufficiently strong interest in the property to require compensation if the government takes it in eminent domain. (*County of San Diego v. Miller* (1975) 13 Cal.3d 684, 691–693.) Compelling the developer to give the City a purchase option is an exaction under section 66020. Because of this conclusion, we need not decide whether forcing the developer to sell some units below market value, by itself, would constitute an exaction under section 66020. 57 Cal.4th at 1207 (emphasis added).

The Court may have taken the San Jose case in order to have a vehicle to decide this reserved issue as to whether a purely inclusionary requirement would be subject to the Mitigation Fee Act, since San Jose’s ordinance does not involve the city’s taking an

option on the property. If the Court decides that such a program, viewed as one that simply requires below market rate units to be built and sold, is indeed subject to the MFA, then the Court will effectively have rejected the pure police powers rationale for the program. Of course, there are a number of arguments against that position, including that price controls, rent control, mobile home vacancy restrictions, etc., have all been upheld in the past by the Court. Nevertheless, the possibility of a holding that even a program of purely inclusionary housing (with no in lieu fees, possessory interests or other complications) could be held to fall under the Mitigation Fee Act has many cities concerned and evaluating alternative approaches.

Are there other reasons to consider alternative approaches to straight inclusionary housing requirements?

Yes, and the most important such reason is to get around the Palmer case. This is a monkey wrench thrown into the affordable *rental* housing works by the Second District Court of Appeal in 2009. That decision, Palmer/Sixth Street Properties, L.P. v. City of Los Angeles (2009) 175 Cal.App.4th 1396, invalidated a Los Angeles inclusionary housing requirement contained in a specific plan for an area of the city as applied to rental units on the basis that its pricing controls violated the Costa-Hawkins Act of 1995, Civ. Code Section 1954.50, *et seq.*, which outlawed traditional rent control in new buildings in the state.

As a result of Palmer, cities with affordable housing ordinances for rental housing resorted to a variety of actions, including no action. For those which did not ignore the case, some have suspended their ordinances as applied to rental units. Others have bitten the bullet and instituted in lieu fees based on a nexus study (see below). In addition, under Costa-Hawkins, rent control can exist for a project where the builder receives either financial assistance or a Density Bonus Law (Govt. Code Section 65915) concession, and agrees by contract with the city to restrict rents.

Many housing advocates have pushed for a legislative solution; this case is widely viewed as a misapplication of the Costa-Hawkins Act to a situation it was never contemplated to address – thus crying out for a legislative overrule. A number of bills have been introduced to re-establish the legitimacy of affordable housing requirements for rentals. However, the most promising such bill, AB 1229, was vetoed by Governor Brown in October, 2013. In his veto message, he left little hope for an immediate resolution of this impasse:

As Mayor of Oakland, I saw how difficult it can be to attract development to low and middle income communities. Requiring developers to include below-market units in their projects can exacerbate these challenges, even while not meaningfully increasing the amount of affordable housing in a given community.

The California Supreme Court is now considering when a city may insist on inclusionary housing in new communities [the San Jose case]. I would

like the benefit of the Supreme Court's thinking before we make adjustments in this area.

So what approaches may still be valid for inclusionary housing?

The next few sections of this paper will discuss several approaches that may continue to work for inclusionary ordinances. The question admits of a more sanguine response if we broaden it to include affordability requirements other than strict inclusion in new projects (e.g., in lieu fees). Here are some of the major ideas that may be considered:

- Justify inclusion under the police power (the San Jose case)
- Do a nexus study and justify inclusion under the San Remo standard or the MFA
- Convert the inclusionary requirement to a fee and justify it under the MFA
- Do a nexus study and adopt a commercial linkage fee
- Methods that are not directly tied to project impacts
 - Set up a Housing Trust Fund to provide subsidies
 - Set up an Infrastructure Financing District
 - Zone explicitly for a more affordable product
 - Use more development agreements
 - Conserve existing affordable stock (e.g., mobile homes)

Taking these in turn:

Justify inclusion under the police power

This is the traditional justification that was accepted by the Napa case and is being urged by the City of San Jose in front of the California Supreme Court. While the author of this paper is optimistic that this rationale will be accepted by the Court, any city attorney giving conservative advice to his or her city would probably suggest doing a nexus study to justify the ordinance.

Do a nexus study and justify inclusion under the San Remo standard or the MFA

A number of cities have embarked on nexus studies. The ones that this author has seen have all involved affordable housing *fees* (see below for further explanation of such nexus studies). But there seems to be no intrinsic reason why a nexus study could not be done for the inclusionary construction of the housing itself.

Such a requirement (without an in lieu fee component) would presumably, if not justified under the police power, have to satisfy either the standard of San Remo or the stricter standards of the MFA. The former derives from the case of San Remo Hotel L.L.P. v. City & County of San Francisco (2002) 27 Cal.4th 643. That case involved a takings challenge to a San Francisco ordinance requiring that a fee be paid to compensate for the conversion of residential units to transient occupancy units. This was a legislatively adopted fee, and the Court first rejected the argument that the standard of review should be the strict standard under Dolan v. City of Tigard (1994)

512 U.S. 374, Nollan v. California Coastal Commission (1987) 483 U.S. 825 and Ehrlich v. City of Culver City (1996) 12 Cal.4th 854. The Court then held, nonetheless, that “as a matter of both statutory and constitutional law” fees imposed for the purpose of mitigating development impacts “must bear a reasonable relationship, in both intended use and amount, to the deleterious public impact of the development.” 27 Cal.4th at 671. Having a nexus study meet this standard should not be difficult.

In addition to meeting the San Remo standard, compliance with the Mitigation Fee Act could be required if the Supreme Court ultimately decides the question it explicitly left open in the Sterling Park case: “whether forcing the developer to sell some units below market value, by itself, would constitute an exaction under [Govt. Code] section 66020.” If decided in the affirmative, then the Mitigation Fee Act would apply to such an inclusionary requirement. The appropriate approach now would seem to be to produce a nexus study that would comply with both the San Remo standard and the Mitigation Fee Act.

Complying with that Act will require a bit of creativity, since there are no public facilities being constructed under this approach. But since the Supreme Court will be the source of this requirement if they do decide the retained question in favor of the Act’s application to inclusionary housing requirements, one can hope that they will also give some guidance as to how compliance should be demonstrated.

Finally, while this approach could work with for-sale product, it still doesn’t get around the rental impasse created by Palmer. Since, as a practical matter, households below the moderate income level of 80 percent of area median income are normally renters, this approach probably wouldn’t do much for extremely low- and low-income households.

Convert the inclusionary requirement to a fee and justify it under the MFA

The most popular approach, at least in the Bay Area, seems to be to convert the inclusionary requirement into a straight fee to support affordable housing construction, instead of an in lieu fee. This fee can then be used by the city to subsidize the production of affordable units independent of the kind of project on which the fee is assessed. Furthermore, the city can presumably work around the Palmer case by using the money for either for-sale or rental units, since Palmer would not apply to a city-subsidized project (or where the city is a lender and negotiates terms of the loan to include affordability).

There are a number of economic firms producing these studies, including Keyser Marston Associates (KMA), Bay Area Economics (BAE), Economic and Planning Systems (EPS), David Paul Rosen & Associates (DRA), and others. The studies reviewed by this author tend to follow a similar pattern. For example a study designed to determine how many affordable units are needed to house new workers attributable directly and indirectly to the production of 100 rental market-rate apartments, might work as follows:

First, calculate the average market rental rate of the new units.

Second, calculate the household income needed to rent such a unit, using conventional guidelines, such as that rental housing costs should not exceed 30 percent of disposable income.

Third, deduct savings and taxes to calculate total disposable spending power per household.

Fourth, translate that spending power into job creation, determining how many jobs are created in each of various job categories, e.g., retail, health services, transportation, professional services, etc. For this purpose, some companies use a national model called IMPLAN, which takes local county census data as inputs.

Fifth, for the matrix of generated jobs, determine the income level of each net new worker.

Sixth, determine how many households will be formed by those new workers.

Seventh, calculate the average total income of such households, and thus categorize them by affordability criteria as extremely low-, very low-, low-, moderate-, or above moderate-income. This tells the city how many new units are needed for rentals in each of these categories for the new workers and their families.

Eighth, calculate an “affordability gap” for each category of housing. Essentially that is the subsidy needed per unit over and above the amount of the development cost that can be justified by the reduced rents that lower income households can afford to pay.

Ninth, the total of all such required subsidies is the total amount of funds needed to be collected from the developer to enable the appropriate number of affordable units to be constructed.

Tenth, translate that total dollar requirement into a fee per unit or per square foot. This is the *maximum* fee that can be charged.

Finally, set the level of the fee itself, typically at a level well below the maximum permissible. It is always advisable to have some slack in the fee, both because there may be mistakes and uncertainties in the analysis, and also because many cities believe that not all the cost of such units should be borne by the development community.

This process follows in general outline the methodology for Mitigation Fee Act nexus reports (often called AB 1600 studies) that have been used for years to justify development impact fees. This approach has generally been upheld by the courts. *See, e.g., Garrick Development Co. v. Hayward Unified School District* (1992) 3 Cal.App.4th 320 (school fees); *Russ Building Partnership v. City and County of San Francisco* (1987) 199 Cal.App.3d 1496 (transit impact fee on new office development).

It is assumed that this approach should be valid and defensible in State courts for affordable housing fees on residential development as well.

In the Bay Area, fees justified by this method recently have been set typically in the \$15,000 to \$20,000 range per rental unit.

Do a nexus study and adopt a commercial linkage fee

It is also possible to adopt a fee (typically assessed per building square foot) to help meet the need for affordable housing generated by commercial and industrial development, which predictably would generate additional workers, also needing housing. The general approach would be the same as outlined above, and conceptually would be similar to the justification for school impact fees, which are authorized by Govt. Code Section 65995 for both residential and nonresidential construction. The cities of Menlo Park, Oakland, and San Diego have such a fee, and one has been upheld by the Ninth Circuit. See Commercial Builders of Northern California v. City of Sacramento (Ninth Cir. 1991) 941 F.2d 872 (affordable housing fee on commercial development).

Methods that are not directly tied to project impacts

These approaches aren't really related directly to tying the need for affordable housing to the impacts caused by new development, but I thought it would be useful to mention a few other ideas that have been surfaced to aid the production of affordable housing.

The first approach is to set up a Housing Trust Fund to provide subsidies to affordable project developers. This approach is being taken in San Francisco. It must rely on sources of funding other than in lieu fees, such as available excess Redevelopment funds, dedicated taxes or portions thereof, etc.

Another approach, also being tried in San Francisco, is to set up an infrastructure financing district for a particular planning area, and use dedicated property taxes or assessments to fund affordable housing.

Third, it is possible to use zoning laws directly to encourage affordable housing. An example followed by several cities is to require secondary dwelling units to be constructed in conjunction with market rate units. Some small cities in the Bay Area have satisfied their Housing Element mandate to provide sites for affordable dwellings by use of this method. It should also be possible to provide for an explicit mix of unit sizes in a project, including very small units that would, by design, end up being much more affordable than larger units.

Fourth, we have seen growth control measures that reserve a number of building permits (or give more "points" in a competition for a limited number of available building permits) to projects with affordable units.

Fifth, for large projects where developers may want the assurance of vested rights under a development agreement, negotiate affordable housing as one of the city benefits constituting partial consideration for entering into a development agreement.

Finally, and this is actually another required provision in Housing Elements (*see* Govt. Code Section 65583(c)(2)), cities can actively conserve existing affordable stock by such means as assisting in rehabilitation of older units and encouraging preservation of mobile home parks.

Does the recent U.S. Supreme Court decision in the Koontz case affect this analysis?

Like most forays of the U.S. Supreme Court into the area of land use regulation and takings jurisprudence, its recent decision in Koontz v. St. Johns River Water Management District (2013) ___ U.S. ___, 133 S.Ct. 2586, will spur copious critical commentary and leave as many questions unanswered as answered. Undoubtedly, scholars will be kept busy for years trying to understand the limits of the holding. It may ultimately bear some relationship to inclusionary housing ordinances, but the precise delineation of any possible impact will have to await future judicial pronouncements.

Mr. Koontz wanted to develop 3.7 acres of his 15-acre property, most of which was wetlands. He offered to give the permitting authority a conservation easement over the rest of the land. The agency rejected that approach but was willing to grant the permit if he would agree to expend funds to improve an unrelated wetland owned by that agency many miles away from his property. He refused, and the permit was denied.

In a five to four decision penned by Justice Alito, the Court ruled in favor of Koontz, establishing two major principles regarding the strict scrutiny of Nollan and Dolan. First, it can apply when a permit is *denied* for failure of the applicant to accede to an invalid condition, not just when a permit is *granted* with an invalid condition. Second, it applies to demands for money, not just for dedications of property. The first principle was agreed to by all of the Justices, but the second was highly controversial, and brought forth a spirited dissent by Justice Kagan, joined by Justices Ginsburg, Breyer and Sotomayor.

The first point is truly new law, and will change California takings jurisprudence. It may also change the fundamental relationship between cities and developers as they negotiate permit conditions. The second point, however, is consistent with the decision reached by the California Supreme Court 17 years earlier in Ehrlich v. City of Culver City, *supra*.

The major point left unsettled by Koontz, however, and one that may have significant ramifications for inclusionary ordinances, is whether the “nexus” and “rough proportionality” requirements of Nollan/Dolan apply only to ad hoc, *adjudicative* decisions (as most courts have held, including in California), or whether they also can

be applied to *legislative* enactments imposing a fee of general applicability based on a set formula. The majority opinion in Koontz doesn't give much indication that the Court intends to so extend the Nollan/Dolan doctrine, but in dissent, Justice Kagan warns of just such an eventuality:

Perhaps the Court means in the future to curb the intrusion into local affairs that its holding will accomplish; the Court claims, after all, that its opinion is intended to have only limited impact on localities' land-use authority. [Citation omitted]. The majority might, for example, approve the rule, adopted in several States, that *Nollan* and *Dolan* apply only to permitting fees that are imposed ad hoc, and not to fees that are generally applicable. *See, e.g., Ehrlich v. Culver City*, 12 Cal. 4th 854, 50 Cal. Rptr. 2d 242, 911 P. 2d 429 (1996). *Dolan* itself suggested that limitation by underscoring that there "the city made an adjudicative decision to condition petitioner's application for a building permit on an individual parcel," instead of imposing an "essentially legislative determination[] classifying entire areas of the city." 512 U. S., at 385, 114 S. Ct. 2309, 129 L. Ed. 2d 304. Maybe today's majority accepts that distinction; or then again, maybe not. At the least, the majority's refusal "to say more" about the scope of its new rule now casts a cloud on every decision by every local government to require a person seeking a permit to pay or spend money. 133 S.Ct. at 2608.

So, as to whether Nollan/Dolan scrutiny will be extended to legislatively imposed fees or exactions, at least four members of the current U.S. Supreme Court would vote no. As Justice Kagan notes, however, the existence of a fifth vote is unknown. If such scrutiny is extended to legislatively enacted fees, it would directly contradict the California Supreme Court's holding to the contrary in Ehrlich. Fees or exactions adopted pursuant to a proper nexus study could meet that standard, however.

August 5, 2014
Andrew L. Faber
Berliner Cohen
10 Almaden Blvd., Suite 1100
408 286-5800
alf@berliner.com