Land Development ADVISORY

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In-Lieu Affordable Housing Fees Struck Down

An opportunity for developers of residential housing to lower project development impact fees is available in light of court decisions in 2009. We urge developers whose projects are or have been conditioned to pay an in-lieu affordable housing fee to check the methodology used to calculate the fee. There is a chance the fee was not properly calculated.

In a November 2009 announcement that is expected to boost the morale of the development and building industry in California, the U.S. Supreme Court will not review the January 2009 decision rendered by California's Fifth District Court of Appeal in *Building Industry Association of Central California v. City of Patterson*, 171 Cal. App. 4th 886 (2009) (modified in March 2009). The California Supreme Court previously denied a similar request last summer.

In the Court of Appeal's ruling, it held that the city did not reasonably justify an increase in the city's affordable housing fee, also known as an in-lieu fee. The Court of Appeal specifically stated that while Patterson conducted a fee justification study, there was no evidence in the study or elsewhere in the administrative record that the affordable housing fee was based upon "the need for affordable housing associated with new market rate development." *Patterson*, 171 Cal. App. 4th at 899. The *Patterson* decision is likely to have deep and negative ramifications for other cities in California that adopted affordable housing fees utilizing fee justification studies similar to the study commissioned by Patterson.

By way of background, Morrison Homes, Inc. owns two residential subdivisions consisting of 214 single family residential lots in Patterson. Morrison Homes' predecessor in interest entered into a development agreement with the city in 2003. Among other things, the development agreement required the developer to build affordable or senior housing units or pay an in-lieu housing fee, which at the time of development project approval was $734 per market rate unit. The development agreement also said the fee was currently being evaluated by the city and that an updated analysis of the fee was forthcoming. The developer agreed to be bound by the revised fee so long as the fee was "reasonably justified."

The city's Fee Justification Study, released in 2005, recommended an increase of the in-lieu fee to $20,946 per market rate unit. The recommendation was based on

> bridging the so-called 'affordability gap' between the cost of a new market rate unit and the cost of units affordable to very low, low and moderate income households. The affordability gap analysis compared the cost of units to an estimate of what the three different income levels could afford. The difference was an estimate of the subsidy someone of that income level would need to be able to obtain housing.

Patterson, at 171 Cal. App. 4th at 892. The next step in the city's fee "calculation involved multiplying the amount of the subsidy for each income level by the number of units needed for that income category." *Id*. The number of units for each income category was derived from the 2001-2002 Regional Housing Needs Assessment for Stanislaus County. That assessment allocated 235 units of very low income, 182 units of low income and 225 units of moderate income housing (642 units total) to Patterson. When multiplied by the subsidy amount for each respective income level, the city's total subsidy pool was estimated to be around $73.5 million. The Fee Study then spread the total subsidy over the remaining un-entitled units (3,507 units) left to be constructed in the city, resulting in an in-lieu fee of $20,946 per new single family unit. *Id*.

The California Court of Appeal grappled with the question of whether the fee was in accordance with the standard set forth in the development agreement—whether it was "reasonably justified" under the governing development agreement. The court concluded that the term "reasonably justified" meant that any increase in the fee must conform to existing law and "not violate established legal principles." *Id*. at 896.

The Court of Appeal next evaluated the applicable established legal principles. In particular, the *Patterson* court looked at *San Remo Hotel v. City and County of San Francisc*o, 27 Cal.4th 643 (2002), for guidance. The *San Remo Hotel* court had said that legislatively imposed development mitigation fees, such as those required by Patterson for affordable housing, "must bear a reasonable relationship, in both intended use and amount, to the deleterious public impact of the development." 27 Cal.4th at 671. Government Code section 66001, subdivision (b), requires a similar "reasonable relationship." Therefore, the *Patterson* court concluded that the increase in the in-lieu fee was not reasonably justified unless there was a reasonable relationship between the amount of the fee as increased and "the deleterious public impact of the" proposed development by Morrison Homes. *Patterson*, 171 Cal. App. 4th 898.

Applying the principles discussed in *San Remo Hotel*, the *Patterson* court concluded that the fee increase did not reasonably relate to the need for affordable housing generated by the Morrison Homes project. *Id*. at 899. The court's evaluation of the evidence concluded that the fee was calculated based on an estimate of the city's need for 642 units of affordable housing. There was no connection shown by the Fee Justification Study between this 642-unit figure and the need for affordable housing generated by Morrison Homes' new market rate development project.

In essence, Patterson improperly imposed the burden of providing affordable housing on new development despite the fact that the city had approved thousands of homes previously without any such impact being spread equitably. Significantly, and despite the message falling on deaf ears over the years as cities have continued to enact inclusionary housing laws, *Patterson* illustrates that it is not the individual developer's responsibility to cure the social ills and housing needs of a community. The community and the local agency should share in filling this obvious need.

It is expected that cities that have relied on methodologies similar to that of Patterson's in order to calculate their in-lieu fees will now go back to the drawing board if challenged to develop fee calculations that comply with the holding of the *Patterson* case, so that they can continue to legally exact fees to fund future development of affordable housing in their cities.

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