



Government & Regulatory Law Update June 2015

California Supreme Court Holds That the City of San Jose's Inclusionary Housing Ordinance Does Not Impose Exactions And Therefore May Be Valid If Shown to Be Reasonably Related to Achieving Legitimate Public Welfare Objectives

On June 15, 2015, the California Supreme Court issued its decision in ***California Building Industry Association v. City of San Jose***, addressing the legal standards to be used in determining the constitutionality of ordinances imposing mandatory "inclusionary housing" requirements on new development. The Court ruled that the San Jose ordinance (the "Ordinance"), in contrast to some other inclusionary ordinances, did not require that developers dedicate property or property interests as a condition of development approval and thus did not impose an "exaction" subjecting the Ordinance to heightened scrutiny under *Nollan v. California Coastal Commission* (1987) 483 U.S. 825 and *Dolan v. City of Tigard* (1994) 512 U.S. 374. Reasoning that the Ordinance did not require a developer to pay a fee but instead merely placed a limit on the use of its property, the Court also ruled that the Ordinance was not subject to the level of scrutiny it found applicable to legislatively imposed fees in *San Remo Hotel v. City & County of San Francisco* (2002) 27 Cal.4th 643, 671 ("such fees must bear a reasonable relationship, in both intended use and amount, to the deleterious public impact of the development."). The Court thus affirmed the Court of Appeal's decision to remand the case to the trial court for review under the more deferential standard of review applicable to most ordinary land use regulations which focuses on whether the land use regulation is reasonably related to a legitimate public interest.

The City of San Jose had adopted a "Citywide Inclusionary Housing Ordinance" in January 2010, which generally required that any new residential development involving more than 20 units provide at least 15% of the new units for sale to City-qualified buyers at City-determined prices which were to be tied to differing levels of median household income. Prior to adopting the Ordinance, the City revised it to make it inapplicable to new rental housing developments, in view of the 2009 appellate court decision in *Palmer/Sixth Street v. City of Los Angeles* (2009) 175 Cal.App.4th 1396 finding state preemption of local restrictions on new housing rentals. However, the City expressly declined to prepare any "nexus" analysis or other evidentiary showing that building new market-rate homes caused or exacerbated the City's existing need for affordable housing.

Shortly after the Ordinance was adopted, the California Building Industry Association ("CBIA") filed litigation challenging the constitutionality of the ordinance on its face, on the grounds that it imposed exactions as conditions of development approval in violation of the

“unconstitutional conditions” doctrine expressed in U.S. Supreme Court decisions like *Nollan* and *Dolan*. The trial court repeatedly asked the City to provide some limiting principle as to how much might be demanded if it were not required to demonstrate a nexus to justify the Ordinance’s requirements. Because the City did not adequately respond to the trial court’s concerns in this regard, the trial court declared the Ordinance to be invalid and enjoined the City from implementing the Ordinance unless and until it produced a valid nexus study.

The Sixth Appellate District reversed the trial court’s decision in 2013, holding that the trial judge had demanded too much from the City. The appellate court held that the San Jose ordinance was like an ordinary land use regulation, and as such, merely needed to meet the deferential standard applied to police power regulations, i.e., such regulations must bear a “real and substantial relationship to the public welfare.” Slip Opn., p. 21. The Supreme Court, in turn, granted review of the appellate court’s decision.

Shortly after granting review of the San Jose case, the Supreme Court decided *Sterling Park v. City of Palo Alto* (2013) 57 Cal.4th 1193. In *Sterling Park*, the Court unanimously held that Palo Alto’s below market rate affordable housing ordinance did impose exactions on developers, at least for purposes of the “pay under protest” provisions of the Mitigation Fee Act (Gov. Code, §§ 66020 and 66021). The Mitigation Fee Act requires that a reasonable relationship exist between an impact fee and the development on which it is imposed. The Court rejected Palo Alto’s argument that its affordable housing requirements were like ordinary land use regulations rather than exactions. One distinguishing factor between the Palo Alto ordinance and the San Jose Ordinance is that the Palo Alto ordinance required developers to give the City a recordable option to purchase the designated affordable housing units to assure their restricted status.

The new decision finds that the San Jose Ordinance, unlike the “below market rate” housing ordinance in Palo Alto, did “not require a developer to convey or dedicate to the city a property interest [or money in lieu thereof] as a condition of development, and therefore is not an exaction for purposes of the unconstitutional conditions doctrine” Slip Opn., p. 38 (emph. added). Since the Court did not consider the San Jose Ordinance to impose “exactions” of property or money on developers, it agreed with the Court of Appeal that the trial court had erred by requiring the City to demonstrate a reasonable relationship or nexus between the approval of new residential development and the City’s claimed need for more affordable housing units or funding.

The lengthy (64 page) majority opinion in *San Jose* explained, limited, or distinguished many appellate decisions involving review of development fees and exactions in the years since the U.S. Supreme Court decided *Nollan* and *Dolan*. It also distinguished the U.S. Supreme Court’s 2013 decision in *Koontz v. St. John’s River Water Mgt. Authority* (2013) 570 U.S. __ [186 L.Ed.2d 697], which held that the *Nollan/Dolan* standard of review should apply to all “monetary

exactions." The *San Jose* opinion commented that *Koontz* was "at least somewhat ambiguous" as to the scope of its holding, noted several other ambiguities it deemed unresolved by *Koontz*, and observed that *Koontz* "did not purport to decide whether the *Nollan/Dolan* test is applicable to legislatively prescribed monetary permit conditions."

The Court viewed the San Jose Ordinance as a price control regulation, i.e., that the City merely regulated the "use" of property for housing so long as the developer provided at least 15% of the new homes for sale at controlled prices. The Court found nothing wrong with such price controls, so long as they were not "confiscatory," and even went so far as to suggest that a city could adopt an ordinance restricting the sales prices of all home sales in the community, not just new homes needing development permits. See Slip Opn., p. 37:

As we have explained, an ordinance that places nonconfiscatory price controls on the sale of residential units and does not amount to a regulatory taking would not constitute a taking of property without just compensation even if the price controls were applied to a property owner who had not sought a land use permit.

Since such a price control regulation could, arguably, be adopted as a city-wide ordinance and applied to all home sales, the Court reasoned that there is nothing wrong with a City adopting a price control ordinance that only regulates the prices of some of the new homes to be developed in the City.

The majority opinion, by the Chief Justice, was joined by five of the Court's justices. Justice Chin wrote a separate concurring opinion, explaining that he agreed with the outcome, but on narrower grounds. Justice Chin cautioned that an ordinance which required the developer to provide subsidized (i.e., below cost) housing "would present an entirely different situation." He found that the San Jose Ordinance did not, at least on its face, require the developer to provide subsidized housing because it does not prohibit a developer from building the required affordable units more cheaply and to different interior standards than the market-rate units. Justice Chin further observed that the public interest in providing affordable housing is an interest of the community at large, and that the community as a whole, not merely some segment of the community, "should bear the burden of furthering this interest." Justice Werdegar signed the majority opinion but also wrote a separate concurrence in which she commented on "the current status and meaning of the reasonable relationship constitutional standard" of review described in *San Remo Hotel*. Justice Werdegar commented that the majority opinion "appropriately refrains from addressing in detail issues that are not before us here."

While the Court's decision in *San Jose* addresses the standard of review applicable to a facial challenge to the adoption of an affordable housing ordinance, it leaves many questions unanswered. For instance, of what significance, if any, is the Mitigation Fee Act in enacting or challenging development requirements to provide or fund affordable housing? Do different

standards govern conditions of approval imposed for purposes of mitigation as opposed to other public welfare purposes? What constitutes a confiscatory price control and under what circumstances would such a price control be deemed a regulatory taking? What implications does the Court's ruling have on the standard of review for other conditions imposed on development projects? Rutan attorneys will continue to monitor these and other issues in this dynamic and evolving area of law so as to advise its public and private sector clients on strategies to achieve their policy/business goals and objectives.

Rutan attorneys were counsel of record to CBIA in *California Building Industry Association v. City of San Jose*.

Clients with questions about this Alert or related issues are welcome to contact the article authors, or the Rutan & Tucker attorney with whom you are regularly in contact.

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