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CITY ATTORNEY

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REPORT RE:

**DISCUSSION OF  
CALIFORNIA BUILDING INDUSTRY ASSOCIATION V. CITY OF SAN JOSE,  
61 Cal.4th 435 (2015) AND RELATED LEGISLATIVE OPTIONS**

Honorable Eric Garcetti, Mayor  
Room 303, City Hall  
200 North Spring Street  
Los Angeles, California 90012

Honorable City Council  
of the City of Los Angeles  
Room 395, City Hall  
200 North Spring Street  
Los Angeles, California 90012

Honorable Mayor and Council Members:

This report analyzes a recent California Supreme Court case with important implications for the creation of affordable housing in Los Angeles. *California Building Industry Association v. City of San Jose*, 61 Cal.4th 435 (2015), (CBIA) upheld a local mandatory inclusionary housing ordinance that requires certain residential housing developments to set aside units for affordable housing.

Given the City's acute affordable housing needs – for homeless people, low-wage workers and many others – this report also presents opportunities now available to the Council and the Mayor to create affordable housing in conjunction with new for-sale and for-rent housing developments. These include:

1. Inclusionary Housing/For-Sale Developments

As discussed below, under *CBIA* the Council could require that for-sale developments include a percentage of affordable units, while offering alternative compliance options, such as construction of off-site affordable units, payment of an in-lieu fee, dedication of land, or acquisition and rehabilitation of a comparable number of affordable units.

2. Development Impact Fees/Rental Developments

The Council could impose a development fee that offsets the impacts of new residential rental projects. The Los Angeles Housing and Community Investment Department (HCID) completed a nexus study for such a fee in 2011.

3. State Legislation Authorizing Local Inclusionary Mandates on Rental Developments

While state law currently preempts municipalities from imposing inclusionary requirements on rental developments, the Council and Mayor could sponsor or support legislation allowing cities to require affordable housing in rental developments.

It is crucial that Los Angeles create more affordable housing. My office will prioritize any efforts – through ordinance or otherwise – that will help make this goal a reality.

**I. Summary and Analysis of *California Building Industry Association v. City of San Jose***

A. San Jose's Mandatory Inclusionary Housing Ordinance

*CBIA* involves an unsuccessful challenge by the California Building Industry Association to the City of San Jose's citywide inclusionary housing ordinance. The ordinance imposes price control measures, requiring new residential development projects of a certain unit count to set aside fifteen percent of those units for affordable housing. The ordinance includes several alternative compliance options, including the construction of off-site affordable units; payment of an in-lieu fee; dedication of land; or the acquisition and rehabilitation of a comparable number of affordable units. *Id.* at 449-450.

The ordinance also provides additional incentives to developers who provide units onsite, including a density bonus, reduced parking requirements, reduced minimum set-back requirements, and financial subsidies and city assistance in the sale of the affordable units. *Id.* at 451. It ensures that the number of affordable units built under the ordinance's requirements are maintained even in the event of resale. *Id.* at 452.

B. The California Supreme Court's Analysis

The California Supreme Court upheld San Jose's ordinance as a permissible land use regulation under the city's police power, and rejected CBIA's claim that the ordinance effectuated a takings resulting from an illegal exaction. *Id.* at 456-457. In declining to analyze the ordinance's provisions as exactions, the Court considered them under the more deferential judicial review afforded to a municipality's exercise of its police power. The Court recounted the broad authority a municipality has under its general police power to regulate land use to promote the public welfare: "As a general matter, so long as a land use restriction or regulation bears a reasonable relationship to the public welfare, the restriction or regulation is constitutionally permissible." *Id.* at 457. The Court concluded that the condition imposed by San Jose on developments of for-sale units is a lawful exercise of a municipality's police powers to regulate the use of land to serve the legitimate interests of the public. *Id.* at 461-462.

The legitimate public interests upon which San Jose relied were the goals of increasing affordable housing in compliance with the city's regional share of housing needs under the California Housing Element Law, and locating affordable housing in economically diverse developments. *Id.* at 462-463. The Court held that price controls like the ones used by San Jose to achieve the city's stated purpose are, "as a general matter, a constitutionally permissible means to achieve a municipality's legitimate public purposes." *Id.* at 463.

In finding that the ordinance was a lawful exercise of the city's general police powers, and that the ordinance was predicated on a legitimate governmental interest, the Court focused on San Jose's findings and its rationale for imposing the conditions on development:

[T]he conditions are intended not only to mitigate the effect that the covered development projects will have on the city's affordable housing problem but also to service the distinct, but nonetheless constitutionally legitimate, purposes of (1) *increasing the number of affordable housing units in the city* in recognition of the insufficient number of existing affordable housing units in relation to the city's current and future needs, and (2) assuring that new affordable housing units that are constructed *are distributed throughout the city as part of mixed-income developments* in order to obtain the benefits that flow from economically diverse communities and avoid the problems that have historically been associated with isolated low income housing.

*Id.* at 444 (emphasis in original).

The Court noted San Jose's articulation of the relationship between the ordinance's affordable housing requirement and the impact created by market rate housing development that the ordinance sought to address. First, the development of market-rate housing occupies land available for any type of housing while simultaneously driving up the price of remaining land. Second, an increase in market rate housing drives up the demand on public and private sector services without creating housing affordable to the employees needed to carry out those services. This either forces those employees into commuting to their jobs in the city, living in inadequate housing within the city, or paying disproportionate shares of their incomes to live in adequate housing within the city. *Id.* at 449.

Also compelling to certain members of the Court was the fact that San Jose, in developing its ordinance, was cognizant of the developers' desire to earn a profit on their projects. The San Jose ordinance requires the affordable units in a development to be constructed with the same quality of exterior design and with comparable bedroom count and square footage as the market rate units. However, it gives a developer the flexibility to choose different (but functionally equivalent) interior finishes, amenities and features for the affordable units. *Id.* at 451. The Court was also persuaded by the availability of incentives like a density bonus and parking requirement reductions, insofar as those incentives effectively offset any potential reduction in a developer's profit as a result of complying with the ordinance. It found that such incentives were an effective counterargument to CBIA's contention that the ordinance divests a developer of the difference between the market value and the affordable housing price of the property, and that this divestiture is tantamount to a taking. *Id.* at 466.

## **II. Opportunities to Create Affordable Housing in Conjunction with New For-Sale and For-Rent Housing Developments**

### **A. For-Sale Housing: The Council Can Impose Affordable Housing Requirements on Residential For-Sale Developments Through its Own Inclusionary Housing Ordinance**

Based on the holding in *CBIA*, the Council can pass similar legislation to the San Jose ordinance to address the City's affordable housing needs. To increase the likelihood that a court would find an inclusionary housing ordinance adopted by the Council a lawful exercise of the City's police power, the Council should consider including the elements of San Jose's ordinance highlighted in Section I of this report. Those elements, along with the requisite findings made by San Jose's city council following a comprehensive study detailing the relationship between the impact of new for-sale housing and the goals advanced by the ordinance, were highlighted by the *CBIA* Court as evidence that this type of inclusionary housing ordinance is not an unconstitutional taking or exaction.

**B. Rental Housing: The Council Can Impose Development Impact Fees on Residential Rental Projects to Fund the Cost of Offsetting the Impacts of Private Market-Rate Rental Developments on Affordable Housing**

In the context of determining the appropriate standard of review for inclusionary housing ordinances, *CBIA* alludes to another measure available to local governments seeking funding for affordable housing: development impact fees imposed pursuant to Government Code Sections 66000-66025 (the Mitigation Fee Act). A development impact fee is a “monetary exaction...charged by a local agency to the applicant in connection with approval of a development project for the purpose of defraying all or a portion of the cost of public facilities related to the development project...” Govt. Code §66000(b). “Public facilities” are defined as “public improvements, public services, and community amenities.” Govt. Code §66000(d).

Housing impact fees, a category of development impact fees designed to address the dearth of affordable housing created by new market rate development, are already being collected around the state. San Jose, in fact, adopted its housing impact fee by resolution in 2014, requiring new market rate rental housing developments with three or more units to pay a one-time impact fee of \$17 per finished livable square foot.

Before any fee can be established and imposed on development projects as a condition of approval, the City would need to have in place a thorough fee study that can support the findings required by the Mitigation Fee Act. First, a fee must have an identified purpose. Second, the use of the fee must be clearly identified. Third, its use must have a reasonable relationship with the type of development upon which the fee is imposed. With regard to this requirement, San Jose made a “reasonable relationship” finding in its inclusionary housing ordinance, citing two factors: (1) the development of market-rate housing occupies land available for any type of housing while simultaneously driving up the price of remaining land; and (2) an increase in market rate housing drives up the demand on public and private sector services without creating housing affordable to the employees needed to carry out those services. The same findings could be used to satisfy the Mitigation Fee Act’s “reasonable relationship” requirement. Fourth, the need for the public facility being funded by the fee and the development upon which the fee is imposed must also have a reasonable relationship. Govt. Code §66001(a) & (b).

In 2011, HCID completed a nexus study to support the adoption of a housing impact fee to address the affordable housing crisis here in Los Angeles. If the Council now pursues a housing impact fee, our office should review the 2011 study or any other study on which the Council would base such a fee, to assure a housing mitigation fee ordinance satisfies the requirements of the Mitigation Fee Act.

C. The Council and Mayor Can Sponsor or Support State Legislation Authorizing the Imposition of Mandatory Inclusionary Housing on Residential Rental Developments

Currently, municipalities are preempted by state law from imposing mandatory inclusionary housing on residential rental developments. The City's prior attempt to do so was overturned in *Palmer/Sixth Street Properties, L.P. v. City of Los Angeles*, 175 Cal.App.4th 1396 (2d Dist. 2009). The *Palmer* case held that the City's inclusionary housing requirement in the Central City West Specific Plan, compelling residential rental developments to rent a portion of the units at an affordable rental rate, was preempted by the vacancy decontrol provisions of the Costa-Hawkins Rental Housing Act.

San Jose's ordinance includes a requirement for affordable housing in rental residential development to be operative if and when the *Palmer* case is overturned or modified by the courts or the legislature to render such a requirement lawful. The *CBIA* Court, in a footnote, specifically acknowledged this provision in the ordinance, but refrained from substantively addressing the *Palmer* case. *CBIA v. San Jose*, 61 Cal.4th 435 at fn. 6.

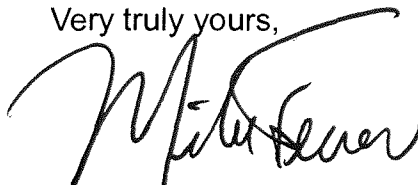
In 2013, Governor Brown vetoed AB 1229, a bill that would have allowed cities to require affordable units as a development condition, thus superseding the *Palmer* ruling. In a letter to the California Assembly dated October 13, 2013, Governor Brown explained that he wanted "the benefit of the Supreme Court's thinking" (referring to the Court's decision in the then still-undecided *CBIA* case) before making any changes in the area of inclusionary housing regulations.

Now that the California Supreme Court has rendered its decision in *CBIA v. San Jose* without altering the holding in *Palmer*, the Council and Mayor may want to sponsor or support legislation to allow municipalities to impose inclusionary housing requirements on residential rental developments.

The Honorable Mayor and City Council  
of the City of Los Angeles  
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As emphasized above, my office stands ready to advance these or other efforts to respond to Los Angeles's ongoing affordable housing crisis. Please direct any questions to either Deputy City Attorney Adrienne Khorasanee at (213) 978-8246 or Managing Assistant City Attorney Terry Kaufmann Macias at (213) 978-8233.

Very truly yours,

A handwritten signature in black ink, appearing to read "Michael Feuer". The signature is fluid and cursive, with a large initial "M" and "F".

MICHAEL N. FEUER, City Attorney

MF/DM/AK:zra  
Transmittal

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