Client Alert

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Inclusionary Housing on the Run

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Several recent legal developments have cast doubt on the ability of California cities to continue using favored tools to promote construction of "inclusionary" affordable housing units. Few would dispute that the state faces a "severe shortage of affordable housing," as the Legislature has declared.[1] But this consensus has not translated into agreement on how best to allocate the societal burden of providing affordable housing. As conflicts have intensified over a number of cities' approaches to inclusionary housing, the courts have created a patchwork of law that has provided little practical guidance to local governments or developers, but recent actions by the Governor and the California Supreme Court may be bringing things into focus.

BACKGROUND: THE *PALMER*/*PATTERSON* LANDSCAPE

The current stage was set primarily by two appellate decisions in 2009 that dealt a blow to affordable housing advocates, but left many questions unanswered. In *Palmer/Sixth Street Properties v. City of Los Angeles*,[2] the Second District Court of Appeal held that an ordinance requiring developers to set aside rental units for inclusionary use violated the state's Costa-Hawkins Act, the rent "de-control" law that allows landlords to set initial rents. Decided around the same time, *Building Industry Association of Central California v. City of Patterson*[3] concerned a requirement to pay in-lieu fees as a condition of developing ownership units. The Fifth District applied an exactions analysis to find that such a fee is not "reasonably justified" unless the City can show a reasonable relationship between that fee and the "deleterious" impact *of the development itself,* a general interest in increasing affordable housing is not enough.

Following these decisions, many cities either amended or suspended their existing ordinances, and developers started looking for opportunities to push back against imposition of legally questionable inclusionary requirements.

AB 1229: A DEFEAT FOR *PALMER* FOES

Since the *Palmer* decision, there have been periodic efforts by the Legislature to give back to cities some of the tools *Palmer* had taken away, including a 2013 bill. Introduced by Assembly member Toni Atkins (San Diego), AB 1229 passed the Assembly and Senate largely along party lines; no Republicans voted for the bill, although several Democrats voted against it. The bill would have reestablished the authority of local governments to impose inclusionary housing requirements as a condition of development approvals, and would expressly supersede *Palmer* to the extent it conflicted with this authority.

[1] Government Code § 65913(a).

[2] 175 Cal. App. 4th 1396 (2009).

[3] 171 Cal. App. 4th 886 (2009).

However, on October 13, Governor Brown returned the bill without his signature. The Governor issued a statement regarding his veto, stating that in his experience as mayor of Oakland, he 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 statement also noted that the Governor would like the benefit of the Supreme Court's view before making other changes to the law.

CALIFORNIA SUPREME COURT WEIGHS IN: *STERLING PARK, L.P. V. CITY OF PALO ALTO*

As Governor Brown alluded, the Supreme Court was considering certain inclusionary housing requirements at the time AB 1229 was vetoed. Just four days later, on October 17, the Supreme Court issued its unanimous opinion in *Sterling Park, L.P. v. City of Palo Alto*,[4] potentially giving developers more ammunition to challenge the imposition of inclusionary housing conditions. Sterling Park received approval to construct 96 residential condominiums in Palo Alto, conditioned upon inclusion of 10 on-site below-market units coupled with payment of a fee totaling approximately 5% of the sales value of the market rate units.

The Court held that both requirements were "exactions" to be considered under the Mitigation Fee Act, rather than land use regulations under the Subdivision Map Act. The distinction is important, not only because a longer statute of limitations may apply under the Mitigation Fee Act, but because "exactions" must be subjected to a higher level of scrutiny than land use regulations. To survive an exactions challenge, a governmental entity generally must demonstrate a "nexus" between the exaction and the impact it is intended to address, and "rough proportionality" in the size of the exaction. However, the Court declined to consider the merits of whether the Palo Alto fee met these requirements (or even to consider whether requiring sales of below-market rate units would be an "exaction" in every case), and remanded to the Sixth District for further review.

CALIFORNIA SUPREME COURT, ROUND 2: CALIFORNIA BUILDING INDUSTRY ASS'N V. CITY OF SAN JOSE

In September, the Supreme Court granted review of another South Bay city's inclusionary housing ordinance. In *California Building Industry Association v. City of San Jose*,[5] the Sixth District had denied a facial challenge to the city's ordinance, on the basis that it was "the wrong question to ask" whether the ordinance complied with the test set forth in *Patterson* and *San Remo Hotel v. City and County of San Francisco*.[6] Because San Jose's inclusionary housing ordinance was not adopted *for the purpose* of mitigating housing loss caused by the new development, the Court of Appeal reasoned that the inclusionary housing requirements did not need to be analyzed as exactions, instead, the Court treated these requirements as land use regulations. But in light of *Sterling Park*, it seems unlikely that San Jose, or any other city, can avoid the exactions analysis simply by framing its inclusionary policies in these terms.

The Supreme Court granted review to address the standard of review that applies to a facial constitutional challenge to inclusionary housing ordinances that require on-site affordable units or payment of in-lieu fees as a condition of project approval.

[4] No. S204771, filed Oct. 17, 2013.

[5] No. H038563, filed June 6, 2013.

[6] 27 Cal.4th 643 (2002).

WHAT LIES AHEAD FOR INCLUSIONARY HOUSING?

What lies ahead depends largely on the Supreme Court's decision in the San Jose case, and potentially on the decision on the merits in the Palo Alto case, following remand. The timing of the Supreme Court decision is impossible to predict, but it is reasonable to expect the decision during 2014. Cities across the state will likely be scrambling to evaluate whether their ordinances pass muster under the "exactions" analysis, though significant changes aren't likely to happen until the Supreme Court weighs in again. In the meantime, the new uncertainty may cause some cities to reevaluate their existing plans and potentially even delay approval of residential projects in the pipeline. A new wave of litigation over as-applied inclusionary requirements may also be coming, as developers seek to test the boundaries of what may be permitted under current law. In any case, each inclusionary housing ordinance will require careful analysis on its own terms to ensure it can pass the exactions test as well as the *Palmer* ruling, which remains good law due to Governor Brown's veto of AB 1229.

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