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California Supreme Court Upholds San Jose's Affordable Housing Ordinance

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On June 15, 2015, the California Supreme Court unanimously upheld San Jose's affordable (or also referred to as "inclusionary") housing ordinance ("Ordinance"), applying a deferential standard of review that is favorable to cities and counties. In *California Building Industry Association v. City of San Jose*, the Court affirmed the opinion of the Court of Appeal and held that the Ordinance must be upheld if the Ordinance "bears a real and substantial relationship to a legitimate public interest."

As discussed in greater detail below, the reach of the Court's opinion may be limited. For example, the Court's holding may apply only to inclusionary housing ordinances applicable to for-sale units and not to rental units. The Court's opinion also implies a heightened, less-deferential scrutiny should apply when cities or counties impose inclusionary housing conditions on a project-specific basis without first enacting a citywide or countywide ordinance. The Court's opinion also does not affect the validity of state or local laws (e.g., SB 1818) that give developers incentives to voluntarily include affordable housing in development projects. Nonetheless, the Court's logic will likely be applied to existing and proposed inclusionary housing ordinances, opening the door for more inclusionary housing ordinances in the future.

CBIA's Facial Challenge to San Jose's Ordinance

In 2010, San Jose adopted a citywide inclusionary ordinance that applies to all developments that create at least 20 new, additional or modified residential units. Under the Ordinance, 15 percent of the proposed on-site for-sale units must be sold at an "affordable" price to households earning no more than 120 percent of the area median income for Santa Clara County. The Ordinance provides alternative compliance options for developers who do not want to restrict sales of on-site units, including: (a) constructing off-site affordable for-sale units; (b) paying an in-lieu fee based on the median sales price of a housing unit affordable to a moderate income family; (c) dedicating land equal in value to the applicable in-lieu fee; and (d) acquiring and rehabilitating a comparable number of affordable units. The Ordinance also provides a menu of incentives for developers to include on-site affordable units, including a density bonus, a reduction in required parking spaces, a reduction in minimum set-back requirements and financial subsidies and assistance from the city to sell the affordable units.

San Jose made several findings in support of its Ordinance, including that the Ordinance (1) is reasonably related to the impacts attributable to rising land prices preventing development of new affordable housing and the need for more affordable housing options for the new employees needed to serve new development projects in the city; (2) will assist in meeting the city's regional share of housing needs; (3) will further the goal of residential integration of affordable units with market rate neighborhoods; and (4) will alleviate the impacts that result from allowing only market- rate units to take advantage of available residential land.

The California Building Industry Association (CBIA) filed a facial challenge to the Ordinance, alleging that it was unconstitutional under state and federal law. The superior court agreed with CBIA, but the court of appeal reversed. The Supreme Court granted review to evaluate the applicable legal standard for such inclusionary ordinances.

The Ordinance Does Not Constitute an Exaction

CBIA relied on the unconstitutional conditions doctrine, applied in the context of the Takings Clauses in the U.S. and California constitutions. It argued that the Ordinance was unconstitutional because the city failed to demonstrate that the alleged need for "affordable" housing was caused by or attributable to new, additional or modified residential development; without such a showing, CBIA argued, the affordable-housing condition effected an unlawful taking of property without compensation by impinging on homebuilders' fundamental right to freely alienate property. The city responded that heightened scrutiny under the unconstitutional conditions doctrine did not apply because the condition did not "exact" or require the dedication of any property. The Court agreed with the city.

The Court considered the U.S. Supreme Court takings cases of *Nollan v. California Coastal Commission* (1987) 483 U.S. 825 (Nollan) and *Dolan v. City of Tigard* (1994) 512 U.S. 374 (*Dolan*), which require the government to find there is an "essential nexus" and "rough proportionality" between a required dedication of land and a proposed project's impacts when the government requires a property owner to dedicate part of its property for public use without just compensation. The U.S. Supreme Court more recently held in *Koontz v. St. Johns River Water Management District* (2013) 570 U.S.___ (*Koontz*) that the heightened scrutiny of the *Nollan/Dolan* test also applies when the government conditions approval of a project upon an owner's payment of money.

Applying *Koontz* specifically to the San Jose Ordinance, the California Supreme Court held that the *Koontz* holding was narrow and applied only to a payment that is intended to mitigate a project's impacts. Since the San Jose Ordinance does not require a developer to give up a property interest for which the government would have to pay compensation but simply places a restriction on the way the developer can use its property, the Court held that the Ordinance is not an exaction. Instead, it held that the Ordinance falls within the city's broad discretion to regulate the use of real property to serve the legitimate interests of the general public just like other zoning, density or height requirements. As a law enacted under the city's police power to promote the public welfare, the Ordinance is constitutionally permissible because it "bears a reasonable relationship to the public welfare." (Opinion, p. 23.)

The Court also found that the Ordinance advances constitutionally permissible goals. In that regard, the Court found support in other laws that allow municipalities to enact requirements that achieve similar housing goals, such as requiring all new residential development to include a certain number of studio,

one-bedroom or small units. The Court also held that the Ordinance is an example of a permissible price control, and price control statutes have long been held to be constitutional land use regulations. Price controls are unconstitutional if they are confiscatory and deny a property owner a fair and reasonable return on its property. Yet the Ordinance has not yet been applied to a particular project, and the Court found no evidence that the Ordinance would have such an effect. Since most land use restrictions reduce the value of property, the Court held that diminishing the value of a project is not sufficient to trigger a takings analysis.

Responding to two other cases relied on by CBIA, the Court also distinguished its prior decision in *San Remo Hotel L.P. v. City and County of San Francisco* (2002) 27 Cal.4th 643 (*San Remo Hotel*) and disapproved the court of appeal decision in *Building Industry Association of Central California v. City of Patterson* (2009) 171 Cal.App.4th 886 (*City of Patterson*). In *San Remo Hotel*, San Francisco imposed a "housing replacement" fee on the hotel owner under its Ordinance that required property owners who convert existing long-term rental units to short-term tourist units to provide comparable long-term rental units off-site or to pay an in-lieu fee. The Court ultimately upheld the challenged fee in *San Remo Hotel* because it was reasonably related to mitigating the impact of the hotel conversion. Unlike the *San Remo Hotel* Ordinance that was intended to mitigate the specific adverse impacts of conversions of long-term rental units, the Court held that the San Jose Ordinance has a broad public purpose to benefit the community as a whole and goes beyond mitigating the impacts attributable to the proposed developments subject to the Ordinance.

The Court also addressed the appellate court decision in *City of Patterson*. That decision addressed an ordinance that gave developers the option to build affordable housing units or pay an in-lieu fee. The appellate court had struck down the fee imposed because it was not reasonably related to the need for affordable housing associated with the project. The Court overruled *City of Patterson* to the extent that it holds conditions imposed by an inclusionary ordinance are valid only if they are reasonably related to the need for affordable housing attributable to a specific development project.

Future Implications of the Supreme Court's Decision

The Court's holding may be limited given the particular circumstances of the San Jose Ordinance. First, the Court's opinion does not expressly apply to laws that impose inclusionary conditions for rental units, since San Jose's Ordinance applies only to for-sale units. In a footnote, the Court noted without commentary that the Ordinance itself stated it could not apply to rental units until the Supreme Court overturned or disapproved of the 2009 decision in *Palmer/Sixth Street Properties, L.P. v. City of Los Angeles* (2009) 175 Cal. App.4th 1396 (*Palmer*), which held the Costa-Hawkins Rental Housing Act (Civ. Code, §§ 1954.50 et seq.) precluded the city of Los Angeles from enforcing an inclusionary housing ordinance for rental units. Therefore, the application of the deferential standard of review to rental inclusionary housing ordinances is an open question. Also, the Court may have been more likely to apply the deferential standard of review to San Jose's Ordinance because the Ordinance allows developers to choose less-expensive materials for the affordable for-sale units. As one of the Court's concurring opinions recognized, the San Jose Ordinance does not require "subsidized" housing given that flexibility. In his concurring opinion, Justice Chin noted that if San Jose's Ordinance had required the sale of some units at *below cost*, the Ordinance could be an exaction subject to heightened scrutiny under *Nollan/Dolan/Koontz* and not simply a form of price control.

Second, the Court's opinion implies that the heightened level of scrutiny under the *Nollan/Dolan/Koontz* test should apply if a city or county imposes inclusionary housing conditions on a project-by-project basis without first passing a citywide or countywide inclusionary housing ordinance. The Court distinguished the *Koontz* decision in part because the permit condition in that case was applied on an ad hoc basis to an individual permit applicant rather than to a broad class of permit applicants. As the Court noted, when conditions are imposed on an ad hoc basis there is a greater risk of arbitrariness and abuse.

Finally, the Court's decision does not affect the validity of state and local laws that implement SB 1818 (Gov. Code, § 65915), which requires municipalities to provide incentives to developers who voluntarily include affordable housing in their development projects.

Approximately 170 cities and counties throughout the state have adopted some form of inclusionary housing ordinances to meet affordable housing needs. Even with some unanswered questions from the *CBIA* decision, courts will likely now apply a deferential standard of review to those ordinances under a municipality's exercise of police power, making future fights against such ordinances more difficult.

The Court's full opinion for *California Building Industry Association v. City of San Jose* (Case No. S212072) can be read here.

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