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INCLUSIONARY ZONING AFTER *PALMER* & *PATTERSON*—

ALIVE & WELL IN CALIFORNIA

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INCLUSIONARY HOUSING UNDER ATTACK—THE SECOND GENERATION

Two recent California Court of Appeals decisions present communities and advocates with new questions regarding the legal parameters of inclusionary zoning and related in-lieu fees—*Palmer/Sixth Street Properties L.P. v. City of Los Angeles*, 175 Cal. App. 4th 1396 (2009) and *Building Industry Assn of Central California v. City of Patterson*, 171 Cal. App. 4th 886 (2009).[1] This memorandum attempts to sort these out and considers a variety of options for continued implementation of local inclusionary laws.

In most cases, revisions to existing ordinances should not be immediately necessary, as the legal issues raised by these decisions can be addressed adequately in the development approval process. Indeed, jurisdictions may risk triggering new statutes of limitations to challenge an ordinance based on the adoption of the amendment. But, in light of *Palmer* it is probably necessary to consider alternative means of ensuring affordable rental housing is developed. And, although the in-lieu fee formula examined in *Patterson* was unlike any other in California, in view of the attempts of some developers to bootstrap the result in *Patterson* into attacks on conventional inclusionary and in-lieu fee requirements, clear responses are needed and are considered below.

[1] In 2002 PILP and WCLP published a comprehensive memorandum on legal issues raised by local Inclusionary Zoning Laws—*Inclusionary Zoning—Legal Issues.* (http://www.pilpca.org/www/docs/IZLEGAL_12.02.pdf.) It focused principally on the first California appellate court case to consider the legality of inclusionary zoning in the face of takings, due process and Mitigation Fee Act challenges, upholding Napa's ordinance—*Homebuilders of Ass'n of Northern California v. City of Napa,* 90 Cal.App.4th 188 (2001). Since 2002, in addition to *Palmer* and *Patterson*, the U.S. Supreme Court in *Lingle v. Chevron U.S.A., Inc.*, 544 U.S. 528 (2005) altered the legal standard under the takings clause of the Constitution, and another California appellate court has considered constitutional and statutory attacks on inclusionary housing programs, upholding Santa Monica's law (*Action Apts. Ass'n v. City of Santa Monica*, 166 Cal.App.4th 456 (2008)). These and other relevant cases are considered in an expanded version of this memorandum.

THE DECISIONS, RESPONSES & ACTIONS NEEDED

A. *PALMER & PATTERSON*

1. Palmer

Palmer held that specific plan provisions that required developers of new rental housing to rent a portion of the units at restricted rents conflict with the Costa Hawkins Act (Civ. Code §1954.50 *et seq.*) adopted in 1995 to permit developers to set initial rents on newly construction units and units voluntarily vacated. The court also found that the alternative of paying an *in-lieu* fee did not save the inclusionary requirement because payment of the fee was "inextricably intertwined" with the mandate to impose rent restrictions. Finally, it noted that the exception in the Act[2], which allows rent restrictions on units developed pursuant to a contract with local government that provides incentives and concessions similar to those in the Density Bonus statute (Gov. C. §65915), does not apply when the developer is mandated by local law to enter into a contract to provide the affordable units.

The court deemed the language of the Costa-Hawkins Act unambiguous and therefore found it unnecessary to review the legislative history of the Act. If it had it would have discovered substantial indication that the Act was only intended to apply to strict rent control ordinances—those which limited rents on all rental units in a community regardless of the income of the tenants or whether the unit had been voluntarily vacated. Indeed, given the number of jurisdictions with inclusionary zoning laws even in 1995 when Costa Hawkins was adopted, it seems apparent that the exception to the Act for units with restricted rents pursuant to contracts with local government was intended to cover inclusionary units.

Although all trial courts in the state are bound by the decision, a case brought in a part of the state covered by a different appellate district could come out differently on appeal. Clarifying amendments by the state Legislature are needed, but probably unlikely until next year. Until another court or the Legislature acts, jurisdictions will not be able to mandate rent restrictions on inclusionary units in new rental housing developments. Existing inclusionary units are likely safe because they are covered by recorded agreements and statutes of limitations have run.

[2] Civ. Code §1954.52(b)

2. *Patterson*

Patterson transformed its traditional 10% on site inclusionary requirement to a "development impact fee," and that's where its problems began. Departing from the standard methodology of basing an inclusionary in-lieu fee on a portion of the actual cost of developing the forgone inclusionary units, Patterson derived a development impact fee ostensibly tied to the impact of new residential development on the need for affordable housing. The *Patterson* court found that the City's unique formula for determining these fees did not yield a fee that is reasonably related to that stated purpose. Local governments can distinguish their in-lieu fees by basing there fees on a formula related to the cost of developing the inclusionary units and clearly indicating that the purpose of their inclusionary obligation and in-lieu fee alternative is to address far more than just a needs for housing created by new housing.

The court's analysis is not relevant to most inclusionary in-lieu fees for at least two reasons. First, the purpose of most inclusionary in-lieu fees is very different than the purpose of Patterson's fee. Almost all are intended to provide a source of funds sufficient to facilitate production of the affordable units the developer otherwise would provide. Patterson's fee, on the other hand, is intended to offset the impact of residential development on the need for affordable housing. Therefore, whereas the *Patterson* court was faced with determining whether there was a reasonable relationship between the amount of the fee and the need for affordable housing created by residential development, courts addressing standard in-lieu fees would need only to assess whether the amount of the fee was related to the cost of developing the inclusionary units.

Patterson based its fee on an intricate analysis of the cost of affordable housing development, the City's share of the regional need for housing and the amount of remaining developable residential land. The court found that the City failed to establish a reasonable relationship between the City's regional housing need and the need for affordable housing associated with new market rate development of remaining land. Significantly, the court did not say the City *could* not establish such a relationship—it simply found that the City had not done so.

The second reason the opinion has limited effect is that it fails to adequately take into account the U.S. Supreme Court's recent *Lingle v. Chevron U.S.A., Inc.*[3] decision, which changed the legal standard for determining whether application of a local law constitutes a taking. In *Lingle* the Supreme Court dispensed with the "substantially advances"/means-end test for determining whether a local law works a taking and is the basis of the "reasonable relationship" test of development fees. No longer is a local law measured by the *extent* to which it actually advances the stated purpose of the ordinance. Instead, court asks whether the ordinance is sufficiently related to its purpose (under due

[3] 544 U.S. 528, 564 (2005)

process and equal protection standards), and when the ordinance is applied to a specific development, under the takings standard of *Penn. Central Transp. Co. v. New York City*,[4] the court examines the extent of the economic impacts of the development in relation to the nature of the requirement and determines whether it goes so far as to be confiscatory.

The reach of the *Patterson* opinion thus should be limited to its narrow and distinctive facts and by its failure to adequately incorporate the *Lingle* analysis. Nevertheless, at least three communities—San Jose, Palo Alto and Sunnyvale—face court challenges attacking their inclusionary ordinances and in-lieu fees based in part on extremely expansive reading and questionable extrapolation of its out-dated legal analysis and the peculiar facts.

B. LOCAL RESPONSES

Palmer. Although there is an effort to seek an amendment to the Costa-Hawkins Act to overturn *Palmer*, the likelihood of that occurring, especially this year, is uncertain. In the meantime, to address *Palmer* local governments must at least implement their inclusionary housing requirements so that developers of rental housing are allowed to determine the initial rents of all units on site. But they must also find a legally viable alternative to ensure that new development in the aggregate will include sufficient affordable housing to accommodate existing and future needs.

Patterson. A few localities, apparently hoping to avoid litigation based on theories expressed in *Patterson*, are planning to revise their in-lieu fee (and some their on-site inclusionary requirements) after undertaking nexus studies unnecessarily limited to determining the extent to which new housing development generates a need for new housing. But, to pass constitutional muster, inclusionary requirements and the attendant in lieu fees need only to be related to their undeniably legitimate and important legislative purpose—to ensure housing affordable to all economic segments of the community and surrounding region is included in future development. Amendment, therefore, may be unnecessary, and may even render these communities vulnerable to legal attacks based on the premise of the studies.

Communities and advocates must confront head-on the misplaced view advanced by some after *Patterson*—that inclusionary housing obligations and in-lieu fees are a type of exaction required to be strictly related to the projected need for new affordable housing created by new housing development *rather* than land use regulations related to the community's legitimate desire to accommodate its critical existing and projected needs for affordable housing, to provide opportunities for households of all income levels and to affirmatively further integration and other fair housing goals.

[4] 438 U.S. 104 (1978)

C. WHAT COMMUNITIES AND ADVOCATES NEED TO DO (AND NOT DO)

Palmer

1. EXISTING ORDINANCES.

- **Inclusionary Requirements on *For-Sale* (Single/Multi) Housing Still Valid**. Ordinances may need amendment to require that affordable units be offered for sale within a defined period of time as a condition for approval of a tentative subdivision map. The tentative map could contain an agreement to provide for-sale affordable units onsite or pay an affordable housing fee. Additionally, the ordinance should reference that developers are allowed to elect to provide affordable rental units under Gov. Code §65589.8. If this option is elected, ordinances should probably provide concessions or incentives to come within the Costa-Hawkins exception.

- **Adequate Procedures Included to Address *Palmer?*** Determine whether the ordinance and regulations contain adequate procedures and discretion to permit approval of rental housing developments in conformance with *Palmer's* interpretation of the Costa-Hawkins Act. For example, the ordinance should have a waiver provision or some other provision that permits the city to dispense with the requirement mandating rental restrictions. When a state law preempts a local law, as the *Palmer* court held Costa-Hawkins did, local governments are obligated to interpret them consistent with the decision. As long as the existing ordinance provides adequate procedures and discretion, ordinances should not require amendment, at least not immediately—it would be appropriate to wait until the housing element or other general plan element is amended to address the issue.

- **Condominium Conversion Protections.** Make sure there are restrictions on conversion of rental housing to condominiums that require the converted complex to contain at least the same percentage of inclusionary units as a new for-sale development (or pay an in-lieu fee).

2. EXISTING RENTAL BUILDINGS WITH INCLUSIONARY UNITS.

- **Most Restrictions Will Not Require Adjustment.** These units will generally be subject to regulatory agreements and deed restrictions that were put in place sometime ago. Almost all will not only restrict rental rates, but also limit occupancy to lower or moderate income occupants. Owners will have a difficult time challenging these because:

a) Developers signed agreements that provided them with substantial incentives, concessions or even financial assistance, bringing them within the Costa-Hawkins exception;
b) The restrictions on the income of occupants are not prohibited by Costa-Hawkins (and indeed are expressly permitted by Government Code §65008);
c) In many cases the statute of limitations will have run.

3. NEW ORDINANCES.

- **Draft with *Palmer* in Mind.** New local laws should acknowledge that new rental housing may not be *required* to include units with rent restrictions, but should maintain requirements on single family and multifamily subdivisions developed for sale. New local laws should also provide alternatives to the requirement to provide affordable for- sale housing, including fees and land donation options. Rental alternatives should comply with Costa-Hawkins through a voluntary agreement that provides regulatory incentives.

- **Include an Inclusionary Housing Policy in a General Plan Element.** An ordinance implementing a valid general plan will be presumed to be reasonably related to a legitimate governmental purpose. This also comports with Gov. Code §65589.8, which allows developers to have the option of building affordable rental units where there is an inclusionary requirement, if that requirement is in the housing element.

4. ALTERNATIVES THAT WILL ENSURE DEVELOPMENT OF AFFORDABLE RENTAL HOUSING.

- **Generally Applicable Affordable Housing Fee on Rental Housing Development.** A community can adopt a policy providing that, for many reasons, a proportion of all future development in the community must be affordable. (Many communities base existing inclusionary programs on such policies, usually contained in a general plan element.) The fee must be related to legitimate governmental purposes, but nothing prohibits those purposes from including other provisions, such as the existing need for affordable housing, the need to reduce vehicle trips or the need to further fair housing opportunities.

  a) A fee on rental housing based on the cost of developing the same proportion of affordable units is reasonably related to a legitimate public purpose—the cost of developing the percentage of units the

community has determined is needed from future development. *Palmer* found in-lieu fees on rental housing inextricably linked to on site rental requirements, but a stand-alone affordable housing fee only would not be in-lieu of on-site rental units.

b) "Nexus" Study Probably Not Required. The Mitigation Fee Act would not apply because the fee would not be imposed to cover the cost of "public facilities." The fee would not run afoul of the language in some cases requiring the development fees to be related to the "deleterious impact of the development" because the impact of the development would be its failure to further the community's aggregate inclusionary purpose.

c) "Nexus" Study Pros and Cons.

- Provides quantified basis clearly establishing the requisite relationship, but limits the fee to the connection to the particular impact studied, e.g. the impact of new housing on the need for housing.
- Limiting the fee on rental development solely to the impact on the need for new affordable housing ignores critical existing housing need and other social, environmental and economic consequences.
- Other impacts are harder to quantify, but the quantification of impact requirements of the *Nollan/Dolan* cases do not apply to generally applicable development fees. The nexus studies evolved to meet the *Nollan/Dolan* requirements for ad hoc fees, not the lesser standard for generally applicable fees.

- **Rental Housing Zoning Overlay or "Super" Density Bonus Ordinance**. A zoning overlay ordinance that offers rental housing development substantial incentives and regulatory concessions in exchange for inclusion of on-site affordable rental housing at greater proportions than would be require by state Density Bonus law would not violate Costa Hawkins. Indeed these developments would fit within the Costa-Hawkins exception. For example, the overlay could require a greater percentage in affordability than the Density Bonus statute in exchange for greater density bonuses, additional regulatory concessions or provision of financial subsidies.

5. SUPPORT AMENDMENT OF COSTA-HAWKINS

- Consider supporting amendment of the Costa-Hawkins Act in the *next* legislative session.

Patterson

1. **BASE IN-LIEU FEES ON THE FINANCING SUBSIDY (GAP) REQUIRED TO DEVELOP THE FOREGONE INCLUSIONARY UNITS.**

- Patterson's mistake was styling its fee as an "impact fee" and basing the fee on an unsound analysis of the impact of new residential housing development on the need for affordable housing in the city. It could have easily and soundly based its in-lieu fee on the cost of producing the inclusionary units. A community that characterizes its in-lieu fee as a fee related to the impact of new development on the need for affordable housing risks the same attack that Patterson got and unnecessarily limits the amount of the fee.

2. **ON-SITE REQUIREMENTS MAY BE BASED ON BROAD PURPOSES, NOT LIMITED TO THE IMPACT OF NEW HOUSING DEVELOPMENT ON THE NEED FOR AFFORDABLE HOUSING.**

- Legislatively enacted inclusionary housing requirements must be reasonably related to their purpose—to address the community's need for affordable housing and the social, economic and environmental consequences of not doing so. Likewise, in-lieu fees related to replacing the affordable units forgone by the developer will necessarily be sufficiently related to the underlying purposes of the inclusionary requirement.

3. **MITIGATION FEE ACT NEXUS STUDY IS NOT NECESSARY.**

- The Act does not apply to in-lieu fees—their purpose is not to finance "public facilities" required by the development.