

May 2009

## MIDCOURSE CORRECTIONS

### Exactions or Extortions?

Roger Bernhardt and David Callies

#### *Building Industry Ass'n v City of Patterson*

*The decision in Building Industry Ass'n v City of Patterson, reported at p 78, may well have become unpublished by the time this column appears, since it clearly is unfriendly to those activists seeking to improve the affordable housing stock in their communities. But the mere fact that a unanimous panel of a court of appeal found the logic behind those efforts to be (constitutionally?) wanting is noteworthy, even if the opinion ceases to have an official existence.*

*To get an outside perspective on those efforts, which are often centered in California, I turned to David L. Callies, the Kudo Professor of Law at the University of Hawaii's William S. Richardson School of Law, whose writings on these issues have always impressed me. Given his credentials (see p 66), it made more sense for me to ask the questions and have him give the answers.—RB*

*RB: David, technically, this decision purports to hold only that the city's interpretation of a development agreement it executed with one developer is incorrect, but I read it to say that its entire affordable housing impact fee—whether imposed by way of a development agreement or an across-the-board ordinance—will not pass constitutional muster. What is your interpretation?*

DC: 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 what about 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?*

DC: True, 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 deference: 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 formula itself, the Patterson opinion requires that the city demonstrate a “reasonable relationship between the amount of the fee, as increased,” and the “deleterious public impact of the development.”-As to the overall size of the fee, what do you think of a formula that calculates an affordable housing fee by starting with the county’s regional housing need calculation of 642 affordable housing units, estimating each one of them to require a subsidy of \$55,000-\$165,000, and then dividing that total subsidy cost (\$73.5 million) among the 3500 unbuilt units in the town, so as to reach 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.

*RB: So are you saying that you think a court (or this court) is saying that there is no nexus, or that step 2 makes no sense without a step 1?*

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: As to the components of the formula, how does a community justifiably estimate its 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 get a number from, how would a city 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: How does a community that makes some of its housing affordable allocate that benefit? If it can't reduce the cost across the board for everybody, how does it decide who the winners are? Are lotteries or waiting lists better? Can only 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: Another case that is reported in this issue—Alfaro v Community Hous. (reported at p 81)—deals with whether affordability covenants can run with the land and restrict the subsequent profits that could otherwise be made by resales by the winners of the affordability sweepstakes. Do you think the inclusion of such features has anything to do with the validity of the ordinance that imposes the fee on a developer?*

DC: I don't see much connection between the covenant and the initial fee, except to observe that if the owner of an affordable unit is going to make a profit of some kind, then (a) the likelihood of a successful 14th Amendment challenge increases for failure to advance a legitimate state interest and (b) the California cases dealing with mobilehomes/parks and "placement value" (such as the January 2008 *MHC Financing Ltd. v San Rafael* federal district court findings of fact and conclusions of law and the April 2009 order for entry of judgment in the same case) probably become relevant. In both, the court held the leaving of a transfer premium—placement value—resulting from a municipal rent control ordinance with a mobilehome pad lessee constitutes an unconstitutional taking of property from the mobilehome park owner-lessor, which becomes relevant for just such a regulatory taking theory. The case number on the latter order is C 00-375 VRW, issued April 17, 2009; the former ruling was issued on January 29, 2008.

*RB: The great issue for me is: How can a city show "the deleterious public impact" on a housing development in terms of creating a need for affordable housing? One can see the linkage between the industrial or commercial development and affordable housing, but where is the nexus when the new development is residential instead? Is it that the new middle-class homeowners moving in need to have their domestics not commuting from too far away? If that is so, wouldn't that be solved more easily by permitting larger houses and servants' quarters?*

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: Will these issues be any easier if the formula is changed? Will an inclusionary zoning ordinance—one that requires the developer to set aside of some percentage of units for low or moderate income housing—survive the Patterson standard, or will that type fail as well?*

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 the requirement be written as a tax instead? Say, an excise tax on the privilege of developing land? That might require a supermajority voter approval in California (because of Proposition 13), but might nevertheless be politically possible because the residents—who are the voters—already live in completed houses that would not be subject to the tax, leaving only the owners of undeveloped land to bear its burden.*

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.

*RB: So?*

DC: 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.

**“In lieu” fees, not based on costs attributable to development for which assessed, are not reasonably justified as required by development agreement.**

*Building Indus. Ass’n of Cent. Cal. v City of Patterson* (Mar. 2, 2009, F054785) 2009 Cal App Lexis 399

A developer entered into a development agreement with the City of Patterson and obtained tentative subdivision maps for the construction of two subdivisions within the city. The development agreement provided for a fee of \$734 per house in lieu of building affordable housing. The development agreement acknowledged that the city was revising its analysis of the affordable housing fee and included the developer’s agreement to a revised in lieu fee schedule, “providing the same is reasonably justified.” Three years later, after the city increased that fee to over \$20,000 per house, the developer sued, alleging violation of vested property rights, the terms of the development agreement, and other statutory and constitutional provisions. The trial court found that the increased fee was permitted under the agreement and was reasonably justified. The court of appeal reversed.

The original fee was based on the “leverage” analysis approach, which assumed that state and federal funding would provide 91 percent of the amount needed to build each house. The increased fee was based on “bridging the affordability gap” between the cost of a market rate housing unit and the cost of units affordable by very low, low, and moderate income homebuyers, respectively, multiplied by the number of units needed for each category. The number of units needed was based on the city’s “Regional Housing Needs Assessment” target. The total fee was then spread over the number of unentitled units, suggested by data available from the city’s Department of Finance, in the city’s general plan area.

The court of appeal decided that the pivotal question was whether, under the development agreement, the fee was “reasonably justified.” “Legislatively imposed development mitigation fees ... must bear a reasonable relationship, in both intended use and amount, to the deleterious

public impact of the development.” *San Remo Hotel v City & County of San Francisco* (2002) 27 C4th 643, 671, 117 CR2d 269. Similarly, such fees are not “special taxes” if the amount bears a reasonable relation to probable costs to the community and benefits to the developer. See *Sinclair Paint Co. v State Bd. of Equalization* (1997) 15 C4th 866, 875, 64 CR2d 447. The evidence showed no connection between the city’s determination of a need for 642 units of affordable housing “and the need for affordable housing associated with new market rate development” attributable to the housing in the developer’s two subdivisions or the estimated total of unentitled lots in the city’s general plan area. No evidence supported a finding that the fees to be borne by the developer’s project were based on costs attributable to that project. The issue of an appropriate remedy was remanded to the superior court.