

A Real Estate and Land Use Law Update

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“Regulatory Takings” Case From Ninth Circuit Gives Ammunition to Land Owners

The Ninth Circuit Court of Appeals issued a recent ruling in *Guggenheim v. City of Goleta*, 2010 WL 5174984 (C.A.9 (Cal.)), which could have a far-reaching impact on future "regulatory takings" claims challenging governmental regulations as a "taking" of property for which an owner is entitled to compensation.

The Guggenheims bought the mobile home park in 1997, which was within unincorporated Santa Barbara County and subject to a County mobile home park rent control ordinance that had been adopted in 1979 and amended in 1987. The ordinance capped the rate of annual rent that the Guggenheims could charge for the mobile home lots, and provided for a maximum of 10 percent rent increases upon the sale of the mobile home to a new tenant. The ordinance provided no cap on the amount mobile home owners could charge when leasing or selling the actual mobile home. In 2002, the property was incorporated into the City of Goleta, which adopted the County's ordinance.

In 2002, the Guggenheims sued the City, claiming that the rent control ordinance constituted a regulatory taking, entitling them to just compensation under the Fifth and Fourteenth Amendments to the federal constitution, in addition to violating the Due Process and Equal Protection clauses of the federal constitution. The Guggenheims challenged the City of Goleta's mobile home rent control ordinance as a "regulatory taking" because it had the effect of transferring as much as 90 percent of the property's value to tenants. The Guggenheims presented evidence that the City ordinance caused a wealth transfer from the mobile home park land owners to the "windfall tenants," and that the ordinance was not written in such a way to further a legitimate state interest (such as providing affordable housing to low income people). Specifically: (a) The mobile home pad spaces rent was about 20 percent of their market value; (b) the value of the lower rents set by the ordinance added 90 percent to the sale price of the mobile homes and this premium went into the pockets of the "windfall tenants" who owned mobile homes at the time of the enactment of the ordinance; and (c) rental rates charged by mobile home owners subleasing their mobile homes were not subject to the cap on rental rates.

A "regulatory taking" occurs when the government regulation "goes too far," which is obvious when a regulation eliminates all economically viable uses of property but is harder to show when a regulation leaves some potential economic value to the property. In *Penn Central Transportation Company v. New York City*, 438 U.S. 104 (1978), the U.S. Supreme Court set

forth a three-factor test that must be considered in determining whether a regulation affects a taking:

1. The economic impact of the regulation on the claimant;
2. The character of the government's action; and
3. The extent to which the regulation interferes with the claimant's investment-backed expectations.

"Ripeness" is a common issue in regulatory taking cases. Under *Williamson County Regional Planning Commission v. Hamilton Bank of Johnson City*, 473 U.S. 172 (1985), before federal courts will reach the merits of a regulatory takings claim, the claim must be "ripe," which means a claimant must first exhaust its state court remedies to obtain compensation before bringing a federal suit. Specifically:

1. The claim is not ripe until the appropriate administrative agency has made a final decision on how the regulation will be applied to the property; and
2. The claimant must seek compensation through procedures provided by the state before bringing a federal suit.

In the past, the ripeness requirement created a conundrum for claimants: If the owner litigates to a final decision on the merits in state court, the federal claim is barred as *res judicata*, but if the owner fails to litigate to a final decision on the merits in state court, the federal claim is unripe and cannot proceed to the merits.

The court in *Guggenheim* found that the first ripeness requirement (final decision by agency) did not apply because this was a "facial" challenge to the ordinance on its face, rather than an "as-applied" challenge to a decision applying the statute or regulation. Regarding the second ripeness requirement, the court assumed without deciding that the claim is ripe. The court explained that the *Williamson* test raises "prudential," not "jurisdictional" concerns, and exercised its discretion to not impose the prudential requirement of exhaustion in state court in this case, because the Guggenheims did litigate in state court and it would be a waste of resources to bounce the case back through more rounds of litigation.

Moving onto the merits, the court held that the City's mobile home rent control ordinance was not a facial taking from owners of the mobile home park under the "investment-backed expectations" factor in *Penn Central*.

The court assumed without deciding that a facial challenge can be made under *Penn Central*, but ruled against the Guggenheims because the 1979 and 1987 county rent control ordinance existed before they purchased the property in 1997, and the city's ordinance adopted in 2002 was merely the continuation of the pre-existing county ordinance: "Whatever wrongs the 1979 and 1987 county ordinances may have done to whoever owned the mobile home park, then those wrongs are not before us."

The court rejected the Guggenheim's argument that, under *Palazzolo v Rhode Island*, 533 U.S. 606, (2001), the fact that the claimants knew of a land-use regulation at the time they took title to

their land does not bar them from challenging that regulation nor from contending that the ordinance lessened the value of their land by interference with their investment-backed expectations. The court distinguished *Palazzolo*, explaining that there is a difference between the facial takings claim in *Guggenheim* and the as-applied takings claim in *Palazzolo*: An as-applied challenge addresses the period during which the administrative or judicial proceedings for relief occur, so it isn't necessarily barred from bringing the action when it ripens, even though he did not own the property when the regulation first started to be applied. By contrast, the court said there is no such extended period applicable to a facial challenge because the only time that matters is the time the ordinance was adopted. The court acknowledged that a future as-applied challenge was still possible: "If the rent control scheme affects an unconstitutional taking when applied, the challenge will be to that application, not to the ordinance on its face, and the time for the challenge will run from when the administrative action became final as opposed to when the ordinance was enacted. It is not as though an unconstitutional law becomes immunized from all challenges once limitations bar facial challenges to its enactment."

The court then addressed the "primary factor," the extent to which the regulation has interfered with distinct investment-backed expectations, and found it to be fatal to the claim. Even assuming that the ordinance transferred \$10,000 a year in rent for the average mobile home owner from the landlord to the tenant and raised the price of the average mobile home from \$14,000 to \$120,000, the court found that the ordinance pre-existed the owner's purchase of the park, and that the price they paid for the park reflected the burden of rent control they would have to suffer.

The court also rejected claimant's substantive due process claim. The court found that the ordinance furthered a legitimate government purpose, even if the ordinance failed to protect the price of sublets, because it protected owners of mobile homes from the leverage owners of the pads had to collect a premium reflecting the cost of moving the mobile home on top of the market value of use of the land. The court rejected the equal protection claim, finding that there was a rational basis for the ordinance.

A dissent filed by Judge Carlos Bea, joined by two other judges, contains a spirited analysis of regulatory takings. According to the dissent, the majority ignores two of the three *Penn Central* factors, and converts the three-factor balancing test into a "one-strike-you're-out" checklist. The dissent would apply *Palazzolo* (the investment backed expectations the law will take into account do not include the assumed validity of a restriction that in fact deprives property of so much of its value as to be unconstitutional). In the dissents opinion, a facial claim and an as-applied claim should be analyzed the same way: "If the expectations are valid and expropriated, what does it matter as to their existence that they will be injured in all cases (facial challenge) or just in some (as-applied challenge)? Either they are valid expectations, or they aren't." A court should analyze the claimant's investment-backed expectations as if the regulation at issue could be repealed at any time. Here, the Guggenheims believed they could free the land from the ordinance through a variance, political lobbying, or court action. An investor can validly expect that a land control measure, in place when he/she invests, is not necessarily eternal, and therefore does not disqualify his regulatory taking claim.

The dissent also finds the majority's reliance on rent control cases misplaced, because the ordinance is not designed to, nor does it control, rents paid by tenants. It also finds its enforcement violates due process and equal protection because "the measure is a wealth transfer, pure and simple," with none of the features of rent control, which further legitimate governmental interests.

In conclusion, although the majority in Guggenheim rejected the property owner's regulatory taking claim, the treatment of ripeness as a prudential requirement is a significant departure from prior federal regulatory takings claims, which have rarely been allowed to proceed to a hearing on the merits. Moreover, where the transfer of value is substantial, local governments can expect an increase in legal challenges from owners who can establish the necessary "investment-backed expectations."

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