Commentary

A Recent California Court of Appeals Ruling Severely Restricts the Imposition of Affordable Housing Requirements on Apartment Developers

by Jeffrey Lee Cosell

SUMMARY OF THE DECISION

On October 22, 2009, the California Supreme Court refused to review a decision by the Second Appellate District of the California Court Of Appeal, (which sits in downtown Los Angeles), that was published on July 22, 2009, in the case of ***Palmer/Sixth Street Properties and Geoff Palmer vs. City of Los Angeles***, *Appeal No. B206102*. As a result, the Supreme Court has left standing the ruling of the Court of Appeal, which held that the ***affordable housing restrictions*** on rental rates imposed on apartment projects by the City's Center City West Specific Plan conflict with and ***are prohibited by the Costa-Hawkins Act*** [California Civil Code Sec. 1954.52, subd. (a)(1)]. In so doing, the Court of Appeal upheld the right of developers and owners of residential units, created by Costa-Hawkins, to ***"establish the initial and all subsequent rental rates for a dwelling or a unit….[which] has a certificate of occupancy issued after February 1, 1995."*** The Court based its decision primarily on the broad preemptive language used in Costa Hawkins, which says that the owners of such units have the right to set their own rents "***notwithstanding any other provision of law."*** As a result, in the view of this author, the Court's decision calls into question the legality and continuing enforceability of the vast majority of the so-called "inclusionary housing" or "affordable housing" restrictions and ordinances that are imposed by an estimated 150 or more jurisdictions throughout California. For the reasons discussed below, in the view of the author of this commentary, this not only means that public entities will be severely restricted in whether and how they can impose such restrictions in the future, but it also means there may be ways to challenge the continuing enforceability of existing restrictions and covenants that were imposed in the past. As discussed below, this new method for challenging affordable housing restrictions is in addition to a variety of constitutional claims for damages and injunctive and other relief that also may be brought.

1. The Court's Decision Should Have Broad Implications In Helping To Strike Down All "Inclusionary Housing" And Other Affordable Housing Restrictions.

The Appellate Court's decision was the result of a lawsuit relating to the "Piero II Project," a 350 unit apartment and retail project being developed by Palmer/Sixth Street Properties, a development entity of Geoff Palmer, one of the largest builders and owners of apartments in Los Angeles County. However, even though the decision was made in the context of a specific project and city ordinance, it should have broad ramifications for all developers of apartment projects throughout California that would otherwise be subject to affordable housing or so-called "inclusionary housing" requirements. Unless contradicted by other Courts of Appeal sitting in other judicial districts or unless the Legislature amends Costa Hawkins, the Court's decision makes it highly unlikely that such affordable or inclusionary housing restrictions can legally be imposed on residential projects anywhere in California, except under certain limited circumstances.

In this regard, Costa-Hawkins contains an express exception that the Act *"does not apply where the owner has otherwise agreed by contract with a public entity in consideration for a direct financial contribution of other forms of assistance…[such as a density bonus under California Government Code Sections 65915-65918]…"* Thus, the Court's decision may not apply if the developer, in exchange for agreeing to set aside affordable housing, voluntarily takes advantage of a density bonus or some other contribution, concession or form of assistance (such as bond or other financing; a loosening of height or other development restrictions; a change in zoning, land use or the general plan; or an exemption from other development or design requirements or restrictions). However, the Court of Appeals made it clear that the mere fact that an inclusionary housing ordinance may offer a density bonus or other form of incentive or assistance, as an alternative to having to provide affordable housing or to pay an in-lieu fee, is not enough, unless the developer voluntarily agrees to take advantage of the offer.

There is also the potential that the Court's decision may be applied to cases where an affordable housing requirement is imposed as a general condition to development, outside the context of a specific law or ordinance; but, rather, in the context of ad hoc discretionary decision making and the imposition of project conditions and exactions. Even if the Court's decision is not applied in this context, other applicable United States and California Supreme Court jurisprudence, (under the *Nollan*, *Dollan*, *Ehrlich* and *San Remo* line of cases), would most likely require that the public entity imposing the requirement establish that there are identifiable negative impacts on affordable housing caused by the development itself; that there is a "nexus" or connection between those negative impacts and the affordable housing conditions being imposed; and that the affordable housing conditions imposed are "roughly proportional" to the negative effects being mitigated. It is this author's view that, in most instances, it will be extremely difficult for the public entity to meet this very strict standard in imposing an exaction relating to affordable housing. These considerations, when combined with the application of the Court's decision, will most likely drastically reduce the ability of public

entities and agencies to continue to enact and impose affordable or inclusionary housing restrictions and conditions.

2. The Court's Decision Also Strikes Down So Called "In-Lieu" Fees That Are Often Imposed On Developers As A Way For Them To Buy Their Way Out Of Having To Set Aside Affordable Units With Restricted Rents.

Many inclusionary or affordable housing ordinances and conditions generally allow the developer to avoid having to set aside and offer units at lower, restricted rental rates by allowing them, instead, to elect to pay what is typically called an "in-lieu" fee. Oftentimes, even though these fees may be exorbitant, developers will "pick their poison" and choose to pay these one-time fees, rather than suffer the long term reduction in their net operating income that results from rental restrictions and the long term adverse effects on the financeable value of their projects that will flows from the reduced operating income.

In the *Palmer* case, the Court rejected the City's argument that the imposition of such in-lieu fees does not run afoul of Costa-Hawkins because the fee provisions are somehow severable from, and should be considered separately from, the provisions in the City's inclusionary housing ordinance that restrict rents. In this regard, the Court held, in essence, that such in-lieu provisions are inextricably intertwined with the invalid provisions that illegally impose rental restrictions and, therefore, are invalid as well.

3. If You Are A Residential Developer That Is Or Will Be Processing A Development Application Or An Owner Or Developer That Has Had An Inclusionary Or Affordable Housing Condition Or In-Lieu Fee Imposed On A Project, You Should Consult An Attorney.

If you are a residential developer that will be or is processing a development application and affordable housing restrictions are a potential issue, you should consult an attorney who is familiar with the Court's decision and with the other relevant law governing affordable housing issues and the legality of government exactions on developments. In most cases, the Costa-Hawkins preemption issue and the Court of Appeal's decision should be raised as early as possible in the administrative decision making process. If, despite this, your jurisdiction imposes inclusionary or affordable rental rate restrictions or an in-lieu fee on your project, after you exhaust your administrative remedies, consideration should be given to bringing a mandamus action in state court, challenging the legality of the decision, within no more than 90 days of the final administrative decision imposing the restriction. In addition, in light of a recent decision of the United States Court of Appeals for the Ninth Circuit and other preexisting constitutional case law, consideration should be given to bringing constitutional claims for injunctive relief and damages, based on, among other things, an unconstitutional taking or inverse condemnation of property, in violation of the 5th Amendment of the United States Constitution and the California Constitution, as well as equal protection and due process violations. And, in light of the decision of the federal Ninth Circuit, there may be circumstances where the constitutional claims can be brought not only with regard to affordable restrictions imposed on rental housing, but also with regard to affordable restrictions imposed on for sale housing.

For those developers who have projects in jurisdictions that are in the process of adopting or debating the adoption of inclusionary or affordable housing ordinances, consideration should be given as to whether, when and how the Costa-Hawkins issue involved in the Court's decision and the constitutional issues should be raised. In jurisdictions that have recently adopted such laws, consideration should be given to mounting a prompt legal challenge quickly after passage, (within no more than 90 days), either by individual developers, groups of developers or trade organizations.

And, it is the author's view that, depending on the circumstances, there may be ways that the Court's decision can be used to challenge the obligations of the owners of apartment projects to continue to comply with existing affordable housing covenants and conditions, as an ongoing matter, in the future, even though the covenants and conditions may have been imposed in the past and the time to mount a legal challenge to them has otherwise long since passed.

In addition, if an in-lieu affordable housing fee has been imposed, but not yet fully paid, there may be legal strategies that can help you.

And, again, depending on how long ago the affordable housing restrictions or fees were imposed, it may not be too late also to bring constitutional claims against the jurisdiction imposing them.

If you have any interest in investigating the viability of such challenges, please feel free to contact the author.

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