

Client Alert

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CA Supreme Court Lays Groundwork for New and Expanded Affordable Housing Requirements

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In a decision likely to have wide-ranging impacts on the building industry, the California Supreme Court has upheld the City of San Jose's inclusionary housing ordinance and bolstered California cities' ability to impose affordable housing requirements without triggering a constitutional "takings" analysis. The Court's long-anticipated opinion in *California Building Industry Association v. City of San Jose*¹ will lay the groundwork for cities to implement new and expanded affordable housing requirements, without having to evaluate these requirements as exactions subject to heightened scrutiny—rather, these requirements can be upheld as long as they have a "reasonable relationship" to a legitimate governmental purpose.

SAN JOSE'S INCLUSIONARY HOUSING ORDINANCE

In 2010, the City of San Jose adopted an inclusionary housing ordinance, which requires all new for-sale residential development projects of 20 or more units to set aside 15 percent of the units for purchase at below market rates, or to contribute to the affordable housing stock through specified alternatives—payment of an in-lieu fee or dedication of land equal in value to the in-lieu fee, construction of off-site affordable units, or acquisition and rehabilitation of a comparable number of affordable units.² The San Jose ordinance provides a disincentive to utilize an alternative by increasing the affordability requirement to the equivalent of 20 percent of the units in the residential development project.

The California Building Industry Association (CBIA) brought a facial challenge to the ordinance shortly after its enactment, alleging that San Jose failed to demonstrate a reasonable relationship between new residential development projects and adverse impacts to affordable housing in San Jose. The Superior Court agreed with CBIA and issued an order enjoining San Jose from implementing the ordinance. However, the Court of Appeal reversed, determining that the ordinance did *not* effect a dedication, and therefore the City only needed to demonstrate a reasonable relationship between the ordinance and the *public welfare*.³ While the trial court considered the ordinance to be an exaction requiring developers to give up a property interest—and requiring a city to do its homework to show why the conditions imposed are constitutional—the Court of Appeal determined

¹ Case No. S212072, filed June 15, 2015.

² San Jose's ordinance also requires developers of rental housing to set aside on-site affordable units. However, the ordinance expressly notes that the set-aside provisions are unenforceable unless the Court of Appeal's decision in *Palmer/Sixth Street Properties, L.P. v. City of Los Angeles*, 175 Cal. App. 4th 1396 (2009), which prohibits cities from requiring on-site affordable unit set-asides in rental housing, is overturned by the courts or Legislature. The rental housing provisions were not at issue in the case before the Supreme Court.

³ 216 Cal. App. 4th 1373 (2013).

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that the ordinance instead was a valid exercise of San Jose's police power, giving it broad discretion to regulate use of real property for the public welfare. (We described the Court of Appeal's decision, along with other inclusionary housing issues, in a prior [Client Alert](#)).

CALIFORNIA SUPREME COURT WEIGHS IN

Unfortunately for market-rate developers, the California Supreme Court adopted the view of the Court of Appeal, and concluded that San Jose was not required to demonstrate that its ordinance's inclusionary housing requirements were reasonably related to the impact that market-rate development was having on affordable housing. In so doing, the California Supreme Court created a roadmap that cities across California are likely to follow when enacting inclusionary housing ordinances designed to avoid heightened judicial scrutiny.

CBIA framed the judicial analysis in constitutional takings terms, due to the City's requirement to either set aside units for below-market rates or make equivalent dedications. However, the Court held that "there is no exaction"—the ordinance simply restricts the *use* of property by placing price controls on a portion of units. The Court found that the purpose of San Jose's ordinance goes beyond mitigating impacts caused by market-rate housing developments; rather, it provides public benefits to the City as a whole by increasing the number of affordable housing units and ensuring that those units are distributed throughout the City in mixed-income developments. The Court determined that these features of the inclusionary housing ordinance made it more like a city-wide zoning law—entitled to deferential review by courts. That review is limited to whether the ordinance bears a real and substantial relationship to a legitimate public interest.

The Court rejected CBIA's attempts to rely on past court opinions which called for more rigorous judicial review, by citing these distinguishing factors:

- In *San Remo Hotel v. City and County of San Francisco*, the Court determined an in-lieu fee imposed when property owners converted long-term rental units to short-term tourist units was valid because it was reasonably related to mitigating the impact of the conversion on preservation of long-term rental units in San Francisco. The Court spent considerable effort distinguishing the *San Remo Hotel* case, principally by framing the requirement of the San Jose ordinance as a limitation on the way developers can *use* their property rather than a requirement that developers pay a monetary fee. By characterizing the San Jose inclusionary housing ordinance as such a use limitation, the Court justified its more deferential review.
- Similarly, the Court rejected CBIA's analogy to *Building Industry Association of Central California v. City of Patterson*, a 2009 Court of Appeal case—and effectively overturned the central holding of that case.⁴ Like San Jose, the City of Patterson had given developers the option of building affordable housing units or paying an in-lieu fee, and the Court of Appeal had applied the *San Remo Hotel* test to conclude that the City of Patterson failed to demonstrate the required reasonable relationship between an in-lieu fee and the "deleterious" impact of the project at issue. According to the Supreme Court, the *Patterson* court failed to recognize that the ordinance was imposed not to mitigate an adverse effect caused by the

⁴ The Court "disapprove[d]" *Patterson* to the extent it can be read to require that inclusionary housing ordinances must be "reasonably related to the need for affordable housing attributable to the projects to which the ordinance applies." It stopped short of expressly overturning *Patterson* as the particular fees at issue in that case were not before the Court in the *CBIA* case.

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project at issue, but rather to further the public purpose of increasing affordable housing stock to meet the City's need for affordable housing under the state-required Regional Housing Needs Assessment. By disapproving *Patterson's* key holding, the Court upended the central analysis many local governments and developers have relied on to determine the appropriate scope of inclusionary housing requirements since 2009.

- Finally, the Court rejected CBIA's reliance on *Sterling Park, L.P. v. City of Palo Alto*, a 2013 California Supreme Court case that we previously analyzed [here](#). According to the Court, *Sterling Park* failed to support CBIA's position because it did not address the level of deference that a court should apply to an inclusionary housing ordinance like San Jose's, but rather narrowly dealt with which of two statutes of limitations should apply to a lawsuit related to affordable housing requirements imposed in a development agreement. The Court declined to take a position on whether the affordable housing requirements of the San Jose ordinance would, like those in *Sterling Park*, be considered "exactions" for purposes of statute of limitations issues.

THE FUTURE OF INCLUSIONARY HOUSING ORDINANCES

One possible silver lining in this cloud over market-rate development is that CBIA brought a facial challenge, rather than a challenge against the ordinance as applied to specific facts. In other words, CBIA argued that the San Jose ordinance was unlawful in all circumstances, not just in relation to one particular development project. Judge Chin's concurring opinion provides a potential template for an as-applied challenge that could be raised. Judge Chin noted that an ordinance requiring a developer to sell some units below its actual costs of building those units would be an exaction, and would likely be subject to a more expansive review by a court. Even under the majority's formulation, it is clear that local governments do not have a blank check to require new housing development to subsidize below-market rate units. If, for example, a city did not offer developers alternative means for compliance or imposed fees at levels that crossed into "confiscatory" territory, it could constitute an exaction subject to heightened scrutiny by the courts. For now, however, developers in the growing list of California cities with inclusionary housing ordinances face an uphill battle in challenging these requirements. CBIA is currently considering whether to bring an appeal to the United States Supreme Court.

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