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# The Endangered Future of Affordable Housing Exactions

Roger Bernhardt

Golden Gate University School of Law, [rbernhardt@ggu.edu](mailto:rbernhardt@ggu.edu)

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# The Endangered Future of Affordable Housing Exactions

by Roger Bernhardt, Professor of Law, Golden Gate University, San Francisco, CA & David Callies, Kudo Professor of Law, William S. Richardson School of Law, Honolulu, HI

*Roger Bernhardt begins:* If the enforceability of local exactions imposed by communities on developers to promote affordable housing in their environs interests you, then do read the decision in *Building Industry Association v City of Patterson*, 171 Cal App 4<sup>th</sup> 886, given its entertaining facts, its complicated logic, and its ominous implications for this cause. The decision was rendered by a Court of Appeal in March, and in June, the California Supreme Court denied review and refused to de-publish it.

As for the facts, in 2003 a developer and a city signed a development agreement for the construction of 214 residential housing units. The agreement called for the developer to pay an affordable housing in lieu fee of \$734 per unit - or more as determined by a "revised fee schedule, including indexing as provided by ordinance at the time of the adoption of the fee, providing the same is reasonably justified".

The affordable housing fee had originally been set at \$319 per unit in 1995, but had been increased to \$734 in 2001, based upon a "leverage" study that assumed that the city would only need to itself cover 9% of the cost of subsidizing affordability. But then, a second study, in 2005, went off the rails: it concluded that, based upon a "needs assessment" of all of Stanislaus County, the City of Patterson needed to develop 642 units of affordable housing - which would cost a total of \$73.5 million! Since there were only 3500 "unentitled" residential lots yet available in the city, the price of subsidizing each affordable unit would require imposing a charge of \$20,946 on each of those undeveloped lots, not \$743, as originally thought. So the fee was increased from \$743 to \$20,946 on each of the developers 214 lots.

A trial court found that the City's "methodology" was reasonable, and upheld it, but the Court of Appeal reversed that decision, and invalidated the new fee. Its opinion went out of its way to avoid taking any easy way out. The court declined to hold that the developer had any vested rights to the earlier, lower fee, given the specific language of the development agreement. It also held that under the development agreement, the City was free to charge any new fee that was "reasonably justified", and was not required to abide by the earlier leverage formula it had used in originally calculating that fee. Nor could the developer get itself protected by a heightened constitutional scrutiny theory a la *Nollan/Dolan*; based on the California Supreme Court decision of *San Remo Hotel v San Francisco*, 27 Cal 4<sup>th</sup> 643, 2002, the City of Patterson was only required to show "a reasonable relationship between the amount of the fee, as increased, and the 'deleterious public impact of the development.'"

Using that kind of test, the court "located nothing that demonstrates or implies the increased fee was reasonably related to the need for affordable housing associated with the project."...No connection is shown . . . between this 642 figure and the need for affordable housing associated with new market rate development." Since the city failed to demonstrate any reasonable relationship between the new fee and any deleterious impact connected to the project, it was invalid

Technically, one can read this decision as holding merely that the city's interpretation of a development agreement that it executed with a developer was incorrect, but I took it to say that a town's entire affordable housing impact fee—whether imposed by way of a develop-

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ment agreement or by an across-the-board ordinance—might not pass constitutional muster.

To get an outside perspective on this case, I turned to David L. Callies, the Kudo Professor of Law at the University of Hawaii's William S. Richardson School of Law. Given his credentials, it made more sense for me to ask the questions and have him give the answers. So, David, what is your reading of Patterson?

*David Callies:* The latter. Moreover, it seems to me the reasoning of the case applies not only to housing set-asides/fees/exactions, but all land development conditions/in lieu/mitigation fees. Although *Nollan/Dolan* intermediate scrutiny may not apply, the court is clearly requiring some demonstrable connection between a problem caused by the development/developer and the fee/set-aside.

*RB:* But isn't there the notion that across-the-board, wide-ranging impositions, especially those legislatively enacted, should survive judicial scrutiny more successfully than individualized, adjudicative decisions that come out of appointees in agencies? If that applies here, might Patterson be better able to do by ordinance what it could not get away with in a development agreement?

*DC:* True, if legislatively enacted according to the California Supreme Court in *Ehrlich v Culver City* (1996) 12 C4th 854, 50 CR2d 242, though I admit to the same puzzlement as Justice Thomas in his dissent from the U.S. Supreme Court's denial of certiorari in *Parking Ass'n of Georgia v City of Atlanta* (1995) 515 US 1116, 1117, 132 L Ed 2d 273, 274, 115 S Ct 2268: Certainly, legislative bodies can impose conditions that are just as unconstitutional as those imposed by administrative agencies. The rest of the California Supreme Court's *Ehrlich* decision is a stark example of what results from the mindless application of legislative defer-

ence: upholding the levying of a public art fee on the developer of a small condominium complex, without any attempt to link that development with a presumably public desire for public art. How does any private development even remotely drive a need for art?

*RB:* Getting to the merits of the fee formula itself, the opinion's requirement that the city demonstrate a "reasonable relationship between the amount of the fee, as increased," and the "deleterious public impact of the development" looks like it might be a possibly insurmountable hurdle. What do you think of the idea of calculating the housing fee by 1) starting with an estimate of the countywide need for affordable housing, 2) allocating 642 affordable housing units to this town, 3) estimating each unit to require a subsidy of \$55,000-\$165,000 (for moderate or low income householders), for a total of \$73.5 million; and then 4) spreading out that total subsidy cost among the 3500 remaining unbuilt lots in the town, in order 5) to get to a fee of \$21,000 on each new building permit? Do you think that will ever be upheld as a legitimate way to start?

*DC:* We don't get to proportionality if there is no nexus. However, even if one gets past nexus, the suggested calculation above places the entire burden for affordable housing on new development—which, I suspect, will not pass even a watered-down version of a proportionality test. Thus, for example, why should all unbuilt units pay an identical impact fee? Why shouldn't the city pay a substantial portion of the cost of affordable housing, once the fee has been separated from the need for lack of nexus? Note that the Ninth Circuit Court of Appeals was impressed by the City of Sacramento's willingness to pay half the cost of the affordable housing need generated by the proposed hotel (according to the city's studies) in *Commercial Builders of N. Cal. v City of Sacramento* (9th Cir 1991) 941 F2d 872.

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*RB:* So are you saying that you think a court (or this court) is saying that there is no nexus, or the nexus logic in this case didn't work?

*DC:* The latter. The court found no demonstrable relationship between the housing fee and the public impact of the contemplated/proposed residential development. Therefore, considering proportionality—the size of the fee—in this circumstance is moot.

*RB:* Let's look at some of the particular components of the fee formula themselves. How does a proactive community justifiably estimate its local need for affordable housing? Can it just accept the number given to it by its county or regional government agency? If there is no such higher authority to give it a number, is there a way for it calculate its own number? Would it have to make a census of its residents and then derive the shortfall mathematically by comparing the median income of its residents with the median cost of its housing? Given the emphasis on regional housing needs, wouldn't the city also have to look at the economic situation of the outsiders who might like to move into town but cannot afford to do so?

*DC:* The issue is not the community's need, but the legality/constitutionality of the mechanism that it chooses to use to attempt to meet that need. Extracting (some would say extorting) the housing necessary to satisfy that need from a housing provider of more expensive housing is a tax, pure and simple: It is a means of raising revenue or its equivalent. Impact fees, exactions, and dedications, on the other hand, represent exercises of the police power, not the power to tax and raise revenues. The city is entitled to meet those "needs" through land development fees and exactions only if those "needs" are generated by the proposed development. If the development is commercial, then depending on the nature of that commercial use, the Ninth

Circuit's *City of Sacramento* decision methodology would be apt: Do a study that determines the number of low-income employment opportunities generated by the development and the shortage of available affordable housing to meet that development-generated need, and then assess the commercial development a share of the cost incurred to meet that need.

*RB:* Assuming that it comes up with a formula that works, how does a community that does create some affordable housing allocate it? Since it clearly can't reduce housing costs across the board for everybody, how does it decide who the winners are, i.e. those who get to move in to the new units? Auctions probably would be self-defeating, so should it to go lotteries or waiting lists? And who should be in the pool of eligible winners; can only existing residents get on the list?

*DC:* The mechanism simply needs to be fair; going beyond residents, however, abandons any pretense of justification based on community need. Since community need is the only basis for levying such a fee in the first place, only residents should be counted in determining that need. Lotteries are pretty random methods for determining who is entitled to a limited amount of affordable housing. Better to use waiting lists with each resident's position on it based upon a combination of factors like current income and family size.

*RB:* The biggest issue for me is: How can a city ever show a "deleterious public impact" from a housing development that creates a need for affordable housing? I can see the linkage between industrial or commercial developments and affordable housing, but where is there any nexus when the new development is residential instead? Do the new middle-class homeowners moving in need to have their maids and gardeners not have to commute from too far away? (And in that case, a better solution might

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be larger houses with servants' quarters rather than lower priced housing somewhere else.)

*DC:* That's the point: The city can't show a deleterious impact on affordable housing resulting from a residential development.-There isn't any. I think these mechanisms won't hold up in court anywhere, and following the *Patterson* decision and the Supreme Court's decision in *Lingle v Chevron U.S.A. Inc.* (2005) 544 US 528, 161 L Ed 2d 876, 125 S Ct 2074, I don't think they're constitutional in California either.

*RB:* Might these issues be any easier with a different formula? Might an inclusionary zoning ordinance that just requires developers to set aside of some percentage of units for low or moderate income housing more safely survive the *Patterson* standard?

*DC:* Inclusionary zoning in the context you suggest is both illusory and misplaced.-The concept was originally used against recalcitrant local governments (as in the New Jersey *Mt. Laurel* litigation (*South Burlington County NAACP v Mount Laurel* (NJ 1975) 336 A2d 713)) that failed to provide for a fair share of affordable housing by, among other things, zoning only for middle to high-end housing. To turn it on its head and apply it to a landowner developer is flawed from the beginning.

*RB:* Could affordability be brought about by a tax instead, say, an excise tax on the privilege of developing land? That would be harder in California, because of Proposition 13, but since the town's residents (those who vote) already live in completed houses that would not be subject to the tax, its financial burden would fall only on the owners of undeveloped land, who probably don't vote.

*DC:* Sure, a tax would solve all the legal problems.-It recognizes such housing exactions

for what they are: revenue-raising measures (as opposed to police power exercises) with no connection to the residential project to which they are applied.

In sum, the *Patterson* case requires some reasonable connection between a land development fee or exaction of any kind and a need that the "charged" developer causes by reason of its development. Gone are the days when a California local government could require the payment of such fees and exactions simply because local government had a need and the developer needed a development permit. Certainly, this is a fair result. No one is quarrelling with the public need. The issue is—and always has been—who pays, and on what basis.

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*RB:* Before we finished polishing the comments above, another decision came down that we thought ought to be tied in to them. On July 22, a different court of appeal rendered its decision in *Palmer/Sixth Street v City of Los Angeles*, 175 Cal.App.4th 1396. What had happened there was that in 1991 the city of Los Angeles had adopted a specific plan for the preservation of the low income characteristics of one of its neighborhoods, requiring that the demolition of any low income housing there had to be offset by construction of new affordable housing either subject to rent control or else by payment of an in lieu fee of \$80000-\$100000 for each unit so lost. This 60 unit building had been torn down in 1990, but the City's specific plan reached back to 1988, leading it to include in the conditional use permit it issued for the developer's new 350 unit project that it create 60 replacement low income rental units or pay an in lieu fee of \$5.8 million.

Both the trial court and appellate court held that the city's demand violated the vacancy

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decontrol requirement of the California Costa Hawkins Act, which declares that residential landlords may “establish the initial and all subsequent rental rates” for their dwelling units. The City’s requirement that 60 of the new units be let at affordable rates was therefore in violation of and preempted by the statute. The in lieu fee alternative, although not mentioned in the Costa Hawkins act, was so intertwined as to be also preempted. That meant, of course, that the city of Los Angeles would be no more successful at mandating affordability through rent control measures that the city of Patterson had been in achieving affordable pricing.

This is technically a rent control decision rather than a land-use exaction one, and will not be too informative to residents of other jurisdictions that lack local rent control ordinances or statewide preemption of it. But the court’s holding that a city’s demand on a developer to replace 60 units of low income housing that had been demolished in a particular neighborhood ran afoul of a statutory vacancy decontrol mandate seemed to me to demonstrate a kind of willingness to stretch out to prohibit a local government from overreaching. After all, this was not a classic citywide rent control ordinance but rather a conditional use permit applicable only in special circumstances. Do you agree David?

*DC:* Well, sort of. The circumstances are sufficiently odd that it is difficult for me to draw any generally-applicable conclusions.

*RB:* When this holding is combined with *Patterson*, the future of affordable mandates seen even bleaker. *Patterson* prohibited a city from mandating affordable sale prices, and now this case prohibits it from mandating affordable rental prices. Is there anything left?

*DC:* Sure: mandatory set-asides on commercial and industrial development that

really does generate a need for nearby affordable/workforce housing, just like the 9<sup>th</sup> Circuit held in the City of Sacramento case way back in 1991. It’s still all about nexus and proportionality.

*RB:* Well, this case does illustrate a situation where the nexus that was missing in *Patterson* might be found. You and I feared that a local government might never be able to satisfy a court of the need to charge a developer for affordable housing that it wanted to see built, but perhaps it could make such a demand when that developer began the project by demolishing some affordable housing that was already there?

*DC:* Your fear, Roger, not mine. I never did buy the city’s notion as accepted by the California Court of Appeals in the Culver City case that a socially useful or desirable private facility like a sports club (or, for that matter, an inexpensive dwelling) becomes affected with or coupled to a governmental/public interest to which government can attach replacement conditions to a demolition or change-of-use permit. If government wants, or the public needs (not necessarily the same thing...) low income, affordable, workforce housing then it can either (1) build it (2) subsidize it or (3) provide incentives to the private development sector, such as the obviously popular density bonus which California authorizes by statute, and which, according to a recent study by a housing nonprofit, is successfully used by 90% of the local government respondents, according to its 2004-2005 surveys.

*RB:* Oh, well. If that’s all it requires...

