Developers Handed Victory from California Supreme Court on City Inclusionary Housing Fees

by M. Brett Gladstone

California Supreme Court Gives Developers a Big Victory In Litigation Concerning When a City May Impose Fees, Exactions and Affordable Housing Requirements When Approving New Market Rate Development.

In October 2013, the California Supreme Court reached a unanimous decision in *Sterling Park L.P. v. City of Palo Alto*, 2013 Cal. LEXIS 8112 (published Oct. 17, 2013), in which it held that inclusionary housing requirements are an exaction subject to the California Mitigation Fee Act, Cal. Gov. Code Sec. 66000, et. seq., a law which allows one to pay government imposed exactions under protest. Inclusionary housing requirements are laws that require a property owner to create on or off-site affordable housing when he or she builds a certain number of market rate units. In some instances, a fee may be paid in lieu of the construction of the affordable housing. The case involved a project to build 96 residential condominiums on 6.5 acres in Palo Alto. Under Palo Alto ordinances, this project was required to set aside at least 20 percent of units as moderate income housing or pay a fee. The developer agreed to provide 10 units for moderate income housing and to pay $3.2 million to the city's housing fund in lieu of providing 10 additional units. When the project was nearing completion and the city asked the developer to start to sell the below market rate units, the developer instead filed suit using the Mitigation Fee Act to challenge the requirements.

The Mitigation Fee Act was enacted to assist developers who are concerned that a city is imposing an illegal and unfair development fee, dedication, or exaction on his or her project. It created a "pay or perform under protest" process that allows development to progress while fighting the requirements and fees. Protests must be filed within 90 days of notice that the fees or exactions are being imposed, and a lawsuit must be filed within 180 days.

In *Sterling Park*, the developer argued that he never received such notice and as such was allowed to bring suit 3 years after he received project approval. The State Supreme Court found that the amount of a fee or cost of dealing with another kind of exaction, and any expected negative effects on existing or future affordable housing, must bear a rough proportionality to each other. Most land use ordinances today must only meet a legal

test which asks whether the imposition bears a reasonable relationship to the public interest and welfare.

As a result of this ruling, local inclusionary housing ordinances may have to meet a stricter standard of judicial review than land use regulations which merely restrict the size and features of a real estate development. If a city imposes an inclusionary housing requirement, a city must show a nexus (a connection) between the requirements and the state interest being advanced. For example, it may be that a city will have to show that the creation of market rate housing directly causes the loss of affordable housing before an affordable housing requirement is imposed.

In addition, cities will now need to provide developers clear notice of the imposition of inclusionary housing requirements and other conditions of approval as soon as possible, or risk legal challenges being brought years later.

The California Supreme Court will soon be reviewing a similar inclusionary housing case, *California Building Industry Association v. City of San Jose*, in which the developer alleged that the inclusionary housing ordinance imposed exactions on developers but that the city did not show a reasonable relationship between the exactions and the need for such housing. 216 Cal. App. 4th 1373 (Cal. App. 2013).

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